

Bosnia and Herzegovina: Second and Third Reviews Under the Stand-By Arrangement—Staff Report; Staff Supplement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Bosnia and Herzegovina

In the context of the second and third reviews under the Stand-By Arrangement, the following documents have been released and are included in this package:

- the staff report for the second and third reviews under the Stand-By Arrangement, prepared by a staff team of the IMF, following discussions that ended on **November 15, 2002**, with the officials of Bosnia and Herzegovina on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on April 28, 2003.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a staff supplement of **June 2, 2003** updating information on recent developments.
- a Press Release summarizing the views of the **Executive Board as expressed during its June 6, 2003 discussion** of the staff report that completed the review.
- a statement by the Executive Director for Bosnia and Herzegovina.

The document(s) listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Bosnia and Herzegovina*
Supplementary Memorandum of Economic and Financial Policies by the authorities
of Bosnia and Herzegovina*
Supplementary Technical Memorandum of Understanding*

*May also be included in Staff Report

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

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

Copies of this report are available to the public from

International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623-7430 • Telefax: (202) 623-7201
E-mail: publications@imf.org • Internet: <http://www.imf.org>

Price: \$15.00 a copy

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

BOSNIA AND HERZEGOVINA

Second and Third Reviews Under the Stand-By Arrangement

Prepared by the European I and Policy Development and Review Departments

(In consultation with other Departments)

Approved by Carlo Cottarelli and G. Russell Kincaid

April 28, 2003

The Fund staff met: (a) at the State level, Members of the Presidency: Messrs. Sarovic, Tihic and Covic; the Prime Minister and his deputies: Messrs. Terzic, Ivanic and Colak; the Minister of Finance and Treasury Ms. Maric; Central Bank Governor Mr. Nicholl; (b) in the Federation of Bosnia and Herzegovina: the Prime Minister Designate Mr. Hadzipasic, the Minister of Finance Designate Mr. Vrankic; the Deputy Minister of Finance Ms. Hafizovic; the Minister of Defense Mr. Anic; the Minister for War Veterans Ms. Hadzovic; and (c) in the Republika Srpska: President Mr. Cavic; Prime Minister Mikerevic; the Minister of Finance Vilendecic; Defense Minister Stankovic. The Fund staff also met with High Representative Lord Ashdown, representatives of the international community, and representatives of business and labor.

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

Table of Contents

	Page
I. Introduction	5
II. Background.....	5
III. Report on the Discussions.....	9
A. Monetary and Financial Policies	10
B. Macroeconomic Outlook for 2003 and the Medium Term	12
C. Fiscal Policy for 2003	13
D. Structural Fiscal Policies.....	14
E. Structural Reforms	15
IV. Staff Appraisal	17
Text Tables	
1. Fiscal Outturn, 2001-2002	5
2. Escrow Flows and Balances, 2002	6
3. Revised Transfers from Abroad, 2001	7
4. Merchandise Trade, 2001-2002.....	7
5. Growth of Bank Credit, 2001-2002.....	8
6. Manufacturing Trends, 2000-2002.....	8
7. Unemployment, 2001.....	8
8. Capital Flows, 2001-2002	9
9. Banks' Reserves, end-January 2003.....	10
10. Medium-Term Macro Framework, 2001-2007.....	12
11. Fiscal Policy, 2002-2003.....	13
12. Foreign Financing for the Budget, 2002-2003	14
Figures	
1. Selected Financial and Economic Indicators, 1998-2002.....	20
2. Selected Indicators by Entity, 1998-2003.....	21
3a. Central Government Tax Revenue, 2000-2003	22
3b. Real Effective Exchange Rate, 1999-2003	23
4. Indicators of Manufacturing, 1999-2003.....	24
Text Figure	
1. Interest Rate Differential, 2002.....	9
Text Box	
1. Indirect Taxation and the State.....	15
Tables	
1a. Selected Economic Indicators, 1998-2003	25

1b.	Selected Economic Indicators for the Entities, 1998-2003	26
2a.	General Government, 1998-2003	27
2b.	General Government, 1998-2003	28
2c.	General Government, 1998-2003	29
2d.	General Government, 1998-2003	30
2e.	General Government, 1998-2003	31
2f.	General Government, 1998-2003	32
2g.	Federation Fiscal Operations, 2000-2003	33
2h.	Republika Srpska Fiscal Operations, 2001-2003	34
2i.	State Fiscal Operations, 2000-2003	35
3a.	Balance of Payments, 2000-2007	36
3b.	Balance of Payments, 2000-2007	37
4.	Monetary Survey, 1997-2003	38
5.	Quantitative and Structural Performance Criteria Under the 2002-2003 Stand-By Arrangement	39
6.	Structural Benchmarks, September 2002-June 2003	40
7.	Medium-Term Reform Scenario, 2000-2007	41
8.	External Financing Requirements and Possible Sources of Financing, 2000-2003	42
9.	Vulnerability Indicators, 2000-2006	43
 Appendices		
I.	Fund Relations	44
II.	IMF-World Bank Relations	47
III.	Statistical Issues	57
IV.	Letter of Intent and Supplementary Memorandum on Economic and Financial Policies	60
	Table 1. Quantitative and Structural Performance Criteria Under the 2002-2003 Stand- By Arrangement	70
	Table 2. Revised Structural Benchmarks, September 2002-June 2003	71
V.	Supplementary Technical Memorandum of Understanding on Definitions and Reporting Under the 2002-2003 Economic Program	73

ABBREVIATIONS AND ACRONYMS

BIH	Bosnia and Herzegovina
FDI	Foreign Direct Investment
GDP	Gross Domestic product
IBRD	International Bank for Reconstruction and Development
IMF	International Monetary Fund
OSCE	Organization for Security and Cooperation in Europe
RS	Republika Srpska
USAID	United States Agency for International Development
VAT	Value Added Tax

I. INTRODUCTION

1. **Two missions visited Bosnia and Herzegovina (BiH) to hold discussions for the second review under the Stand-By Arrangement (SBA) for SDR 67.6 million (40 percent of quota), approved by the Executive Board on August 2, 2002.** However, the Executive Board discussion will occur after end-March data for the performance criteria for the third review become available, so the end-March performance criteria will be controlling. Early indications suggest that these performance criteria have been observed, but a staff statement will be issued before the Board meeting reporting the final outcome. On this basis the second and third reviews will be discussed jointly. The SBA expires on November 1, 2003; two purchases of SDR 19.6 million and SDR 12.0 million were made respectively at the time of Board approval and on December 27, 2002 after the first review.
2. **At the first review, Directors welcomed the faster-than-programmed fiscal consolidation, the progress in structural fiscal reforms, and the adoption of budgets for 2003.** They noted the strength of international reserves, the low inflation delivered by the currency board arrangement, and the progress to strengthen the banking system through privatization. Performance had been marred, however, by misreporting and nonobserved performance criteria, but appropriate corrective actions had been taken and waivers were granted.
3. **Following the October 5, 2002 elections, new administrations with strong nationalist representation have formed, all evincing commitment to reform.** The High Representative (HR), Lord Ashdown, has also mandated a raft of economic laws and has led efforts to establish a state level VAT and unification of customs administration. The country's Entity structure and the role of the HR are outlined in Box 1, page 6, in (EBS/02/203).

II. BACKGROUND

4. **Activity and fiscal performance have continued to exceed expectations.**

- A pickup in industrial production in both entities in H2 2002 alongside a strong RS agricultural harvest, yielded estimated overall BiH GDP growth of 3¾ percent for the year (Tables 1a-b, and Figures 1 and 2). Inflation in 2002 was -¼ percent and 1¾ percent in the Federation and the RS, respectively.
- Partly reflecting strengthened activity, the consolidated budget deficit for 2002 is projected at 4.3 percent of GDP, better than

Text Table 1: Fiscal Outturn
(Percent of BiH GDP)

	2001	2002 Prog.	2002 Proj.
BIH			
Revenue (incl. grants)	51.8	53.0	51.8
Expenditure	57.6	58.6	56.2
Balance	-5.8	-5.5	-4.3
<i>Of which:</i>			
Federation	-1.2	-1.8	-1.4
RS	-1.2	-0.2	0.0
State	0.0	-0.1	0.0
Foreign projects	-3.4	-3.4	-2.9

programmed (Text Table 1, Table 2a-i, and Figure 3a).

(a) In the RS, the stronger fiscal outturn was largely due to savings on transfers to the pension fund and on debt service payments—the latter mainly reflecting Euro (and therefore KM) appreciation relative to the U.S. dollar. The end-year demobilization proceeded smoothly and new expenditure arrears were avoided. Revenue has continued strong through March 2003.

(b) In the Federation, the 2002 deficit outturn was also stronger than programmed, with expenditure—notably on military outlays and war veterans—lower than programmed. This allowed early reconstitution of KM 27 million of succession monies used for demobilization in mid-2002. However, the overall deficit for the cantons looks set to reach KM 42 million (0.4 percent of GDP), significantly above the programmed level, with this difference apparently largely financed by arrears accumulation.

(c) State revenue was better than expected, reflecting the one-off impact of higher proceeds from the issuance of identity cards and other fees. But expenditure was also higher, also reflecting one-time outlays.

- Fiscal structural reforms have continued. More licenses under the excise attribution mechanism have been issued in recent months. And effective January 1, 2003 Brcko District introduced the road fee thereby harmonizing this tax throughout the whole country. Local government treasury reforms are on schedule in the Federation, where the first 2 of 10

Canton treasuries recently started operations. The monthly reporting system on Entity transfers to the State established following the misreporting incident has been observed and administrative and debt transfers have been timely, (EBS/02/193, 11/19/02). Privatization receipts continue to be placed in escrow (Text Table 2).

	Receipts	Uses	Recon.	Balance
RS				
Privatization (pre-Aug 2, 2002)	23.5	15.2	4.5	12.8
Privatization (post Aug 2, 2002)	7.4	0	0	7.4
Succession monies	38.5	10.2	0	28.3
Federation (Central Government)				
Privatization (pre-Aug 2, 2002)	5.5	5.5	0	0
Privatization (post Aug 2, 2002)	2.1	0	0	2.1
Succession monies	71.5	71.5	27.0	27.0
Cantons				
Privatization (pre-Aug 2, 2002)	262.2	262.2	0	0
Privatization (post Aug 2, 2002)	11.3	5.2	0	6.1

- Despite the political interlude following the October 5 2002 elections, structural reforms continued, including efforts to privatize the remaining few state owned

banks. The IBRD reports progress to strengthen the business environment—including in respect of market entry requirements and procedures to register pledged assets—paving the way for disbursement of the second tranche of the associated World Bank credit. The RS has taken steps to prepare the first bankruptcies under its September 2002 bankruptcy law and similar legislation is being prepared in the Federation.

5. **Despite this strong fiscal performance, two fiscal performance criteria were not observed at end-December, 2002 (Tables 5 and 6).** Nonobservance of the two limits on government borrowing from banks in the RS occurred because repayment of debt of RS extra budgetary funds to banks was delayed into January, and the Roads Directorate took a temporary (two-week) bank loan of KM 5 million just before end-December. Other end-December, 2002 performance criteria were observed.

6. **The structural benchmark on the application of banking regulations was also not observed (Table 6).**

- Despite 18 months notice, 7 of 30 Federation banks and 2 of 10 RS banks failed to meet the increase in the minimum capital requirement of KM 5 million to KM 15 million effective end-December 2002.
- And a significant number of banks in both Entities did not observe the regulations on foreign currency exposures—with some far outside the limit of 30 percent of capital at end-December 2002.

7. **Newly available Central Bank data on private transfers indicate much higher inflows than previously thought, significantly lowering past estimates of the current account deficit (Text Table 3).** The new data are based on the number of former residents of the Federation working abroad, grossed up for the whole country, and sample surveys of remittances.

(In percent of GDP)	2001 Old	2001 New
Private transfers	3.4	11.0
Current account balance	-23.1	-15.5
Other capital inflows	29.1	21.5
Change in reserves	15.7	15.7
Private National Savings	-5.0	2.6

8. **At the same time, the external deficit seems to have deteriorated sharply compared to 2001.**

- Trade data from partner countries—used in the absence of reliable Bosnian data—indicate that the external current account deficit rose by 4½ percentage points of GDP in 2002 reflecting strong import growth (Text Table 4 and Table 3). But exports also fared poorly—despite a

	2001	2002	
		1 st Rev.	Est. ^{1/}
Exports	5.2	8.5	6.6
Imports	8.0	4.2	10.3

^{1/}Based on DOTS through October 2002, and bilateral trade data for Serbia and Montenegro.

surge in activity with Serbia and Montenegro—with a deceleration of the European export market in 2002 and declining exports of electricity partly responsible. Remittances also declined as refugees abroad continued to return in numbers.

- Imports appear to have been boosted by a rapid expansion of bank credit to households and the associated stimulus to domestic demand (Text Table 5 and Table 4). Following privatization and a surge of deposits in the context of the introduction of euro notes and coin in 2002, banks have aggressively expanded their small scale consumer and housing portfolios while shying away from corporate lending, especially in the RS, due to the greater perceived credit risks there. This financial deepening—which has increased the stock of bank lending to the private sector by 6½ percentage points of GDP during 2002—suggests that household consumption and housing investment rather than corporate investment has led the expansion of domestic demand, and that household savings rates have likely declined.

Text Table 5. Growth of Bank Credit

	2001	2002
Private Sector	11	26
Federation	16	37
RS	0	15
Households	78	111
Federation	81	95
RS	19	570
Enterprises	1	7
Federation	6	12
RS	0	1

- Corporate savings rates also appear to have dropped significantly in 2002, evidenced by declines in output prices relative to unit labor costs, with losses funded by additional intercompany and wage arrears (Text Table 6 and Figures 3 and 4). These trends in profitability have been largely driven by growth in paid employment in the Federation and weak output in the RS, without commensurate offsetting responses in nominal wage growth. And while increased employment helps to reduce unemployment—which the IBRD estimates even on its strictest ILO definition at 16 percent and at much higher rates on definitions which imply more plausible estimates of the participation rate—the associated profits squeeze qualifies the durability of this employment growth (Text Table 7).

Text Table 6. Manufacturing Trends

	2000	2001	2002
Manufacturing prices/Unit Labor Costs			
Federation	100	83	72
RS	100	95	89 ^{1/}
Growth in paid employment (manufacturing)			
Federation	16	11	12
RS	-1	-19	7 ^{1/}
Nominal gross wage growth (manufacturing)			
Federation	12	6	16
RS	7	10	2

^{1/} January-November.

Text Table 7. Unemployment, 2001 (In percent)

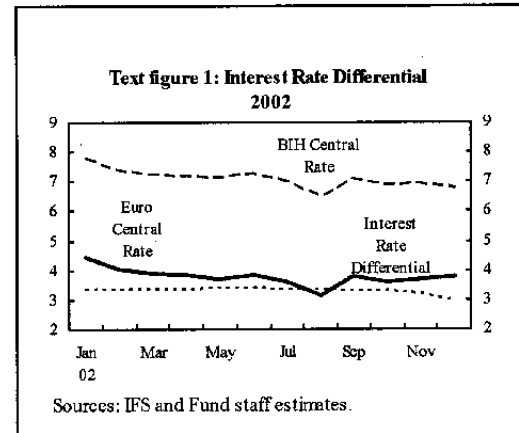
	Unemployment Rate	Participation Rate
ILO definition	16	48
Definition incl discouraged workers and refugees	31	61

Source: IBRD

9. **However, international reserves have declined only modestly in 2002 (Text Table 8 and Table 3).** The stronger than expected capital inflows alongside broadly stable differentials between the KM and Euro interest rates offered by banks suggests that the current account and reserves trends have not elicited concerns in capital markets, though differentials have widened more recently (Text Figure 1).

	2001	2002 Est.
Current Account ^{1/}	-830	-1,111
Financing	1681	986
<i>Of which: Reconstruction</i>	556	427
Other official	55	54
Net FDI	143	244
Net commercial bank	-232	92
Other private ^{1/}	1,160	170
Change in reserves	851	-125
Stock of gross reserves	1,385	1,260

^{1/} Adjusted for new data on transfers.



III. REPORT ON THE DISCUSSIONS

10. **The policy framework was much strengthened in 2002; but rapid bank credit and import growth constitutes an immediate test for the new administrations. Moreover, the medium-term economic and political reform agendas are daunting.** Given the large external imbalance—even before the recent boost from rapid credit growth—alongside Mid-East tensions and slow European activity growth, there is need to reverse the 2002 deterioration swiftly to ensure the sustainability of the macroeconomic framework. As the liquidity banks gained from windfall deposits already has been largely exhausted by the credit already extended during 2002, credit growth is set to decelerate sharply. But how soon and how fast is uncertain and so discussions focused on how to ensure an early deceleration of credit. The authorities also concurred that further fiscal consolidation and structural reforms would be needed to lay the foundation for eventual EU accession and to improve medium-term performance in the context of prospective declines in reconstruction aid inflows. But in regard to the short- and medium-term challenges, the authorities stressed the priority of reflecting Bosnia's political structures and social concerns in the policy responses.

A. Monetary and Financial Policies

11. **The new administrations have anchored their economic strategies in the commitment to maintain the currency board (¶7)¹.** Agreeing with staff that it insulated monetary policy from undue political influences and was essential to macroeconomic stability, the State Presidency announced publicly in February, on behalf of the new administrations, their intention to retain the currency board arrangement.

12. **With the terms of the Central Bank board members, including the governor, expiring in August 2003, the State Presidency has also taken steps to secure a smooth transition to the new board (¶8, bullet 3).** As the State Presidency wished to follow practice in other central banks of early announcements in order to minimize uncertainties, the new members would be nominated in April 2003. Under the constitution, the new governor will be appointed by the new Bank board. Staff welcomed these steps. The monetary authorities also reported progress to strengthen the internal operations of the Bank (¶3, bullet 6).

13. **With these issues thus addressed, the authorities concurred that steps were needed to slow credit growth and maintain confidence in the macroeconomic framework.** Deposit growth had already returned to “pre-Euro introduction” rates, and gross official reserves relative to private sector deposits and sight deposits were at a healthy 81 percent and 132 percent, respectively, at end-2002. However, alternative potential sources of funding for credit remained, notably from banks’ external parents and reduced excess reserves, the latter of which stood at over 2½ percent of GDP at end-2002.

14. **Monetary reforms would spearhead efforts to ensure a rapid correction.**

- Foreign currency liabilities will be incorporated into the base of reserve requirements (Text Table 9, ¶8, bullet 1). This change will require an amendment to the central bank law. The authorities noted that this eliminates the former wholly inappropriate discrimination against the KM. Staff concurred. At the prevailing reserve requirement rate of 10 percent, this would eliminate excess reserves (lowering them by over 2½ percent of GDP).

Text Table 9. Banks’ Reserves at end-January 2003

	KM million	% of GDP
Total reserves	466	4.1
o/w: Cash in vaults	150	1.3
Required reserves	176	1.6
Excess reserves	290	2.6

¹ Paragraph references are to the Supplementary Memorandum of Economic and Financial Policies.

- The authorities also proposed to redefine assets eligible to meet reserve requirements to exclude cash in vaults (Text Table 9, ¶8, bullet 1). This will address their longstanding concerns with the inability to audit banks' reporting of cash. Noting that international practice on eligibility of cash in vaults varied considerably and that the technical arguments for and against were finely balanced, staff concurred with the initiative in the spirit of local ownership. The step would lower excess reserves by a further 1½ percent of GDP and will require amendment to the central bank law.
- The authorities agreed that the combined effect of the two policy actions would produce a reserve deficiency and represent an excessive tightening of the monetary stance. To avoid this, when the base is widened, the legally prescribed permissible range for the reserve requirement ratio will be changed to 0-20 percent from 10-20 currently, and soon thereafter, the required reserve ratio would be reduced in consultation with staff in light of overall program objectives. Subsequent second round developments will be monitored closely.

The authorities noted that though the monetary adjustment could in theory be achieved by raising the rate of required reserves immediately and lowering it again once the structural changes in the reserve requirement regime are implemented, this two-step rate adjustment process was regarded as disorderly. Instead, they proposed to reflect the urgency of action by incorporating the changes in the reserve requirement regime as prior actions for the completion of the second review (¶8, bullet 1).

15. **These efforts would be backed by regulatory reforms.** The authorities noted that deviations of banking regulations from international standards had accommodated the credit boom and should be eliminated. Banks may deduct losses from tier 2 capital—rather than from tier 1 as Basle Core Principles (BCP) and EU standards recommend. This increases scope for banks to expand credit given capital endowments. Furthermore, banks typically index KM loans to foreign currencies. Including this indexation, which is largely to the euro, the banking systems has forex exposure which are above international norms, but indexation is ignored in currency exposure regulations. And the “forbearance” evident in regulators’ tolerance of breaches of the foreign currency exposure limits and the minimum capital requirements may be tempting banks to test the limits of other regulatory requirements. Staff observed that the competitive environment following bank privatization had strengthened incentives to exploit these lapses in the regulatory framework, while the authorities noted that enforcement had earlier suffered as resources had been devoted in 2002 to completing bank privatization.

16. **Accordingly, the authorities proposed several regulatory reforms.**

- The authorities intend—as a prior action for completion of the second review—to amend their definitions of core capital to require that losses are deducted from tier 1 capital (¶9, bullet 3). The amendment will be phased in over a period to be established in consultation with staff, but likely by end-2003. The preannouncement of this change is intended both to encourage banks to adjust their credit policies

immediately and to allow them time to raise additional capital as may be necessary. Banks' progress towards the end-year deadline will be monitored closely in consultation with staff.

- The authorities also intend—also as a prior action—to enforce the minimum capital requirement of KM 15 million (¶9, bullet 2). The sole exception will be banks engaged in restructuring activities under the auspices of the World Bank group, given that these arrangements are expected to be completed shortly. Banks which do not observe the requirement will have their licenses withdrawn or will be placed under administration—thereby being subject to tight restrictions on deposit taking and credit extension—until they meet the capital requirement.
- The authorities also intend to amend their foreign currency exposure regulations to include indexation of KM liabilities and loans to foreign currencies (¶9, bullet 1). Accordingly—as a prior action for the second review—the authorities will complete the data-gathering exercise on banks' foreign currency positions including indexation as at end-December. They then plan to introduce changes to the regulations to include indexation of all non-Euro currencies by end-June 2003 with immediate effect—as a structural performance criterion in the program. The regulations will incorporate a phase-in period for Euro indexation, the length and monitoring of which will be determined in consultation with staff, in order to give banks time to adjust.
- In addition, the authorities committed to application of corrective actions specified in the law if banks breached regulatory requirements (¶9, bullet 4). This signals an end to regulatory forbearance and is expressed in the revised wording of the structural benchmark on banking supervision (Table 2, SMEFP).
- The authorities noted that by August 2003, banks would be required to comply with the requirements of the State Deposit Insurance Agency. This would further strengthen the soundness of the banking system.

B. Macroeconomic Outlook for 2003 and the Medium Term

17. The macroeconomic framework was reassessed in light of recent trends during 2002, the revision to staff estimates of transfers from abroad, and the prospective liquidity and bank regulatory reforms (Text Table 10, and Table 7). The authorities agreed that external influences on GDP growth in 2003 would likely be mixed—a mild acceleration

	2001	2002	2003	2004	2005	2006	2007
(Growth rate)							
GDP	4.5	3.8	3.3	5.0	5.8	5.9	6.2
Inflation	3.1	0.3	1.0	1.7	1.9	2.0	2.1
(In percent of GDP)							
Current Account balance	-15.5	-20.0	-15.4	-15.2	-13.8	-11.5	-9.0
Fiscal balance	-5.8	-4.3	-2.2	-2.0	-1.7	-1.2	-1.0

in the European economy would support exports and remittances, while increased international oil prices would raise corporate costs, prices, and imports. The authorities noted further that if the liquidity and regulatory reforms succeeded in checking credit growth to 10-15 percent, the momentum of domestic demand and imports would likely be slowed, allowing a correction in the external current account deficit of 4-5 percentage points of GDP. They saw limited risks that these negative factors would be compounded by a wave of corporate bankruptcies following application of the new bankruptcy laws given the significant administrative bottlenecks still impeding these legal processes.

18. **Looking further ahead, the authorities observed that external and domestic factors pointed to strengthened activity in the medium term.** Stronger European activity and softening oil prices would buoy the external current account balance in line with the expected trend decline in external aid from recent exceptional levels. And alongside deepening structural reform, these trends would further support activity.

C. Fiscal Policy for 2003

19. **The authorities agreed that continued fiscal consolidation would support liquidity and regulatory reforms aimed to contain the credit boom, and would maintain momentum towards medium-term consolidation.** Thus, the authorities committed to implement the approved 2003 budgets, having endorsed them in the post-election legislatures (Text Table 11, and Table 2).

Text Table 11. BiH Fiscal Policy
(Percent of BiH GDP)

	2002 Est.	2003 Budget
Revenue (incl. grants)	51.8	50.6
Expenditure	56.2	52.8
Balance	-4.3	-2.2
<i>Of which:</i>		
Federation	-1.4	0.5
RS	0.0	0.3
State	0.0	-0.1
Foreign Projects	-2.9	-2.9

20. **The authorities observed, however, that the deceleration of credit poses risks to the revenue projections for the 2003 budgets.** Agreeing with staff that, if demand and credit slowed as targeted, tax revenue may fall short of target by some ¾ of a percent of GDP, and that securing a swift external correction required that the fiscal deficit objectives be secured, they have committed to take further action. In particular, they have committed to continue—as in Q1—to hold aggregate spending below budget allocations. Any changes would be made in consultation with staff in the context of program reviews and this will form a particular focus for the last review under the program later this year, when the necessary data will be available (¶8, bullet 2). Furthermore, given that the pace and timing of credit deceleration is uncertain, they plan that if credit growth remains excessive—possibly allowing tax revenue to equal or even exceed the budget projections—the cumulative spending reductions relative to budget projections will be devoted to larger-than-anticipated fiscal consolidation, implying a fiscal deficit target of 1½ percent of GDP in 2003 in this context. Staff welcomed these commitments noting that they were an essential component of the policy response to the credit and external trends and hence to securing the program's objectives and completion of the review.

21. **Amendments to the 2003 budgets may occur, but within strict parameters** (¶10). While the composition of expenditures in the inherited budgets may be altered to reflect their preferences, the authorities reached understandings with staff that the consolidated deficit target for 2003 would not be increased, tax policies would not be altered, revenue projections would remain cautious, and any budget revisions would be made in consultation with staff. These commitments were reflected in the authorities' request to convert the end-June fiscal indicative targets into performance criteria. Strengthened fiscal controls would increase the authorities' ability to secure these targets (¶8, bullet 4; ¶11, bullet 3; ¶12, bullets 1 and 2).

22. **Several adjustments in spending policies are envisaged in 2003.** Politically contentious discussions continue on shifting resources from the Entities to the State—with the latter anxious to commence various legislated but unfunded activities and the former concerned with the consequent pressures on their budgets. In this context, staff welcomed an imminent EU study of scope for rationalization of State spending. Staff noted that IBRD proposals on reform of veteran benefits—including limiting increases in individual benefits, and rationalization of other benefits such as duty free import of personal vehicles—would raise spending efficiency and could release resources needed at State level. The authorities stressed the social sensitivities involved, underscoring the pressures by referring to calls—which they had rejected—to transfer some of the central bank's capital to the state to fund added spending. Staff agreed that this step would be inappropriate because it would directly jeopardize efforts to bolster the currency board.

23. **Prospects for external financing are broadly unchanged from 2002 (Text Table 12, and Table 8).** The first tranche (Euro 15 million, all grant) of the European Union's Euro 60 million macro-financial assistance program was disbursed in February 2003. The two remaining tranches will be partly loans which will require parliamentary ratification in BiH. Disbursements from the World Bank of Euro 28.5 million are contingent on progress with social expenditure reform and further improvements in the regulatory framework for business climate.

Text Table 12. Foreign Program Financing for the Budget
(Percent of BiH GDP)

	2002	2003
EU	0.0	1.0
World Bank	1.2	0.5
IMF	0.8	0.8
Other	0.4	0.0
Total	2.3	2.3
Memo:		
Financing (Euro mil.)	128.9	132.6

D. Structural Fiscal Policies

24. **On the tax side, a commission has been established to propose a framework and legislation to unify customs administration and prepare to replace sales tax with a state level VAT, in line with EU standards.** Drawing representatives of the Entities and the State, the commission began its work in early March, and, as a structural benchmark, will prepare a framework to achieve these goals before mid-2003 (¶8, bullet 5).

25. **The proposal of a commission was politically contentious, touching Entity concerns over taxation rights and the role of the state.** Staff emphasized that the reforms should strengthen macroeconomic stability, have good prospects of enduring—including beyond the eventual closure of the OHR—and provide a secure basis to finance the state. Thus, they should ensure close links between responsibility for revenue raising and spending at the different levels of government and should be accepted by the public. To achieve these goals, staff suggested that discussions on customs and VAT should be embedded in a wider reform of the framework for the design and operation of all indirect taxes (Box 1). The authorities acknowledged that the outline proposals met many of their concerns; the EU and the OHR developed them further and endorsed them; and the resultant proposals will be reviewed by the commission. The authorities and staff noted that vigilance will be required to ensure that tax and customs enforcement does not suffer in the process of implementation of the reforms.

Box 1. Indirect Taxation and the State

Staff proposed that all indirect taxes should be legislated at state level to secure harmonization. Decisions over tax rates and structures should be subject to joint endorsement by Entities and the State to link revenue and spending responsibilities.

Indirect taxes and customs should be administered by a single institution, the annual budget and management of which would also be determined jointly. Revenues would be allocated to the Entities by a ratio adjusted periodically in light of collections data.

The State should receive, directly from the indirect tax administration, funds for its administrative costs and external debt service obligations. The former could be determined by fixed formula, rising annually a little below potential nominal GDP, adjusted for additional spending responsibilities transferred from the Entities. This provides certainty and a hard budget constraint to the State.

These arrangements should be established ahead of the VAT, allowing them to be tested before its introduction.

26. **The authorities are committed to push ahead with other fiscal reforms.** Preparations are underway to bring the point of collection of sales tax on “high value goods” back from retail level to importer and wholesale level where evasion can be more effectively countered. Staff noted that arrangements for an attribution mechanism would need to be developed, akin to those for excises.

27. **The authorities are committed to prepare, by June 2003, a comprehensive strategy to restructure outstanding domestic claims on government.** Good progress is being made with regard to the quantification of these claims, including by establishing databases on outstanding expenditure arrears with FAD technical assistance. Proposals for restructuring and clearing claims will be determined once they are properly quantified (¶13).

E. Structural Reforms

28. **Progress with the structural reform agenda has continued including through:** (i) preparations to initiate bankruptcies under new legislation; (ii) the IBRD-supported

program to strengthen the business environment; and (iii) OHR-led efforts to strengthen the judicial system—under which all judges are subject to reappointment (§15, bullet 1). The preparations for bankruptcy mark a critical step to improving business operations and stemming corporate losses by (albeit indirectly) strengthening discipline over wage setting. And the legal reforms, which form a central part of the OHR's "Justice and Jobs" program, aim to strengthen the rule of law across the board, with particular economic benefits in terms of tax compliance and business entry. In addition, a variety of steps suggested by business and other groups to reduce administrative "red-tape" are envisaged under the "Bulldozer" initiative (§15, bullet 3).

29. The authorities also intend to increase the momentum of privatization.

- The RS authorities are seeking to accelerate the privatization of large scale enterprises—notably the large petroleum refineries which they hope to sell in 2003—but this is an area where social concerns will be significant. In this context, they are reviewing the privatization laws (§15, bullet 2). Bank privatization would be completed during 2003.
- Some 200 Federation companies are scheduled for privatization in 2003, similar to 2002, but this time including more large companies and more sales through tenders (§15, bullet 2). Tender transparency would be improved under IBRD and USAID auspices and bank privatization would be wrapped up. The new authorities want to adopt a case by case approach, notably in regard to public utilities.

30. The authorities expected the financial system to strengthen further. Enhanced competition, the strengthened regulatory framework, and the requirement for banks to acquire deposit insurance by August 2003 would drive banking consolidation further, likely reducing the 40 banks at end 2002 to 25 within a year.

31. The authorities observed that considerable development of their reform agendas was needed to convert their intentions on enterprise reform into a coherent policy framework (§16). While the authorities were concerned that many companies appeared to be loss-making—not least because this heralded eventual job-losses—they noted that loss-making companies typically cut wages paid and accrue wage arrears, increasing enterprise indebtedness and weakening privatization prospects. Accordingly, they argued that a substantial enterprise shake-out was needed, led by bankruptcies, rather than direct intervention to curb wage growth.

32. Staff concurred, and stressed that given adverse trends in unit labor cost and exports, there was a need to accelerate the implementation of the structural reform agenda to help support competitiveness in the context of the currency board. In this context, reforms of bankruptcy, privatization, and labor markets seemed particularly important. Accordingly, staff noted concerns with the legal system's limited capacity to process bankruptcies. Moreover, aversion—even on the part of creditors—on social grounds to initiate them meant that the prospect for an early enterprise shake-out was limited. Further,

management of state-owned companies needed strengthening alongside accelerated privatization. And minimum wage reform also seemed necessary—given IBRD research findings that minimum wages are binding in the Federation (though not in the RS)—alongside a review of hire-and-firing regulations. Though the latter are within EU norms, the requirement that firms must clear back-pay due before releasing workers acts as a major impediment to workforce restructuring given widespread wage arrears. The World Bank is preparing specific recommendations on these matters which will be reflected in discussions for the last review under the program.

33. **The authorities concurred with staff that the poor quality of statistics is a major impediment to economic analysis.** In this regard, staff encouraged the early appointment of a new director for the state agency for statistics, and early action to harmonize entity statistics laws with the new state statistics law.

IV. STAFF APPRAISAL

34. **Activity and fiscal policy continue to exceed expectations, but strong bank credit growth has fuelled a sharp increase in the current account deficit.** Alongside weak exports, imports surged on the back of financial deepening and the associated consumer credit boom and decline in household savings rates. These external trends are not indefinitely sustainable.

35. **In this context, the new administrations have recognized the need to establish their macroeconomic credentials quickly—and they have done so.**

- Most important has been the renewed commitment to the currency board and the associated arrangements for the nomination of a new central bank board, well ahead of the August 2003 deadline.
- This is backed up by actions to tighten bank liquidity both through the removal of cash in vaults from assets eligible towards the reserve requirement and the prospective de facto increase in reserve requirements as part of the structural reform of its base.
- The authorities' commitment to implement the 2003 budgets is reflected in their swift action to address concerns with possible revenue shortfalls—by applying additional spending controls—and their undertaking to secure lower-than-budgeted deficits if credit growth remains excessive. The overshoots of the end-December fiscal performance criteria in the RS were modest and reflected shortcomings in the administration and control of borrowing, both of which have been corrected.
- The progress towards a commission on customs unification and VAT, though still politically contentious, constitutes a further major step forward, signaling prospective strengthening of the fiscal system with attendant benefits over the medium term.

36. **These actions are supported by strengthened bank regulations.** The reform of the definition of core capital in line with EU standards and the commitment to put undercapitalized banks under administration or to withdraw their licenses constitutes a timely signal to banks that regulatory forbearance will end. The reforms to foreign currency exposure regulations due in mid-year will bite harder on banks, reinforcing the message that prudence will be needed in all areas, including credit extension. This package of regulatory reform measures constitutes an appropriate response to the non-observance of the structural benchmark on banking regulations.

37. **The clarity of these steps will stand the authorities in good stead even if they fail to check the momentum of credit growth immediately or completely.** Thus, they will buy time for further measures, if those turn out to be necessary, and the authorities have committed to further steps as needed.

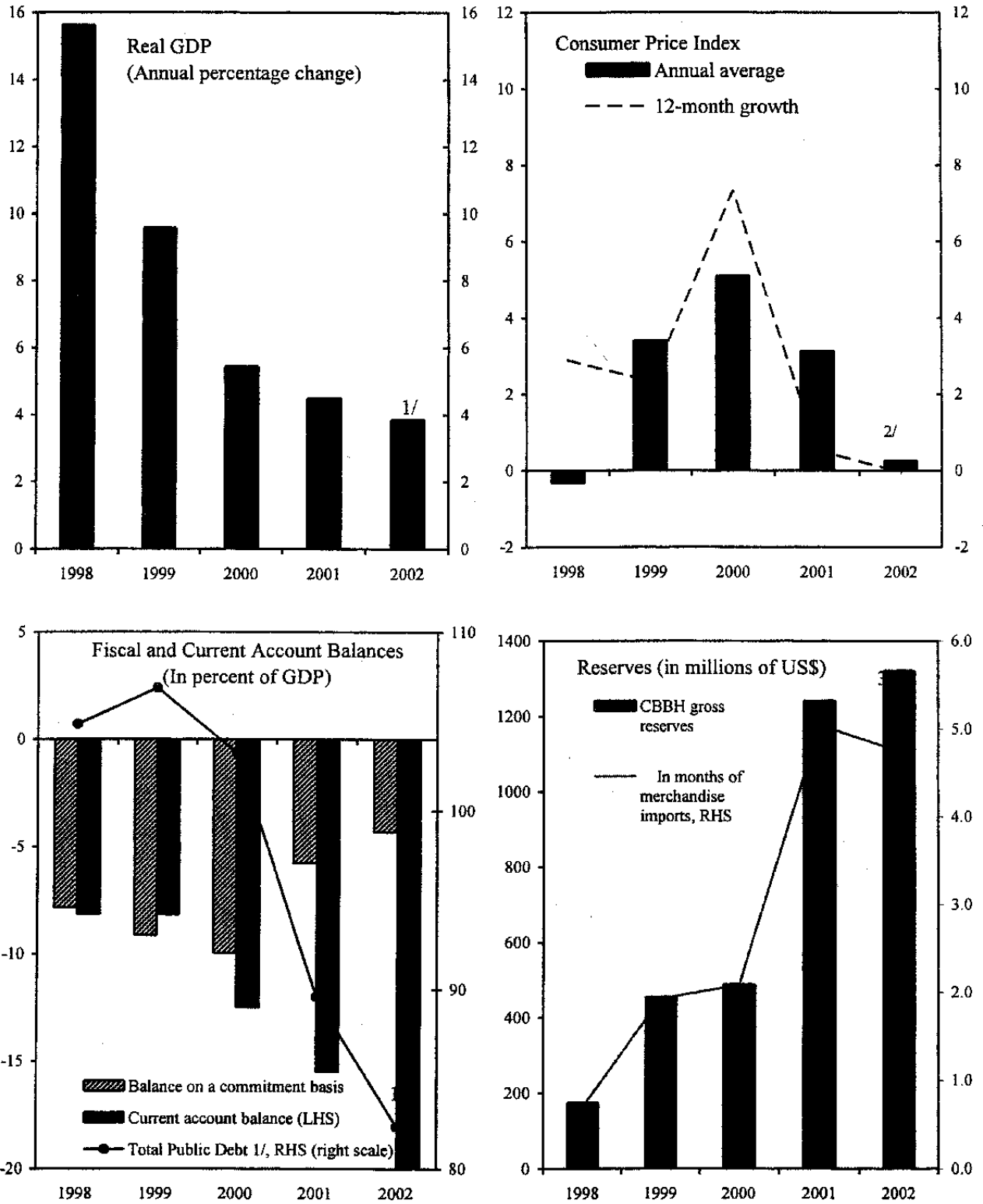
38. **The new administrations recognize the need for sweeping structural reforms if their aspirations to eventual EU membership and sustained growth are to be realized.** These reform initiatives have continued under the caretaker administrations—notably in regard to the harmonization of indirect taxation, the development of the treasury systems, reform of the legal system, bankruptcy legislation, and continued progress towards a settlement of unsustainable domestic claims on government.

39. **But plainly, with unemployment high and with large aid inflows set to decline further, much more needs to be done.** The commitments made to review legislative impediments to privatization are welcome. But these will need to be hardened into concrete reforms, supported by a much stronger political push for privatization, bankruptcies, and initiatives to increase the flexibility of labor markets. Given that the new administrations have barely taken office, have taken strong policy actions where these were needed immediately, and have indicated their intention to pursue strong structural policies, these issues will be taken up, in consultation with other international agencies specializing in these issues, in the last review of the program, and in preparation for its successor.

40. **Risks plainly remain.** Though private credit growth will slow, the pace of deceleration and the associated current account correction is highly uncertain, as is the durability of the patience of markets with such sizable external imbalances. Political uncertainties have eased with the formation of new administrations, but they are broad coalitions with attendant risks of fissure. Thus, political tensions remain significant, notably in regard to the envisaged unification of customs and the VAT, the privatization of some utilities, and in initiatives to increase funding for State level activities. Mid-East tensions and lingering weaknesses in European activity aggravate the underlying macro risks further. And the poor quality of statistics—clearly illustrated by the recent major revisions to estimates of remittances and reliance on delayed partner country data for trade—impedes effective surveillance, with the associated risk of surprise. Set against these are the strengthening of the policy framework during 2002, the actions of the caretaker and incoming administrations which signal continued commitment to the program objectives, and the steadying hand of the High Representative.

41. **In this context, the program remains an appropriate framework for policies and deserves the continued support of the Fund.** The nonobservance of the end-December 2002 performance criteria were not symptomatic of macroeconomic problems, and corrective action has already been taken.

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



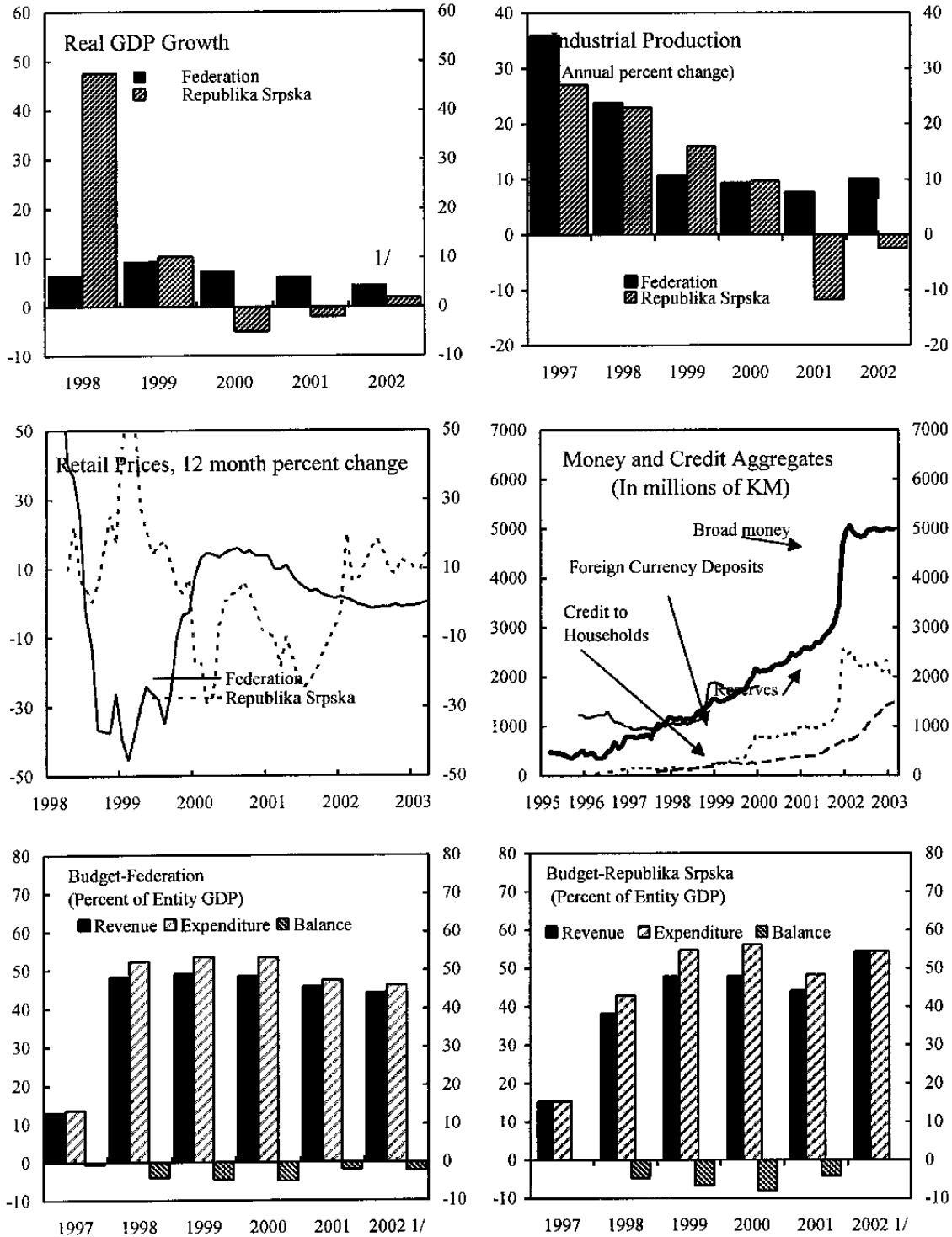
Sources: Data provided by Bosnian authorities; and IMF staff estimates.

1/ IMF projections.

2/ Twelve month CPI through December 2002.

3/ December 2002.

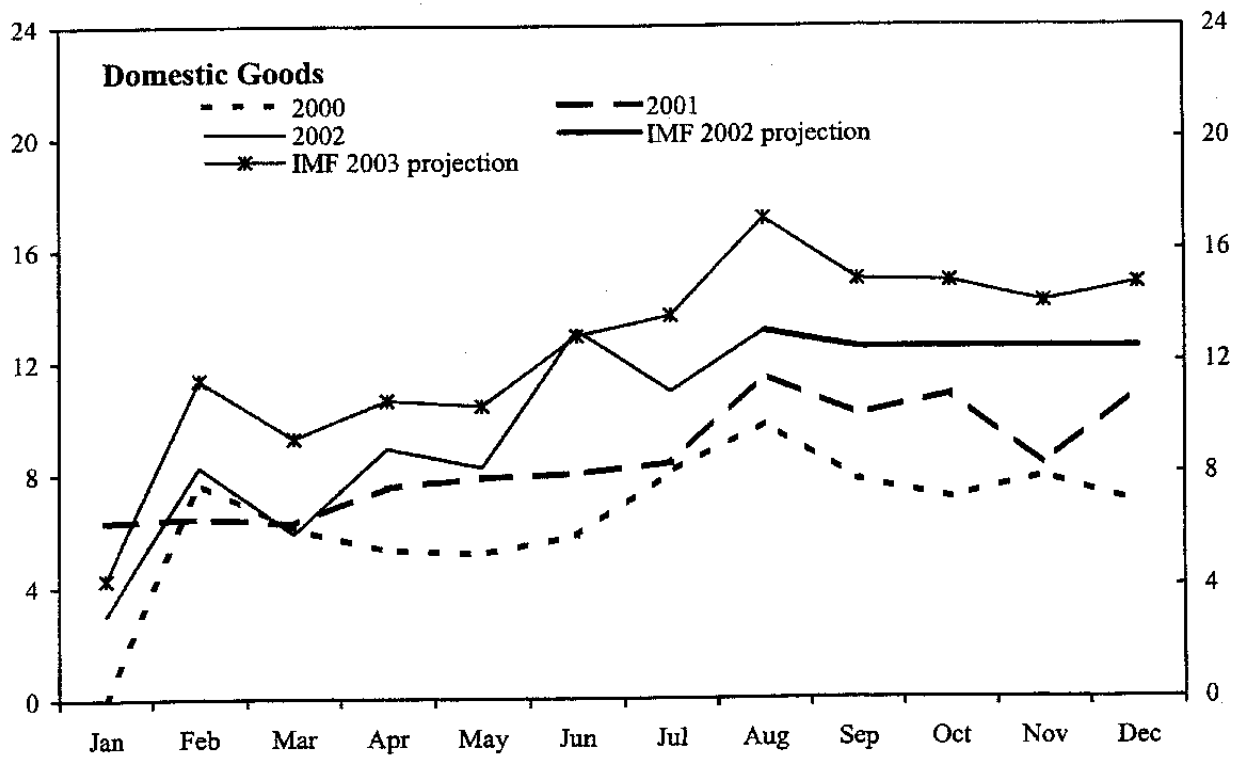
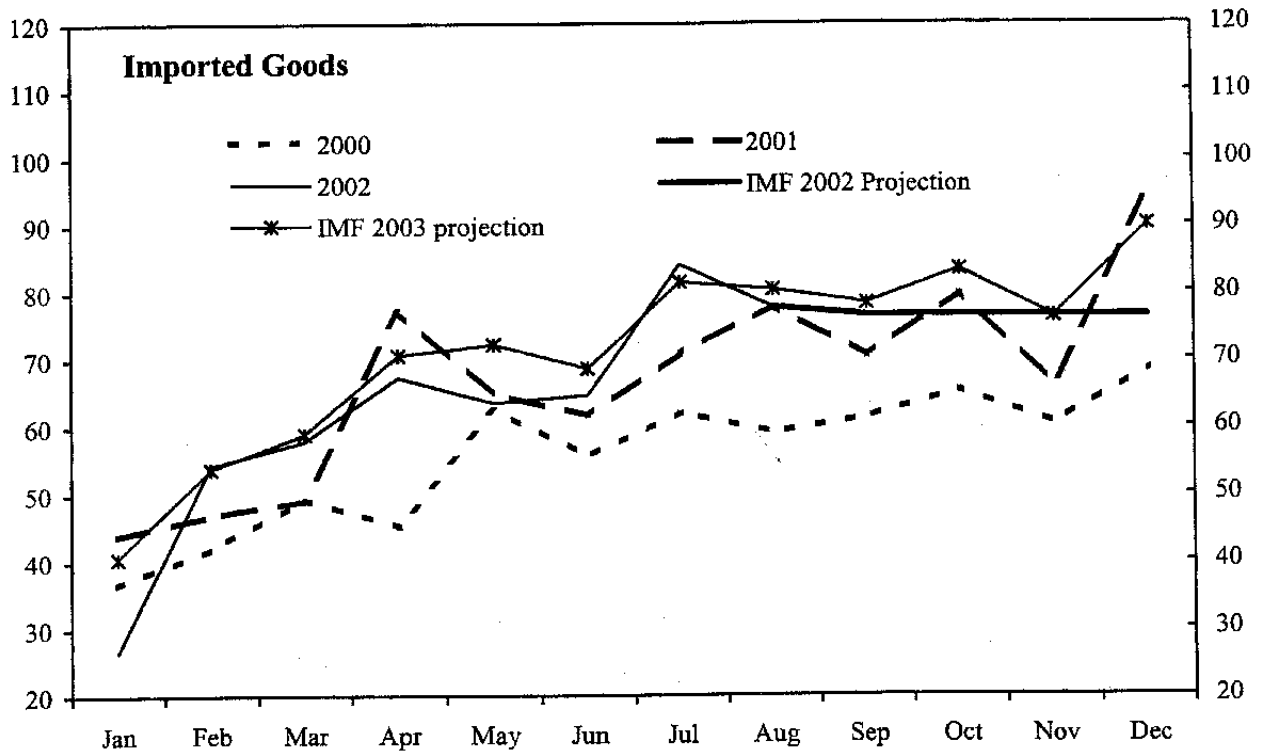
Figure 2. Bosnia and Herzegovina: Selected Indicators by Entity (1998-2003)



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

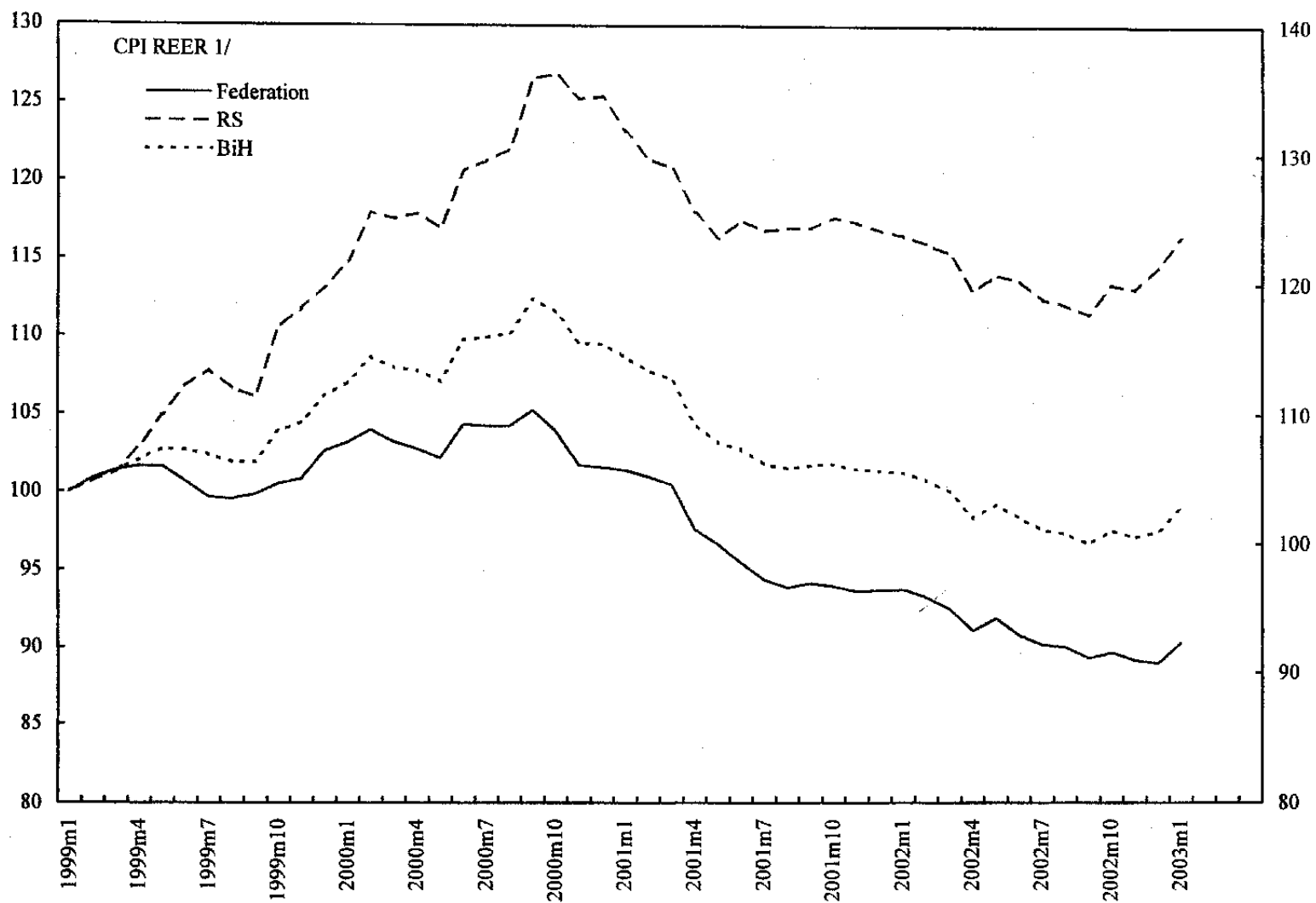
1/ IMF projections.

Figure 3a. Federation: Central Government Tax Revenue, 2000-2003
(In millions of KM)



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

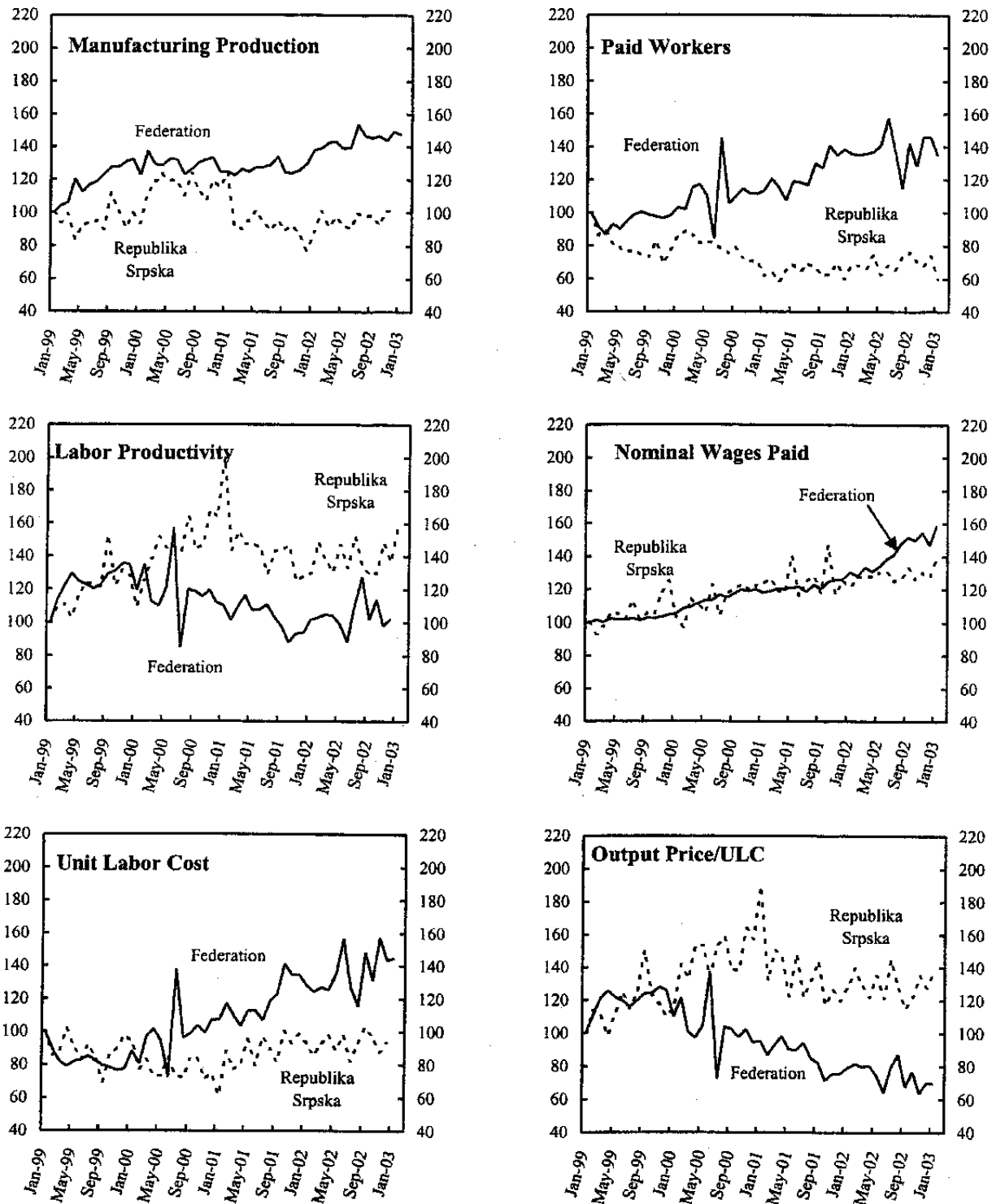
Figure 3b. Bosnia and Herzegovina: Real Effective Exchange Rate, 1999-2003



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

1/ Increase indicates appreciation.

Figure 4. Bosnia and Herzegovina: Indicators of Manufacturing, 1999-2003
(Seasonally Adjusted, January 1999=100)



Source: Data provided by Bosnian authorities.

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

Population (2001, est.): 3.8 million
 GDP per capita (2001, est.): \$1,263
 Quota: SDR 169 million

	1998	1999	2000	2001	2002	2002	2003	2003
				Est.	First review	Revised	First review	Revised
Nominal GDP (KM million)	7,559	8,603	9,611	10,480	10,902	10,879	11,462	11,342
Gross national saving (percent of GDP)	17.7	12.8	8.8	3.9	-3.2	-0.8	1.0	3.4
Gross investment (percent of GDP)	25.9	21.0	21.2	19.4	19.1	19.2	20.5	18.8
	(Percent change)							
Real GDP	15.6	9.6	5.4	4.5	3.9	3.8	4.7	3.3
Index of industrial production (period average) 2/	23.3	12.1	9.4	2.8	5.0	7.6	...	...
Gross wages (period average) 2/	4.8	11.4	12.7	9.1	9.2	8.0	...	...
CPI (period average) 2/	-0.3	3.4	5.1	3.1	0.3	0.3	0.5	1.0
Money and credit								
Broad money (end-of-period) 3/	29.7	39.4	14.0	88.5	9.8	7.0	5.1	5.0
Net domestic assets (percent contribution to broad money growth)	24.3	-1.0	3.4	3.2	14.4	15.6	4.1	6.9
Of which: Credit to the public sector	0.9	1.9	1.0	-7.0	-1.2	-1.7	-0.7	-1.2
Net foreign assets (percent contribution to broad money growth)	5.4	40.4	10.7	85.4	-4.5	-8.5	1.0	-1.9
	(Percent of GDP)							
General government budget								
Revenue	56.7	61.3	56.1	51.8	52.2	51.8	50.5	50.6
Of which: Grants	12.1	13.3	9.8	7.4	5.4	5.3	4.0	4.2
Expenditure (on a commitment basis)	64.5	70.4	66.0	57.6	56.2	56.2	52.6	52.8
Of which: Change in stock of arrears	2.7	3.4	4.0	0.9	-0.5	-0.2	-0.2	-0.2
Of which: Investment expenditure	15.5	17.5	14.0	11.8	8.7	8.5	7.6	7.5
Overall balance	-7.8	-9.1	-10.0	-5.8	-4.0	-4.3	-2.1	-2.2
Total public debt 4/	104.9	106.9	103.2	89.6	86.6	82.3	83.7	79.5
Debt to domestic banks	0.4	0.4	0.3	0.3	0.6	0.6	0.6	0.6
Stock of domestic spending arrears	2.7	5.7	9.2	9.3	8.5	8.8	7.8	8.2
External public debt	64.7	68.2	64.6	53.3	51.6	47.2	50.6	46.1
Stock of frozen foreign currency deposits	37.0	32.5	29.1	26.7	25.9	25.7	24.6	24.7
	(Millions of U.S. dollars)							
Balance of payments								
Exports of goods and services	1,375	1,404	1,393	1,391	1,459	1,481	1,616	1,742
Imports of goods and services	2,997	2,828	2,806	2,952	3,061	3,343	3,192	3,644
Official current grants	197	86	36	28	33	19	24	44
Of which: Budget support	38	25	36	28	33	19	24	44
Current account balance 5/	-350	-383	-572	-755	-777	-1,049	-734	-971
(percent of GDP)	-8.1	-8.2	-12.5	-15.5	-14.9	-20.0	-12.8	-15.4
Gross official reserves	175	454	488	1,241	1,203	1,322	1,253	1,372
(in months of imports)	0.7	1.9	2.1	5.0	4.7	4.7	4.7	4.5
External debt service	116	131	94	81	121	125	162	162
(percent of exports of goods and services)	8.4	9.4	6.8	5.8	8.3	8.5	10.0	9.3

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

1/ Data refer to the entire country.

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

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

4/ Excludes any liabilities arising from war damage claims.

5/ 2002 and 2003 data have been adjusted to reflect new data on private transfers

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

	1998	1999	2000	2001	2002	2002	2003	2003
				Est.	First review	Revised	First review	Revised
Federation								
Nominal GDP (KM million)	5,602	6,141	6,723	7,274	7,592	7,596	8,057	7,959
	(Percent change)							
Real GDP	6.5	9.3	7.3	6.2	4.7	4.5	5.6	3.8
Index of industrial production (period average)	23.8	10.6	9.4	7.6	7.5	10.1	...	...
Gross wages (period average)	2.7	8.8	10.2	7.4	6.9	9.2	...	...
CPI (period average)	5.1	-0.9	1.9	1.9	-0.2	-0.2	0.5	1.0
	(Percent of Federation GDP)							
Central government budget								
Revenue	12.8	12.0	13.2	14.9	14.0	13.8	14.1	13.8
Expenditure (on a commitment basis)	15.4	13.7	15.0	15.5	15.3	15.4	13.5	13.1
<i>Of which: Change in stock of arrears</i>	1.4	1.3	1.2	-0.1	0.0	0.2	0.0	0.0
Overall balance	-2.6	-1.7	-1.8	-0.6	-1.3	-1.7	0.6	0.7
Overall balance (percentage of BiH GDP)	-1.9	-1.2	-1.3	-0.4	-0.9	-1.2	0.4	0.5
Budget for cantonal governments and extra budgetary funds								
Revenue	35.4	37.0	35.3	30.8	31.1	30.4	30.2	30.7
Expenditure (on a commitment basis)	36.9	39.9	38.3	32.0	31.0	30.7	30.2	30.7
<i>Of which: Change in stock of arrears</i>	4.3	4.5	3.0	0.4	-0.6	-0.4	0.0	0.0
Overall balance	-1.5	-2.8	-3.1	-1.2	0.1	-0.3	0.0	0.0
Overall balance (percentage of BiH GDP)	-1.1	-2.0	-2.2	-0.9	0.1	-0.2	0.0	0.0
Republika Srpska								
Nominal GDP (KM million)	1,957	2,462	2,734	2,993	3,043	3,061	3,126	3,151
	(Percent change)							
Real GDP	47.5	10.2	-5.0	-2.0	1.5	1.9	2.0	1.7
Index of industrial production (period average)	23.0	15.9	9.7	-11.8	-7.0	-2.5	...	...
Gross wages (period average)	47.1	22.3	18.5	13.8	2.0	2.4	...	...
CPI (period average)	-14.0	14.1	14.0	7.0	1.9	1.7	0.7	1.2
	(Percent of Republika Srpska GDP)							
Budget for central government and municipalities								
Revenue	24.9	33.4	33.7	30.0	38.4	38.3	37.5	37.0
Expenditure (on a commitment basis)	29.6	39.2	37.7	31.9	39.2	38.3	36.2	35.9
<i>Of which: Change in stock of arrears</i>	1.8	3.2	3.9	0.8	-1.1	-0.7	-0.8	-0.8
Overall balance	-4.7	-5.9	-4.1	-2.0	-0.8	0.0	1.2	1.1
Overall balance (percentage of BiH GDP)	-1.2	-1.7	-1.2	-0.6	-0.2	0.0	0.3	0.3
Budget for extra budgetary funds								
Revenue	13.4	14.6	14.4	14.2	17.0	16.2	16.9	15.8
Expenditure (on a commitment basis)	13.4	15.5	18.5	16.3	17.0	16.2	16.9	15.8
<i>Of which: Change in stock of arrears</i>	0.0	0.9	4.1	2.1	0.0	0.0	0.0	0.0
Overall balance	0.0	-0.9	-4.1	-2.1	0.0	0.0	0.0	0.0
Overall balance (percentage of BiH GDP)	0.0	-0.3	-1.2	-0.6	0.0	0.0	0.0	0.0

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

1/ 2002-2003 program projections reflect the already negotiated SBA.

Table 2a. Bosnia and Herzegovina: General Government, 1998-2003

	1998	1999	2000	2001 1/	2002 Proj.	2002 Prel. Act	2003 Proj.
	(in millions of KM)						
Revenue	4,285.4	5,275.0	5,389.8	5,433.2	5,692.2	5,639.2	5,741.9
Tax revenue	3,099.2	3,660.9	4,094.8	4,209.2	4,571.2	4,528.1	4,739.2
Indirect taxes	1,198.8	1,474.6	1,554.6	1,470.3	1,573.9	1,527.0	1,634.9
Trade taxes	406.6	491.6	599.0	840.0	985.1	989.6	942.0
Direct taxes	325.5	336.1	415.3	362.4	378.9	362.2	389.7
Social Security contributions	1,170.2	1,358.7	1,526.0	1,536.5	1,633.4	1,649.3	1,772.7
Non-tax revenue	272.1	470.7	355.1	446.7	533.9	538.1	529.8
Grants	914.1	1,143.4	939.8	777.3	587.1	572.9	472.9
Budget support	66.0	47.7	114.7	39.5	74.8	61.6	92.6
Foreign investment projects	848.1	1,095.7	825.2	737.9	512.2	511.3	380.3
Consolidated expenditure on a commitment basis	4,877.8	6,060.4	6,346.9	6,038.4	6,126.8	6,108.2	5,990.4
Of which: Change in stock of domestic arrears	203.1	290.2	388.3	91.0	-49.4	-19.9	-25.8
Consolidated expenditure on a cash basis	4,674.7	5,770.3	5,958.5	5,947.4	6,176.2	6,128.1	6,016.2
Interest payments	87.0	103.1	131.2	129.3	124.0	129.7	122.1
Subsidies and transfers to non-public agents 2/	1,437.2	1,631.2	1,918.9	2,011.1	2,278.7	2,259.2	2,260.3
Other current spending	1,981.3	2,530.5	2,567.6	2,571.6	2,821.5	2,811.4	2,784.6
Investment expenditure	1,169.2	1,505.5	1,340.8	1,235.4	952.0	927.9	849.3
Foreign financed investment projects	1,114.6	1,437.1	1,220.3	1,089.5	841.2	830.2	712.8
Other investment expenditure	54.6	68.4	120.5	145.9	110.8	97.7	136.5
Balance on a commitment basis	-592.4	-785.5	-957.0	-605.2	-434.6	-469.1	-248.5
Balance on a cash basis	-389.3	-495.3	-568.7	-514.2	-484.0	-489.0	-274.3
Financing on a commitment basis	592.4	785.5	957.0	605.2	434.6	469.1	248.5
Privatization proceeds	0.0	63.0	126.0	80.6	13.0	13.2	8.6
Foreign loans	389.3	432.3	459.2	437.0	431.2	428.4	316.1
Budget support	122.8	146.4	130.7	134.1	210.4	222.7	181.2
Foreign investment projects	266.5	341.5	395.1	351.6	328.9	318.9	332.5
Amortization	0.0	-55.6	-66.6	-48.8	-108.2	-113.2	-197.6
Domestic financing 3/	0.0	0.0	-16.4	-3.4	39.9	47.4	-50.3
Change in stock of domestic arrears (+ = increase)	203.1	290.2	388.3	91.0	-49.4	-19.9	-25.8
Memorandum items:							
Stock of domestic spending arrears 4/	3	6	882	973	923	953	927
External public debt 5/	5,302	7,400	6,083	5,735	5,604	5,604	5,742
Primary balance	-505	-682	-826	-476	-311	-339	-126
Public consumption	3,709	4,555	5,006	4,803	5,175	5,180	5,141
Public saving	-271	-376	-441	-108	5	-52	220
Nominal BiH GDP	7,559	8,603	9,611	10,480	10,897	10,879	11,342

Sources: Ministries of Finance; and IMF staff estimates.

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

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

3/ Including use and reconstitution of succession monies.

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

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

Table 2b. Bosnia and Herzegovina: General Government, 1998-2003

	1998	1999	2000	2001 1/	2002 Proj.	2002 Prel. Act	2003 Proj.
	(In percent of BiH GDP)						
Revenue	56.7	61.3	56.1	51.8	52.2	51.8	50.6
Tax revenue	41.0	42.6	42.6	40.2	41.9	41.6	41.8
Indirect taxes	15.9	17.1	16.2	14.0	14.4	14.0	14.4
Trade taxes	5.4	5.7	6.2	8.0	9.0	9.1	8.3
Direct taxes	4.3	3.9	4.3	3.5	3.5	3.3	3.4
Social Security contributions	15.5	15.8	15.9	14.7	15.0	15.2	15.6
Non-tax revenue	3.6	5.5	3.7	4.3	4.9	4.9	4.7
Grants	12.1	13.3	9.8	7.4	5.4	5.3	4.2
Budget support	0.9	0.6	1.2	0.4	0.7	0.6	0.8
Foreign investment projects	11.2	12.7	8.6	7.0	4.7	4.7	3.4
Consolidated expenditure on a commitment basis	64.5	70.4	66.0	57.6	56.2	56.1	52.8
Of which: Change in stock of domestic arrears	2.7	3.4	4.0	0.9	-0.5	-0.2	-0.2
Consolidated expenditure on a cash basis	61.8	67.1	62.0	56.8	56.7	56.3	53.0
Interest payments	1.2	1.2	1.4	1.2	1.1	1.2	1.1
Subsidies and transfers to non-public agents 2/	19.0	19.0	20.0	19.2	20.9	20.8	19.9
Other current spending	26.2	29.4	26.7	24.5	25.9	25.8	24.6
Investment expenditure	15.5	17.5	14.0	11.8	8.7	8.5	7.5
Foreign financed investment projects	14.7	16.7	12.7	10.4	7.7	7.6	6.3
Other investment expenditure	0.7	0.8	1.3	1.4	1.0	0.9	1.2
Balance on a commitment basis	-7.8	-9.1	-10.0	-5.8	-4.0	-4.3	-2.2
Balance on a cash basis	-5.1	-5.8	-5.9	-4.9	-4.4	-4.5	-2.4
Financing on a commitment basis	7.8	9.1	10.0	5.8	4.0	4.3	2.2
Privatization proceeds	0.0	0.7	1.3	0.8	0.1	0.1	0.1
Foreign loans	5.1	5.0	4.8	4.2	4.0	3.9	2.8
Budget support	1.6	1.7	1.4	1.3	1.9	2.0	1.6
Foreign investment projects	3.5	4.0	4.1	3.4	3.0	2.9	2.9
Amortization	0.0	-0.6	-0.7	-0.5	-1.0	-1.0	-1.7
Domestic financing 3/	0.0	0.0	-0.2	0.0	0.4	0.4	-0.4
Change in stock of domestic arrears (+ = increase)	2.7	3.4	4.0	0.9	-0.5	-0.2	-0.2
Memorandum items:							
Stock of domestic spending arrears 4/	2.7	5.7	9.2	9.3	8.5	8.8	8.2
External public debt 5/	64.7	68.2	64.6	53.3	54.8	47.2	47.7
Primary balance	-6.7	-7.9	-8.6	-4.5	-2.9	-3.1	-1.1
Public consumption	49.1	52.9	52.1	45.8	47.5	47.6	45.3
Public saving	-3.6	-4.4	-4.6	-1.0	0.0	-0.5	1.9
Nominal BiH GDP (in millions of KM)	7,559	8,603	9,611	10,480	10,897	10,879	11,342
Real GDP growth (in percent)	15.6	9.6	5.6	4.5	3.9	3.8	3.3
Inflation (CPI, period average, in percent)	-0.3	3.4	5.1	3.1	0.3	0.3	1.0
Current account deficit	-18.5	-17.9	-12.5	-15.5	-14.9	-20.0	-15.4
Gross official reserves (in months of imports)	0.7	1.9	2.1	5.0	4.7	4.7	4.5

Sources: Ministries of Finance; and IMF staff estimates.

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

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

3/ Including use and reconstitution of succession monies.

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

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

Table 2c. Bosnia and Herzegovina: General Government, 1998-2003

	1998	1999	2000	2001 1/	2002 Proj.	2002 Prel. Act	2003 Proj.
(In millions of KM)							
Federation budget							
Revenue (including grants)	716.9	738.3	889.6	1085.0	1066.3	1045.7	1094.6
Expenditure on a commitment basis 2/	860.0	841.6	1010.1	1126.1	1162.8	1170.2	1040.5
<i>Of which:</i> Change in stock of domestic arrears	78.2	78.2	78.2	-10.5	0.0	13.3	0.0
<i>Of which:</i> Transfers to the State	65.0	110.8	153.5	143.6	191.4	196.5	259.7
Balance on a commitment basis	-143.2	-103.2	-120.5	-41.1	-96.5	-124.5	54.1
Cantonal budget							
Revenue	1106.4	1288.9	1252.9	1036.6	1113.8	1033.3	1082.8
<i>Of which:</i> Transfers from the Federation budget	7.0	15.9	25.1	18.0	14.5	13.9	13.0
Expenditure on a commitment basis	1106.4	1378.9	1400.9	1214.1	1122.3	1075.0	1082.8
<i>Of which:</i> Change in stock of domestic arrears	0.0	27.0	22.0	100.8	0.0	6.1	0.0
Balance on a commitment basis	0.0	-90.0	-148.0	-177.4	-8.5	-41.7	0.0
Federation extra-budgetary Funds 3/							
Revenue	879.3	984.3	1117.9	1203.4	1248.0	1276.7	1359.4
<i>Of which:</i> Transfers from the Federation budget	24.3	6.9	8.8	84.0	25.8	24.0	9.0
Expenditure on a commitment basis	963.3	1068.3	1176.9	1115.4	1230.6	1259.3	1359.4
<i>Of which:</i> Change in stock of domestic arrears	84.0	84.0	59.0	-88.0	-17.4	-17.4	0.0
Balance on a commitment basis	-84.0	-84.0	-59.0	88.0	17.4	17.4	0.0
RS budget and municipalities							
Revenue (including grants) 4/	486.7	821.5	921.0	896.3	1169.2	1171.9	1165.7
Expenditure on a commitment basis	579.5	966.2	1031.9	955.6	1192.3	1170.9	1126.4
<i>Of which:</i> Change in stock of domestic arrears	35.0	79.0	105.7	25.0	-32.0	-21.9	-25.8
<i>Of which:</i> Transfers to the State	55.0	74.3	88.9	82.3	129.0	119.9	118.0
Balance on a commitment basis	-92.8	-144.7	-110.9	-59.3	-23.1	1.0	39.3
RS extra-budgetary funds 3/							
Revenue	261.4	358.7	392.6	425.1	517.9	495.0	499.3
<i>Of which:</i> Transfers from the RS budget	0.1	28.1	36.7	16.0	115.3	106.4	85.5
Expenditure on a commitment basis	261.4	380.7	505.1	488.6	517.9	495.0	499.3
<i>Of which:</i> Change in stock of domestic arrears	0.0	22.0	112.5	63.5	0.0	0.0	0.0
Balance on a commitment basis	0.0	-22.0	-112.5	-63.5	0.0	0.0	0.0
State budget							
Revenue (including grants)	138.0	223.6	280.2	294.7	402.0	427.2	495.1
<i>Of which:</i> Transfers from the Federation and RS budgets	120.0	185.1	242.4	225.9	320.4	316.4	377.7
Expenditure on a commitment basis	143.9	223.6	291.2	294.9	397.0	429.5	504.6
<i>Of which:</i> Change in stock of domestic arrears	5.9	0.0	11.0	0.2	0.0	0.0	0.0
Balance on a commitment basis	-5.9	0.0	-11.0	-0.2	5.0	-2.4	-9.5
Breko District budget 5/							
Revenue	0.0	0.0	23.5	98.1	138.7	138.7	150.0
Expenditure on a commitment basis	0.0	0.0	23.5	98.1	138.7	138.7	150.0
Balance on a commitment basis	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign investment projects							
Grants	848.1	1095.7	825.2	737.9	512.2	511.3	380.3
Expenditure on a commitment basis	1114.6	1437.1	1220.3	1089.5	841.2	830.2	712.8
Balance on a commitment basis	-266.5	-341.5	-395.1	-351.6	-328.9	-318.9	-332.5

Sources: Ministries of Finance; and IMF staff estimates.

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

2/ Includes transfers to Cantons and extrabudgetary funds.

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

4/ Includes transfers to extrabudgetary funds.

5/ Data for 2000 are incomplete.

Table 2d. Bosnia and Herzegovina: General Government, 1998-2003

	1998	1999	2000	2001 1/	2002 Proj.	2002 Prel. Act	2003 Proj.
(In percent of BiH GDP, unless stated otherwise)							
Federation budget							
Revenue (including grants)	9.5	8.6	9.3	10.4	9.8	9.6	9.7
Expenditures on a commitment basis 2/	11.4	9.8	10.5	10.7	10.7	10.8	9.2
<i>Of which:</i> Change in stock of domestic arrears	1.0	0.9	0.8	-0.1	0.0	0.1	0.0
<i>Of which:</i> Transfers to the State	0.9	1.3	1.6	1.4	1.8	1.8	2.3
Balance on a commitment basis	-1.9	-1.2	-1.3	-0.4	-0.9	-1.1	0.5
Cantonal budget							
Revenue	14.6	15.0	13.0	9.9	10.2	9.5	9.5
<i>Of which:</i> Transfers from the Federation budget	0.1	0.2	0.3	0.2	0.1	0.1	0.1
Expenditure on a commitment basis	14.6	16.0	14.6	11.6	10.3	9.9	9.5
<i>Of which:</i> Change in stock of domestic arrears	0.0	0.3	0.2	1.0	0.0	0.1	0.0
Balance on a commitment basis	0.0	-1.0	-1.5	-1.7	-0.1	-0.4	0.0
Federation extra-budgetary Funds 3/							
Revenue	11.6	11.4	11.6	11.5	11.5	11.7	12.0
<i>Of which:</i> Transfers from the Federation budget	0.3	0.1	0.1	0.8	0.2	0.2	0.1
Expenditure on a commitment basis	12.7	12.4	12.2	10.6	11.3	11.6	12.0
<i>Of which:</i> Change in stock of domestic arrears	1.1	1.0	0.6	-0.8	-0.2	-0.2	0.0
Balance on a commitment basis	-1.1	-1.0	-0.6	0.8	0.2	0.2	0.0
RS budget and municipalities							
Revenue (including grants) 4/	6.4	9.5	9.6	8.6	10.7	10.8	10.3
Expenditure on a commitment basis	7.7	11.2	10.7	9.1	10.9	10.8	9.9
<i>Of which:</i> Change in stock of domestic arrears	0.5	0.9	1.1	0.2	-0.3	-0.2	-0.2
<i>Of which:</i> Transfers to the State	0.7	0.9	0.9	0.8	1.2	1.1	1.0
Balance on a commitment basis	-1.2	-1.7	-1.2	-0.6	-0.2	0.0	0.3
RS extra-budgetary funds 3/							
Revenue	3.5	4.2	4.1	4.1	4.8	4.6	4.4
<i>Of which:</i> Transfers from the RS budget	0.0	0.3	0.4	0.2	1.1	1.0	0.8
Expenditure on a commitment basis	3.5	4.4	5.3	4.7	4.8	4.6	4.4
<i>Of which:</i> Change in stock of domestic arrears	0.0	0.3	1.2	0.6	0.0	0.0	0.0
Balance on a commitment basis	0.0	-0.3	-1.2	-0.6	0.0	0.0	0.0
State budget							
Revenue (including grants)	1.8	2.6	2.9	2.8	3.7	3.9	4.4
<i>Of which:</i> Transfers from the Federation and RS budgets	1.6	2.2	2.5	2.2	2.9	2.9	3.3
Expenditure on a commitment basis	1.9	2.6	3.0	2.8	3.6	3.9	4.4
<i>Of which:</i> Change in stock of domestic arrears	0.1	0.0	0.1	0.0	0.0	0.0	0.0
Balance on a commitment basis	-0.1	0.0	-0.1	0.0	0.0	0.0	-0.1
Brcko District budget 5/							
Revenue	0.0	0.0	0.2	0.9	1.3	1.3	1.3
Expenditure on a commitment basis	0.0	0.0	0.2	0.9	1.3	1.3	1.3
Balance on a commitment basis	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign investment projects							
Grants	11.2	12.7	8.6	7.0	4.7	4.7	3.4
Expenditure on a commitment basis	14.7	16.7	12.7	10.4	7.7	7.6	6.3
Balance on a commitment basis	-3.5	-4.0	-4.1	-3.4	-3.0	-2.9	-2.9
Memorandum item:							
Nominal BiH GDP (in millions of KM)	7,559	8,603	9,611	10,480	10,897	10,879	11,342

Sources: Ministries of Finance; and IMF staff estimates

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

2/ Includes transfers to Cantons and extrabudgetary funds.

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

4/ Includes transfers to extrabudgetary funds.

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

Table 2e. Bosnia and Herzegovina: General Government, 1998-2003

	1998	1999	2000	2001 1/	2002 Proj.	2002 Prel. Act.	2003 Proj.
(In millions of KM)							
Federation							
Consolidated revenue (including grants)	2,671.3	2,988.7	3,226.5	3,223.1	3,387.8	3,317.8	3,514.8
Consolidated expenditure on a commitment basis	2,898.5	3,266.0	3,554.0	3,353.7	3,475.5	3,466.7	3,460.7
<i>Of which:</i> Change in stock of domestic arrears	162.2	189.2	152.2	6.3	-17.4	2.0	0.0
<i>Of which:</i> Transfers to the State	65.0	110.8	153.5	143.6	191.4	196.5	259.7
Consolidated balance on a commitment basis	-227.2	-277.2	-327.5	-130.6	-87.6	-148.8	54.1
RS							
Consolidated revenue (including grants)	748.0	1,152.0	1,276.9	1,305.4	1,571.8	1,560.6	1,579.4
Consolidated expenditure on a commitment basis	840.8	1,318.8	1,500.3	1,428.2	1,594.9	1,559.5	1,540.1
<i>Of which:</i> Change in stock of domestic arrears	35.0	101.0	218.2	88.5	-32.0	-21.9	-25.8
<i>Of which:</i> Transfers to the State	55.0	74.3	88.9	82.3	129.0	119.9	118.0
Consolidated balance on a commitment basis	-92.8	-166.7	-223.4	-122.8	-23.1	1.0	39.3
State budget							
Revenue (including grants)	138.0	223.6	280.2	294.7	402.0	427.2	495.1
<i>Of which:</i> Transfers from the Federation and RS budgets	120.0	185.1	242.4	225.9	320.4	316.4	377.7
Expenditure on a commitment basis	143.9	223.6	291.2	294.9	397.0	429.5	504.6
<i>Of which:</i> Change in stock of domestic arrears	5.9	0.0	11.0	0.2	0.0	0.0	0.0
Balance on a commitment basis	-5.9	0.0	-11.0	-0.2	5.0	-2.4	-9.5
Brecko District budget 2/							
Revenue	0.0	0.0	23.5	98.1	138.7	138.7	150.0
Expenditure on a commitment basis	0.0	0.0	23.5	98.1	138.7	138.7	150.0
Balance on a commitment basis	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign investment projects							
Grants	848.1	1,095.7	825.2	737.9	512.2	511.3	380.3
Expenditure on a commitment basis	1,114.6	1,437.1	1,220.3	1,089.5	841.2	830.2	712.8
Balance on a commitment basis	-266.5	-341.5	-395.1	-351.6	-328.9	-318.9	-332.5

Sources: Ministries of Finance; and IMF staff estimates.

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

2/ Data for 2000 are incomplete.

Table 2f. Bosnia and Herzegovina: General Government, 1998-2003

	1998	1999	2000	2001 1/	2002 Proj.	2002 Prel. Act.	2003 Proj.
	(In percent of BiH GDP)						
Federation							
Consolidated revenue (including grants)	35.3	34.7	33.6	30.8	31.1	30.5	31.0
Consolidated expenditure on a commitment basis	38.3	38.0	37.0	32.0	31.9	31.9	30.5
<i>Of which: Change in stock of domestic arrears</i>	2.1	2.2	1.6	0.1	-0.2	0.0	0.0
<i>Of which: Transfers to the State</i>	0.9	1.3	1.6	1.4	1.8	1.8	2.3
Consolidated balance on a commitment basis	-3.0	-3.2	-3.4	-1.2	-0.8	-1.4	0.5
RS							
Consolidated revenue (including grants)	9.9	13.4	13.3	12.5	14.4	14.3	13.9
Consolidated expenditure on a commitment basis	11.1	15.3	15.6	13.6	14.6	14.3	13.6
<i>Of which: Change in stock of domestic arrears</i>	0.5	1.2	2.3	0.8	-0.3	-0.2	-0.2
<i>Of which: Transfers to the State</i>	0.7	0.9	0.9	0.8	1.2	1.1	1.0
Consolidated balance on a commitment basis	-1.2	-1.9	-2.3	-1.2	-0.2	0.0	0.3
State budget							
Revenue (including grants)	1.8	2.6	2.9	2.8	3.7	3.9	4.4
<i>Of which: Transfers from the Federation and RS budgets</i>	1.6	2.2	2.5	2.2	2.9	2.9	3.3
Expenditure on a commitment basis	1.9	2.6	3.0	2.8	3.6	3.9	4.4
<i>Of which: Change in stock of domestic arrears</i>	0.1	0.0	0.1	0.0	0.0	0.0	0.0
Balance on a commitment basis	-0.1	0.0	-0.1	0.0	0.0	0.0	-0.1
Brcko District budget 2/							
Revenue	0.0	0.0	0.2	0.9	1.3	1.3	1.3
Expenditure on a commitment basis	0.0	0.0	0.2	0.9	1.3	1.3	1.3
Balance on a commitment basis	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign investment projects							
Grants	11.2	12.7	8.6	7.0	4.7	4.7	3.4
Expenditure on a commitment basis	14.7	16.7	12.7	10.4	7.7	7.6	6.3
Balance on a commitment basis	-3.5	-4.0	-4.1	-3.4	-3.0	-2.9	-2.9
	(In percent of Federation GDP)						
Federation							
Consolidated revenue (including grants)	47.7	48.7	48.0	44.3	44.6	43.7	44.2
Consolidated expenditure on a commitment basis	51.7	53.2	52.9	46.1	45.8	45.7	43.5
<i>Of which: Change in stock of domestic arrears</i>	2.9	3.1	2.3	0.1	-0.2	0.0	0.0
<i>Of which: Transfers to the State</i>	1.2	1.8	2.3	2.0	2.5	2.6	3.3
Consolidated balance on a commitment basis	-4.1	-4.5	-4.9	-1.8	-1.2	-2.0	0.7
	(In percent of RS GDP)						
RS							
Consolidated revenue (including grants)	38.2	46.8	46.7	43.6	51.7	51.0	50.1
Consolidated expenditure on a commitment basis	43.0	53.6	54.9	47.7	52.4	51.0	48.9
<i>Of which: Change in stock of domestic arrears</i>	1.8	4.1	8.0	3.0	-1.1	-0.7	-0.8
<i>Of which: Transfers to the State</i>	2.8	3.0	3.3	2.7	4.2	3.9	3.7
Consolidated balance on a commitment basis	-4.7	-6.8	-8.2	-4.1	-0.8	0.0	1.2
Memorandum items:							
Nominal BiH GDP (in millions of KM)	7,559	8,603	9,611	10,480	10,897	10,879	11,342
Nominal Federation GDP (in millions of KM)	5,602	6,141	6,723	7,274	7,592	7,593	7,956
Nominal RS GDP (in millions of KM)	1,957	2,462	2,734	2,993	3,043	3,061	3,151

Sources: Ministries of Finance; and IMF staff estimates.

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

2/ Data for 2000 are incomplete.

Table 2g. Bosnia and Herzegovina: Federation Fiscal Operations, 2000-2003

	2000	2001		2002				2003	
		Budget	Est. 1/	Budget	Prel. Act. Jan-Sep	Prel. Act. Oct-Dec	Proj. EBS/02/203		Prel. Act. Year
(In millions of KM, unless otherwise specified)									
Revenue	828.5	872.7	1,068.7	1,245.0	749.0	284.8	1,038.0	1,033.8	1,055.5
Tax revenue	768.0	813.3	949.6	1,153.3	660.7	269.0	929.6	929.7	952.5
Indirect taxes	745.5	788.4	905.5	1,103.9	654.8	267.0	921.8	921.8	934.5
Profit tax	22.5	24.9	44.1	49.4	5.9	2.0	7.7	7.9	18.0
Nontax revenue	60.5	59.3	119.1	91.7	88.3	15.8	108.4	104.1	103.0
Of which: Dividends of public enterprises 2/	0.0	0.0	27.7	40.0	36.5	0.0	36.5	36.5	25.0
Expenditure	976.4	997.6	1,169.2	1,559.4	891.7	340.7	1,244.3	1,232.4	1,172.2
Wages and contributions 3/	103.0	108.2	122.1	135.9	88.2	31.3	131.2	119.5	130.9
Goods and services	29.8	32.3	29.0	54.1	25.9	18.6	43.1	44.5	64.3
Military	309.6	290.2	296.8	393.8	302.6	65.6	386.7	368.1	243.8
Reconstruction and capital expenditure 4/	47.2	46.6	61.9	83.8	26.7	16.2	53.5	42.9	67.6
Subsidies	14.0	11.2	11.2	126.6	11.4	11.4	20.0	22.8	19.2
Other transfers to households	255.0	278.6	354.6	359.9	240.0	76.0	322.2	316.0	285.5
Transfers to pension funds	8.8	8.8	83.0	45.0	13.0	2.0	21.0	15.0	0.0
Regular transfers	8.8	8.8	19.0	25.0	13.0	2.0	15.0	15.0	0.0
Extraordinary transfers 5/	0.0	0.0	64.0	20.0	0.0	0.0	6.0	0.0	0.0
Transfers for health	0.7	1.0	1.0	1.2	4.8	4.2	4.8	9.0	9.0
Transfers for education	4.9	4.9	5.1	5.6	0.8	0.5	1.2	1.3	1.5
Transfers to war invalids	240.7	263.9	263.5	308.1	221.4	69.3	295.2	290.7	275.0
Transfers to the state government	153.5	167.8	143.6	235.7	120.2	76.3	191.4	196.5	259.7
Administration	30.0	37.0	37.0	51.5	34.1	17.6	57.3	51.7	58.0
Debt service	123.5	130.8	106.6	184.2	86.1	58.7	134.1	144.8	201.7
Transfers to cantons and municipalities	25.1	10.0	18.0	13.0	10.9	3.0	14.5	13.9	13.0
Net lending	-7.0	0.0	3.7	0.0	0.0	0.0	0.0	0.0	0.0
Clearance of domestic arrears	0.0	0.0	46.6	72.3	10.2	-1.5	10.2	8.7	0.0
Other expenditure	46.2	52.7	81.6	84.4	55.6	44.1	71.6	99.7	88.2
Refugees	23.3	25.0	28.0	32.0	28.5	3.0	36.0	31.5	32.0
Refund of prelevmani duties	0.0	4.0	0.0	5.0	0.1	4.3	3.0	4.4	4.0
Intelligence Service	13.5	5.0	12.0	15.6	10.2	6.2	12.3	16.4	14.2
Budgetary reserve	0.0	11.2	15.1	14.0	2.6	6.3	3.5	8.9	10.0
Other	9.4	7.5	26.5	17.8	2.6	24.4	16.9	38.6	28.0
Overall balance (cash basis, before grants)	-147.9	-124.9	-100.4	-314.4	-142.7	-55.9	-206.3	-198.6	-116.7
Foreign grants for budget support	61.1	0.0	16.3	13.2	0.0	11.9	28.3	11.9	39.1
Overall balance (cash basis, after grants)	-86.8	-124.9	-84.1	-301.2	-142.7	-44.0	-178.0	-186.7	-77.6
Financing	86.8	124.9	84.1	301.2	142.7	44.0	178.0	186.7	77.6
Domestic financing 6/	-16.4	14.0	4.5	92.7	-23.9	-13.0	-40.1	-27.5	-43.2
Of which: Reconstitution of succession money	0.0	0.0	0.0	0.0			-31.5	-27.0	-44.5
Foreign loans for budget support 7/	103.2	111.0	79.6	119.5	85.7	57.0	134.3	142.7	120.8
Privatization receipts	0.0	0.0	0.0	55.0	0.0	0.0	3.0	0.0	0.0
Succession money	0.0	0.0	0.0	34.0	71.5	0.0	71.5	71.5	0.0
Memorandum items:									
Revenue (in percent of GDP)	12.4	12.0	14.7	16.4	9.9	3.8	13.7	13.6	13.3
Expenditure (in percent of GDP)	14.6	13.7	16.1	20.5	11.7	4.5	16.4	16.2	14.7
Balance (cash, before grants, in percent of GDP)	-2.2	-1.7	-1.4	-4.1	-1.9	-0.7	-2.7	-2.6	-1.5
Balance (cash, after grants, in percent of GDP)	-1.3	-1.7	-1.2	-4.0	-1.9	-0.6	-2.3	-2.5	-1.0
Balance (commitment, after grants, in percent of GDP)	-1.3	-1.7	-0.5	-3.0	-1.7	-0.6	-2.2	-2.3	-1.0
Military expenditure (in percent of GDP)	4.6	4.0	4.1	5.2	4.0	0.9	5.1	4.8	3.1
Of which: Demobilization (in percent of GDP)	0.0	0.0	0.0	0.0	1.2	0.0	1.2	1.2	0.0
Debt service (in percent of GDP)	1.8	1.8	1.5	2.4	1.1	0.8	1.8	1.9	2.5
Expenditure excluding military and debt service (in percent of GDP)	543.4	576.6	765.7	981.4	503.1	216.5	723.6	719.5	726.7
Nominal GDP	6,723	7,274	7,274	7,592	7,593	7,593	7,592	7,593	7,956

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

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

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

3/ Excludes wages of military and intelligence service staff.

4/ Includes railways.

5/ Transfers to clear pension arrears of previous years.

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

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

Table 2h. Bosnia and Herzegovina: Republika Srpska Fiscal Operations, 2001-2003

	2001	2002				2003	
		Prel. Act. Jan.-Sep.	Prel. Act. Oct.-Dec.	Reb. Bud.	Proj. EBS/02/203		Prel. Act. Year	Proj.
(In millions of KM)							
Revenue	727.7	652.6	276.9	929.0	929.0	929.5	901.9
Tax revenue	631.7	542.7	245.6	778.3	778.3	788.3	768.6
Taxes on goods and services	304.6	315.1	129.5	443.6	443.6	444.6	446.7
Property tax on special goods 1/	...	11.5	4.7	16.1	16.1	16.2	16.5
Trade taxes	187.3	122.7	45.5	170.8	170.8	168.2	143.7
Taxes on income	75.5	76.0	27.4	104.0	104.0	103.3	102.9
Other tax revenue	64.3	17.4	38.6	43.8	43.8	56.0	58.8
Non-tax revenue	47.8	64.9	22.9	88.3	88.3	87.8	91.1
Special revenue 2/	48.2	45.0	8.4	62.4	62.4	53.4	42.2
Expenditure	824.6	747.3	250.7	1044.7	1,027.8	998.0	951.4
Wages	346.0	243.4	99.4	356.7	356.7	342.8	347.0
Of which: Severance package	...	9.1	7.5	16.6	16.6	16.6	0.0
Goods and services	85.8	60.7	19.0	81.9	81.9	79.7	101.7
Subsidies to public enterprises 3/	18.7	29.9	3.0	38.4	38.4	32.9	17.5
Transfers to the social funds	16.0	93.1	13.3	115.3	115.3	106.4	85.5
Transfers to households	141.6	111.1	25.7	139.9	149.9	136.8	128.1
Of which: War invalids	105.2	92.2	16.4	113.5	113.5	108.6	103.2
Transfers to municipalities	2.5	1.3	0.7	2.0	2.0	2.0	2.0
Transfers to the State	101.0	77.1	42.8	123.9	129.0	119.9	147.0
Debt service	82.0	59.2	31.6	98.1	100.2	90.8	118.0
Administration	19.0	17.9	11.2	25.8	28.8	29.1	29.0
Clearance of arrears	34.8	28.8	-6.9	28.8	28.8	21.9	25.8
Capital and reconstruction expenditure	59.7	35.7	19.1	57.3	57.3	54.8	68.9
Of which: Railway	29.4	22.1	8.1	30.5	30.5	30.1	28.4
Other expenditure and unallocated 4/	18.5	66.3	34.5	100.5	78.5	100.8	27.9
Overall balance (cash basis, before grants)	-96.9	-94.7	26.2	-115.7	-98.8	-68.5	-49.5
Foreign grants for budget support	0.0	9.1	0.8	12.9	7.7	9.9	19.6
Overall balance (cash basis, after grants)	-96.9	-85.6	27.0	-102.8	-91.1	-58.6	-29.9
Change in expenditure arrears (increase +)	-34.8	-8.0	-13.9	-21.9	-32.0	-21.9	-25.8
Overall balance (commitment basis, after grants)	-62.1	-77.6	40.9	-80.9	-59.1	-36.7	-4.1
Financing	96.9	85.6	-27.0	102.8	91.1	58.6	29.9
Domestic financing 5/	...	-15.8	-57.3	0.1	-33.5	-73.1	-39.1
o/w reconstitution of succession money	...	0.0	0.0	0.0	-8.3	0.0	-16.6
External loans for budget support 6/	96.9	53.7	26.3	54.2	76.2	80.0	60.4
Privatization receipts	0.0	9.2	4.0	10.0	10.0	13.2	8.6
Succession money	...	38.5	0.0	38.5	38.5	38.5	0.0
Memorandum items:							
Military spending	62.4	84.2	20.8	105.0	105.0	105.0	88
Wage bill	53.9	43.5	30.3	73.8	73.8	73.8	66.5
Other	8.5	40.7	-9.5	31.2	31.2	31.2	21.5
Nominal GDP	2,993	3,061	3,061	3,061	3,043	3,061	3,151
(In percent of RS GDP)							
Revenue	24.3	21.3	9.0	30.4	30.5	30.4	28.6
Expenditure	27.6	24.4	8.2	34.1	33.8	32.6	30.2
Balance (cash basis, before grants)	-3.2	-3.1	0.9	-3.8	-3.2	-2.2	-1.6
Balance (cash basis, after grants)	-3.2	-2.8	0.9	-3.4	-3.0	-1.9	-0.9
Balance (commitment basis, after grants)	-2.1	-2.5	1.3	-2.6	-1.9	-1.2	-0.1
Military spending	2.1	2.8	0.7	3.4	3.5	3.4	2.8
excluding demobilization	2.1	2.5	0.4	2.9	2.9	2.9	2.8

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

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

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

3/ Excludes railway subsidy.

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

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

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

Table 2i. Bosnia and Herzegovina: State Fiscal Operations, 2000-2003

	2000	2001	2002					2003 Proj.
			Budget	Prel. Act. Jan-Sep	Prel Act. Oct-Dec	Proj. EBS/02/203	Prel. Act. Year	
(In millions of KM, unless otherwise specified)								
Revenue	274.8	272.7	432.3	230.7	156.6	363.2	387.4	461.2
Own revenue 1/	32.4	37.6	49.7	32.1	26.9	41.0	59.0	50.6
Transfers from entities	242.4	233.7	369.7	197.3	126.4	318.3	323.7	406.7
Administrative transfers	44.6	55.6	77.3	52.0	28.8	86.1	80.8	87.0
Federation	29.7	37.1	51.5	34.1	17.6	57.3	51.7	58.0
Republika Srpska	14.9	18.5	25.8	17.9	11.2	28.8	29.1	29.0
Debt service	197.8	178.1	292.4	145.3	97.6	232.2	242.9	319.7
Federation	123.8	107.2	181.9	86.1	58.7	134.1	144.8	201.7
Republika Srpska	74.0	70.9	110.5	59.2	38.9	98.1	98.1	118.0
Extraordinary revenue 2/	...	1.4	12.9	1.4	3.3	3.9	4.7	3.9
Expenditure	273.9	294.5	483.8	265.7	163.8	397.0	429.5	504.6
State Border Service	6.0	30.8	51.3	37.3	15.0	50.7	52.3	54.0
Wages	...	22.0	...	25.9	10.9	37.3	36.8	48.0
Other	...	8.8	...	11.4	4.1	13.4	15.5	6.0
New BiH institutions 3/	...	5.5	8.1	5.9	6.9	7.4	12.8	8.5
Clearance of domestic arrears	...	0.0	9.7	0.0	0.0	0.0	0.0	0.0
BiH ministries and institutions 4/	70.1	80.0	122.3	77.2	44.3	106.8	121.5	122.4
Debt service	197.8	178.1	292.4	145.3	97.6	232.2	242.9	319.7
Overall balance (cash basis, before grants)	0.9	-21.8	-51.5	-35.0	-7.2	-33.8	-42.2	-43.4
Foreign grants	5.3	21.9	41.0	32.6	7.2	38.8	39.8	33.9
Overall balance (cash basis, after grants)	6.2	0.2	-10.5	-2.4	0.0	5.0	-2.4	-9.5
Financing	-6.2	-0.2	10.5	2.4	0.0	-5.0	2.4	9.5
Domestic 5/	-6.2	-0.2	0.0	-16.5	5.4	-17.0	-11.2	9.5
Foreign	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Succession money	0.0	0.0	19.6	19.7	0.0	19.6	19.7	0.0
Purchase of shares in IBRD and EBRD	0.0	0.0	-9.1	-0.8	-5.4	-7.6	-6.2	0.0
Memorandum items:								
Revenue and grants excluding debt-service	82.4	116.5	180.8	118.0	66.3	169.8	184.3	175.4
Expenditure excluding debt-service	76.1	116.4	191.4	120.4	66.2	164.8	186.6	184.9

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

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

2/ In 2003, transfer from Brocko District.

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

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

5/ In 2003, borrowing only for CIPS project.

Table 3a. Bosnia and Herzegovina: Balance of Payments, 2000-2007 1/
(In millions of U.S. dollars; unless otherwise indicated)

	2000	2001	2002	2003	2004	2005	2006	2007
			Est.	Proj.	Proj.	Proj.	Proj.	Proj.
Merchandise trade balance 1/	-1,678	-1,793	-2,089	-2,144	-2,107	-2,084	-2,037	-1,963
Exports, f.o.b.	932	957	1,059	1,273	1,460	1,676	1,927	2,216
Imports, f.o.b. 2/	-2,610	-2,750	-3,148	-3,417	-3,567	-3,759	-3,964	-4,179
Reconstruction	-584	-506	-403	-345	-280	-220	-185	-150
Other	-2,026	-2,244	-2,745	-3,072	-3,287	-3,539	-3,779	-4,029
Services, net	264	231	227	242	193	164	177	187
Receipts	460	434	422	469	458	449	475	498
Expenditure	-196	-202	-195	-227	-266	-285	-298	-310
Net factor income	256	250	248	308	308	336	379	424
Earnings	318	309	318	369	374	412	454	501
Interest payments	-63	-59	-70	-61	-66	-76	-75	-77
Unrequited transfers, net	585	556	566	624	583	582	574	581
Receipts	593	563	573	632	592	590	582	590
Official grants	36	28	19	44	11	16	16	16
Private	556	535	554	589	581	573	566	573
Outflows	-8	-7	-8	-9	-8	-8	-8	-9
Current account balance	-572	-755	-1,049	-971	-1,023	-1,002	-906	-771
Excluding official transfers	-609	-784	-1,068	-1,015	-1,033	-1,018	-923	-787
Foreign investment (net)	150	130	230	320	380	500	580	600
Capital transfers for reconstruction	396	346	252	190	150	90	80	60
Foreign loans (net)	192	197	180	153	134	144	117	100
Disbursements	204	211	213	207	176	181	156	141
Reconstruction	188	160	151	155	130	130	105	90
Other 3/	15	51	63	52	46	51	51	51
Amortization	-12	-15	-33	-54	-42	-38	-40	-42
Commercial banks	-146	-213	109	59	50	50	40	20
Other capital 4/	0	917	0	282	398	302	174	41
Capital account balance	592	1,376	772	1,005	1,112	1,086	991	821
Errors and omissions	-1	119	337	0	0	0	0	0
Overall balance	18	740	60	33	90	84	85	50
Financing	-18	-740	-60	-45	-89	-84	-85	-50
Change foreign assets (increase, -)	-26	-743	-63	-49	-94	-92	-93	-62
Of which:								
Gross foreign assets of the central bank	-43	-753	-81	-51	-50	-50	-50	-50
Net use of Fund resources	17	11	17	1	-44	-42	-43	-12
Purchases/loans	37	18	40	49	0	0	0	0
Repurchases/repayments	-20	-8	-23	-48	-44	-42	-43	-12
Short-term liabilities (reduction, -)	0	0	0	0	0	0	0	0
Arrears (reduction, -)	-342	-550	0	0	0	0	0	0
Multilateral creditors	0	0	0	0	0	0	0	0
Paris Club creditors	0	0	0	0	0	0	0	0
London Club	0	0	0	0	0	0	0	0
Other creditors	-342	-550	0	0	0	0	0	0
Debt rescheduling or cancellation (of arrears)	342	550	0	0	0	0	0	0
Multilateral creditors (rescheduling)	0	0	0	0	0	0	0	0
Paris Club creditors (rescheduling) 5/	0	0	0	0	0	0	0	0
London Club (rescheduling) 6/	0	0	0	0	0	0	0	0
Other creditors (cancellation)	342	550	0	0	0	0	0	0
Debt relief, current maturities (cashflow)	8	2	4	5	5	8	8	12
Multilateral creditors	0	0	0	0	0	0	0	1
Paris Club creditors 5/	0	0	0	0	0	0	0	0
London Club 6/	8	2	4	5	5	8	8	11
Total financing gap (-) 7/	0	0	0	-12	0	0	0	0
Memorandum items:								
Current account balance (in percent of GDP)	-12.5	-15.5	-20.0	-15.4	-15.2	-13.8	-11.5	-9.0
Excluding official transfers	-13.3	-16.1	-20.3	-16.1	-15.3	-14.0	-11.7	-9.2
External Public debt/GDP (in percent)	64.6	53.3	47.2	46.1	44.5	42.6	40.3	36.0
External debt service/GNFS	6.8	5.8	8.5	9.3	7.9	7.3	6.5	4.8
Gross official reserves (in millions of U.S. dollars)	488	1,241	1,322	1,372	1,422	1,472	1,522	1,572
(in months of imports of goods and services)	2.1	5.0	4.7	4.5	4.5	4.4	4.3	4.2

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

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

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

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

4/ These are non-debt-creating capital inflows. The figures for 2001 reflect the effects of the introduction of the euro. The amounts may be overstated and may in fact reflect private transfers from abroad.

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

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

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

Table 3b. Bosnia and Herzegovina: Balance of Payments, 2000-2007 1/
(In millions of Euros; unless otherwise indicated)

	2000	2001	2002	2003	2004	2005	2006	2007
		Est.	Est.	Proj.	Proj.	Proj.	Proj.	Proj.
Merchandise trade balance 1/	-1,799	-1,970	-2,213	-1,971	-1,934	-1,909	-1,862	-1,792
Exports, f.o.b.	1,000	1,052	1,121	1,169	1,340	1,536	1,762	2,022
Imports, f.o.b. 2/	-2,799	-3,022	-3,334	-3,140	-3,274	-3,445	-3,624	-3,814
Reconstruction	-627	-556	-427	-317	-257	-202	-169	-137
Other	-2,172	-2,466	-2,908	-2,823	-3,017	-3,243	-3,455	-3,677
Services, net	284	254	241	222	177	150	162	171
Receipts	493	476	447	431	421	412	435	454
Expenditure	-210	-222	-207	-209	-244	-261	-273	-283
Net factor income	274	275	263	283	283	308	347	387
Earnings	341	339	337	339	343	378	415	457
Interest payments	-67	-65	-74	-56	-61	-69	-68	-70
Unrequited transfers, net	627	611	599	573	536	533	525	530
Receipts	636	619	607	581	543	540	532	538
Official grants	39	31	20	40	10	15	15	15
Private	597	588	587	541	533	525	517	523
Outflows	-8	-8	-8	-8	-8	-7	-8	-8
Current account balance	-614	-830	-1,111	-893	-939	-918	-828	-703
Excluding official transfers	-653	-861	-1,131	-933	-949	-933	-843	-718
Foreign investment (net)	161	143	244	294	349	458	530	548
Capital transfers for reconstruction	425	380	267	175	138	82	73	55
Foreign loans (net)	206	216	191	141	123	132	107	91
Disbursements	218	232	226	190	161	166	143	129
Reconstruction	202	176	159	142	119	119	96	82
Other 3/	16	56	66	48	42	47	47	47
Amortization	-12	-16	-35	-49	-38	-35	-36	-38
Multilateral and Paris Club creditors	-11	-16	-35	-49	-38	-35	-36	-38
Commercial banks	-157	-232	92	48	46	46	37	18
Other capital 4/	0	1,008	0	219	363	275	156	35
Capital account balance	635	1,515	794	877	1,019	993	903	747
Errors and omissions	-3	152	170	0	0	0	0	0
Overall balance	18	837	-147	-16	80	75	74	44
Financing	-18	-837	147	5	-80	-74	-75	-44
Change foreign assets (increase, -)	-26	-840	143	1	-84	-82	-82	-55
Of which:								
Gross foreign assets of the central bank	-85	-851	125	0	-44	-43	-43	-44
Net use of Fund resources	18	12	18	1	-40	-39	-39	-11
Purchases/loans	40	20	42	45	0	0	0	0
Repurchases/repayments	-21	-9	-24	-44	-40	-39	-39	-11
Short-term liabilities (reduction, -)	0	0	0	0	0	0	0	0
Arrears (reduction, -)	-367	-604	0	0	0	0	0	0
Debt rescheduling or cancellation (of arrears)	367	604	0	0	0	0	0	0
Debt relief, current maturities (cashflow)	8	3	4	4	4	7	7	11
Multilateral creditors	0	0	0	0	0	0	0	1
Paris Club creditors 5/	0	0	0	0	0	0	0	0
London Club 6/	8	3	4	4	4	7	7	10
Total financing gap (-) 7/	0	0	0	-11	0	0	0	0
Memorandum items:								
Current account balance (in percent of GDP)	-12.5	-15.5	-20.0	-15.4	-15.2	-13.8	-11.5	-9.0
Excluding official transfers	-13.3	-16.1	-20.3	-16.1	-15.3	-14.0	-11.7	-9.2
External Public debt/GDP (in percent)	64.6	53.3	47.2	46.1	44.5	42.6	40.3	36.0
External debt service/GNFS	6.8	5.8	8.5	9.3	7.9	7.3	6.5	4.8
Gross official reserves (in millions of euro)	534	1,385	1,260	1,260	1,304	1,348	1,390	1,434
(in months of imports of goods and services)	2.1	5.1	4.3	4.5	4.5	4.4	4.3	4.2

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

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

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

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

4/ These are non-debt-creating capital inflows. The figures for 2001 reflect the effects of the introduction of the euro. The amounts may be overstated and may in fact reflect private transfers from abroad.

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

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

7/ The fiscal program for 2003 is fully financed. However, the EU's macroassistance of Euro 60 million in 2003 is conditional on the identification of additional Euro 11 million in associated bilateral program financing.

Table 4. Bosnia and Herzegovina: Monetary Survey, 1997-2003
(In millions of KM)

	1997	1998	1999	2000	2001	2002				2003		
						March	June	September	December	January Est.	February Est.	December Proj.
Net foreign assets	-500	-435	195	427	2,543	2,568	2,392	2,331	2,144	2,103	2,007	2,050
Foreign assets (MA)	144	283	866	1,045	2,737	2,569	2,443	2,454	2,488	2,221	2,203	2,488
Foreign assets (DMB)	1,014	887	848	961	1,364	1,540	1,581	1,637	1,452	1,631	1,566	1,358
Foreign liabilities (MA)	0	0	0	-1	-31	-2	-1	-2	-1	-1	-1	-1
Foreign liabilities (DMB)	-1,658	-1,606	-1,519	-1,577	-1,527	-1,540	-1,630	-1,758	-1,795	-1,748	-1,760	-1,795
Domestic credit	2,267	2,635	2,602	2,863	3,016	3,124	3,283	3,556	3,787	3,873	3,977	4,511
Claims on central government (net)	-188	-181	-159	-129	-319	-326	-396	-427	-400	-381	-363	-461
Claims on noncentral government	5	9	17	9	25	37	36	40	29	25	24	29
Claims on private sector	2,450	2,808	2,744	2,983	3,309	3,413	3,642	3,943	4,158	4,229	4,316	4,511
Non-financial enterprises and cooperatives	2,315	2,547	2,467	2,564	2,587	2,576	2,557	2,618	2,643	2,671	2,718	2,855
Households	121	248	268	384	682	789	1,040	1,267	1,440	1,481	1,523	1,596
Other	14	13	9	35	40	49	45	59	75	77	75	61
Broad money	1,178	1,547	2,165	2,467	4,669	4,913	4,852	5,013	4,997	4,993	4,982	5,199
Money	252	310	1,100	1,402	2,692	2,916	2,943	3,031	2,969	2,917	2,904	2,929
Currency outside banks	113	162	515	652	1,674	1,848	1,776	1,768	1,737	1,644	1,632	1,644
Demand deposits of noncentral government	26	21	85	97	178	178	177	176	155	176	169	189
Demand deposits of the private sector	113	127	499	653	841	889	990	1,086	1,076	1,097	1,103	1,097
Non-financial enterprises and cooperatives	94	103	387	454	634	652	666	734	706	720	718	801
Households	5	8	34	79	147	179	265	282	301	310	321	224
Other	14	15	78	119	60	58	58	70	70	68	64	71
Quasi-money	926	1,237	1,065	1,066	1,977	1,998	1,909	1,983	2,028	2,076	2,079	2,270
Time and savings deposits in domestic currency	10	8	22	78	141	165	206	243	261	279	295	329
Foreign currency deposits	917	1,229	1,043	988	1,836	1,833	1,703	1,739	1,767	1,797	1,784	1,941
Other items (net)	589	653	632	816	885	774	818	869	928	982	1,001	875
Memorandum items:												
NFA of the central bank	144	283	866	1,046	2,768	2,571	2,445	2,456	2,489	2,223	2,204	2,489
NFA of the central bank in percent of currency outside the banks	128	174	168	161	165	139	138	139	143	135	135	151
NFA of the central bank in percent of broad money	12	18	40	42	59	52	50	49	50	45	44	48
Broad money growth (year-on-year)	-99.8	31.3	40.0	14.0	89.2	92.6	79.8	68.2	7.0	0.7	-1.6	4.0
NDA contribution to broad money growth (year-on-year)	-384.8	31.3	-2.2	12.1	6.2	6.2	8.9	14.2	16.5	18.5	18.5	5.9
NFA contribution to broad money growth (year-on-year)	254.5	5.5	40.7	10.7	85.8	80.7	64.3	49.3	-8.5	-13.6	-16.0	-1.9
Other items net contribution to broad money growth (year-on-year)	-45.4	-5.5	1.4	-8.8	-2.7	5.8	6.7	4.7	-0.9	-4.1	-4.1	1.2
Private sector credit growth	-99.9	14.6	-2.3	8.7	10.9	10.5	12.7	18.1	25.7	30.9	30.2	8.5
Credit to the household sector (percent growth, year-on-year)	252.7	104.6	8.3	43.3	77.5	98.0	116.7	106.7	108.0	84.4	92.6	10.8
Credit to household sector (in percent of GDP)	2.0	3.4	3.1	4.0	6.5	7.3	9.6	11.6	13.2	13.6	14.0	14.1
Broad money (in percent of GDP)	19.3	21.1	25.2	25.6	44.6	45.2	44.6	46.1	45.9	45.9	45.8	45.8
Excess reserves (in percent of deposits) 1/	-	-	-	-	14.1	11.1	9.5	9.0	8.6	8.9	...	3.8
Domestic credit (in percent of GDP)	37.1	35.9	30.2	29.7	28.8	28.7	30.2	32.7	34.8	35.6	36.6	39.8
Private sector credit (in percent of GDP)	40.1	38.3	31.9	31.0	31.6	31.4	33.5	36.3	38.2	38.9	39.7	39.8
GDP (billions of KM)	6.1	7.3	8.6	9.6	10.5	10.9	10.9	10.9	10.9	10.9	10.9	11.3
Velocity of Broad Money	5.2	4.7	4.0	3.9	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2

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

1/ Starting in March 2003, cash in vaults are excluded from assets eligible to meet reserve requirements.

Table 5. Bosnia and Herzegovina: Quantitative and Structural Performance Criteria
Under the 2002-2003 Stand-by Arrangement

	2002		2003
	End-Dec.		End-Mar.
	Prog. 1/	Est.	Prog. 1/
A. Quantitative performance criteria			
Ceiling on gross credit of the banking system to the consolidated general government			
the State government 2/	0	0	0
the RS government and municipalities	10	14	10
the RS extra-budgetary funds	2	6	2
the Federation government	20	11	20
the Federation cantons	10	10	10
the Federation municipalities	8	4	8
the Federation extra-budgetary funds	0	0	0
Ceiling on contracting or guaranteeing of new concessional external debt with original maturity of more than one year by the public sector 3/ 4/	445	187	445
Ceiling on contracting or guaranteeing of new non-concessional external debt by the general government 3/ 4/	0	0	0
Ceiling on contracting or guaranteeing of new external debt by the general government with an original maturity of up to and including one year 3/	0	0	0
Ceiling on the outstanding stock of external payments arrears 5/	0	0	0
B. Structural Performance Criteria			
Continued adherence of the Currency Board Arrangement as constituted under the law, incorporating the amendments described in paragraph 10 of the MEFP (EBS/02/91, 5/30/02), and paragraph 24 of the SMEFP (EBS/02/203, 12/4/02).			Met

Sources: BIH Authorities; and IMF staff estimates.

1/ Targets for end-December 2002 and end-March 2003 are performance criteria.

2/ Excluding letters of credit at the state level for CIPS financing up to KM 40 million. Actual borrowing for CIPS was KM 8 million at end-December 2002.

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

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

5/ This will apply on a continuous basis.

Table 6. Bosnia and Herzegovina: Structural Benchmarks, September 2002-June 2003

	Implementation Date	Status as of 12/31/02	Lead Institution
1. The Entities will make transfers to the State, at least according to the agreed cumulative monthly schedule reported in Annex 1 of the MEFP.	continuous	Implemented	IMF
2. All privatization receipts accruing to the central governments of the RS and the Federation, and to the Cantons in the Federation will be placed in escrow accounts alongside all succession monies pending a comprehensive strategy to clear arrears.	continuous	Implemented	IMF
3. The Entities and the Brcko District will implement laws establishing the excise attribution mechanism as previously agreed with the World Bank and thereby avoid the double taxation on excises.	continuous	Implemented	World Bank
4. There will be no new free trade zones.	continuous	Implemented	IMF
5. Any changes to the current indirect tax system should retain or strengthen the principle of harmonization.	continuous	Implemented	IMF
6. The Federation pension fund will adhere to the cut-off dates for contribution collections at the end of each month as specified in the 2000 pension law. The RS pension fund will adhere to the cut-off date of the 10th of each month for contributions collected.	continuous	Implemented	IMF
7. (a) The base of the Brcko District sales tax will remain aligned with that in the Entities.	continuous	Implemented	IMF
(b) The two rates of sales tax in the Brcko District will be 8 and 18 percent unless changes are agreed with IMF staff.	continuous	Implemented	IMF
8. A comprehensive strategy to clear arrears will be prepared. All arrears, including frozen foreign currency deposits, will be audited by the Supreme Auditor Institutions.	End-June-2003	In preparation	IMF
9. Bosnia and Herzegovina will not clear domestic government payment arrears that were accrued before end-2000, pending a comprehensive strategy to clear arrears.	continuous	Implemented	IMF
10. There will be no offset operations for tax liabilities that are incurred after 2001.	continuous	Implemented	IMF
11. Banking supervision will be strengthened by enforcing the current prudential regulations..	continuous	Not Implemented	IMF/World Bank

Table 7. Bosnia and Herzegovina: Medium-Term Reform Scenario, 2000-2007

	2000	2001	2002	2003	2004	2005	2006	2007
	Est.	Est.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Real sector								
Nominal GDP (millions of KM)	9,611	10,480	10,879	11,342	12,099	13,026	14,065	15,249
(Percentage change)	11.7	9.0	3.8	4.3	6.7	7.7	8.0	8.4
Real GDP (millions of 1999 KM)	9,070	9,477	9,842	10,165	10,679	11,298	11,968	12,714
(Percentage change)	5.4	4.5	3.8	3.3	5.0	5.8	5.9	6.2
CPI, period average percentage change	5.1	3.1	0.3	1.0	1.7	1.9	2.0	2.1
Savings and investment (percent of GDP)								
Consumption	109.6	112.6	116.3	111.4	107.9	105.4	102.4	99.3
Public consumption	26.7	24.5	25.9	24.5	23.3	22.2	21.0	20.0
Private consumption	82.9	88.1	90.4	86.8	84.6	83.3	81.3	79.3
Investment	21.2	19.4	19.2	18.8	20.5	21.0	21.3	21.5
Public investment	14.0	11.8	8.5	7.5	7.0	6.9	6.8	6.8
Private investment	7.3	7.6	10.7	11.3	13.5	14.1	14.5	14.6
National savings	8.8	3.9	-0.8	3.4	5.3	7.2	9.7	12.5
Public savings	0.4	1.3	0.3	2.7	3.2	4.3	5.0	5.5
Private savings	8.3	2.6	-1.1	0.7	2.1	2.9	4.8	6.9
Foreign savings	12.5	15.5	20.0	15.4	15.2	13.8	11.5	9.0
General government (percent of GDP)								
Total revenue and grants	56.1	51.8	51.8	50.6	48.6	47.5	46.6	45.5
Grants	9.8	7.4	5.3	4.2	2.4	1.5	1.2	0.9
Total expenditure	66.0	57.6	56.2	52.8	50.6	49.2	47.8	46.5
Current expenditure	52.1	45.8	47.6	45.4	43.7	42.3	41.0	39.7
Capital expenditure	14.0	11.8	8.5	7.5	7.0	6.9	6.8	6.8
Own-financed capital expenditure	1.3	1.4	0.9	1.2	1.0	1.2	1.4	1.7
Foreign financed capital expenditure	12.7	10.4	7.6	6.3	6.0	5.7	5.4	5.1
Overall balance	-10.0	-5.8	-4.3	-2.2	-2.0	-1.7	-1.2	-1.0
Overall balance excl. grants	-19.7	-13.2	-9.6	-6.4	-4.4	-3.2	-2.4	-1.9
Accumulation of arrears	4.0	0.9	-0.2	-0.2	-0.7	-0.6	-0.6	-0.5
Overall balance on a cash basis	-5.9	-4.9	-4.5	-2.5	-2.7	-2.3	-1.8	-1.5
Financing	5.9	4.9	4.5	2.5	2.7	2.3	1.8	1.5
Domestic financing	1.1	0.7	0.6	-0.4	0.7	0.3	0.3	0.4
Foreign financing	4.8	4.2	3.9	2.9	2.0	2.0	1.5	1.2
Total foreign assistance 1/ (In millions of US dollars)	15	12	10	9	5	4	3	3
699	588	537	555	337	288	253	218	
Balance of payments (US\$ millions.)								
Current account balance (including official transfers)	-572	-755	-1,049	-971	-1,023	-1,002	-906	-771
(Percent of GDP)	-12.5	-15.5	-20.0	-15.4	-15.2	-13.8	-11.5	-9.0
Export growth rate (in %)	10	3	11	20	15	15	15	15
Import growth rate (in %)	0	5	14	9	4	5	5	5
Gross reserves	488	1,241	1,322	1,372	1,422	1,472	1,522	1,572
(Months of imports of goods and n.f. services)	2.1	5.0	4.7	4.5	4.5	4.4	4.3	4.2
Total public debt 2/ (In millions of US\$)	4,633	4,301	4,803	5,022	5,071	5,132	5,165	5,023
(In percent of GDP)	103.2	89.6	82.3	79.5	75.2	70.5	65.6	58.8
Total external debt service in percent of exports of goods and non-factor services	6.8	5.8	8.5	9.3	7.9	7.3	6.5	4.8
Memorandum item:								
Percentage change in real current public expenditure	4.6	-7.0	7.6	-1.8	1.0	2.4	2.5	2.8

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

1/ Includes disbursements of foreign loans, and grants.

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

Table 8. Bosnia and Herzegovina: External Financing Requirements and Possible Sources of Financing, 2000-2003
(In millions of U.S. dollars)

	2000	2001	2002 Proj.	2003 Proj.
Merchandise trade balance	-1,678	-1,793	-2,089	-2,144
Services balance	264	231	227	242
Net factor income	256	250	248	308
<i>Of which:</i> Interest due	-63	-59	-70	-61
Private transfers, net	549	528	547	580
Current account balance, excluding official transfers	-609	-784	-1,068	-1,015
Amortization of medium and long term obligations 1/	-12	-15	-33	-54
Repurchases of IMF resources	-20	-8	-23	-48
Changes in arrears (- is reduction)	-342	-550	0	0
<i>Of which:</i> Multilateral	0	0	0	0
London Club	0	0	0	0
Paris Club	0	0	0	0
Other 2/	-342	-550	0	0
London Club rescheduling and debt relief	8	2	4	5
Change in official reserves (a "-" sign indicates an increase)	-43	-753	-81	-51
Change in NFA of commercial banks (a "-" sign indicates an increase)	-146	-213	109	59
Gross external financing requirement	-1,165	-2,201	-754	-1,103
Official transfers	27	15	13	0
Capital transfers for reconstruction	396	346	252	190
Disbursement for reconstruction	188	160	151	155
Foreign direct investment	150	130	230	320
Other capital	0	917	0	282
Financing gap after project and humanitarian flows	-404	-633	-108	-156
Other rescheduling and debt relief 2/	342	550	0	0
Remaining financing gap	-62	-83	-108	-156
Identified program support	62	83	109	144
Disbursements under the IMF Stand-By Arrangement	37	18	40	49
World Bank adjustment lending	15	42	63	30
European Union (loans and grants) and other program financing	9	22	6	65
Remaining financing gap (-) 3/	0	0	0	-12

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

1/ Includes IMF repurchases.

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

3/ See footnote 7 in Table 3.

Table 9. Bosnia and Herzegovina: Vulnerability Indicators, 2000-2006

	2000	2001	2002	2003	2004	2005	2006
Exports (annual percent change, US\$ basis)	9.5	2.6	10.6	20.2	14.8	14.8	15.0
Imports (annual percent change, US\$ basis)	0.4	5.4	14.5	8.6	4.4	5.4	5.4
Current account balance (in percent of GDP) 1/	-12.5	-15.5	-20.0	-15.4	-15.2	-13.8	-11.5
Capital and financial account (in percent of GDP)	12.9	28.2	14.7	15.9	16.5	14.9	12.6
Gross official reserves (end-of-period, in millions of U.S. dollars)	488	1,241	1,322	1,372	1,422	1,472	1,522
In months of imports of goods and nonfactor services (GNFS)	2.1	5.0	4.7	4.5	4.5	4.4	4.3
Broad money/NFA (end-of-period)	5.8	1.8	2.3	2.7	...	...	...
Foreign exchange deposits/reserves (percent, end-of-period)	94.5	67.1	71.0	79.7	...	...	...
Total external debt (percent of GDP)	64.6	53.3	47.2	46.1	44.5	42.6	40.3
External debt service/exports of GNFS (in percent) 2/	6.8	5.8	8.5	9.3	7.9	7.3	6.5
External debt service to multilateral creditors/exports of GNFS (in percent)	5.3	4.1	6.9	6.3	5.5	5.5	4.7
External debt service to multilateral creditors (in percent of total debt service)	79.0	70.4	81.8	67.2	70.4	74.8	72.6
External debt service to the IMF (in percent of total debt service)	27.0	19.4	21.5	31.5	30.5	28.0	27.7
Exchange rate (per U.S. dollar, period average)	2.10	2.15	2.07	...	...	...	...
REER depreciation, end-of-period (-) (annual percent change)							
Republika Srpska	10.4	-5.5	...	...	...	...	...
Federation	-1.1	-7.7	...	...	...	...	...

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

1/ Includes transfers.

2/ Includes repayment of IMF loans.

Bosnia and Herzegovina: Fund Relations
As of March 31, 2003

I. Membership Status: Succeeded to the membership of former SFR of Yugoslavia effective 12/14/1992; Article XIV

II. <u>General Resources Account:</u>	<u>SDR Million</u>	<u>%Quota</u>
Quota	169.10	100.00
Fund Holdings of Currency	262.82	155.43
III. <u>SDR Department:</u>	<u>SDR Million</u>	<u>%Allocation</u>
Net cumulative allocation	20.48	100.0
Holdings	0.61	2.98
IV. <u>Outstanding Purchases and Loans:</u>	<u>SDR Million</u>	<u>%Quota</u>
Stand-by arrangements	93.72	55.42

V. Latest Financial Arrangements:

<u>Type</u>	<u>Approval Date</u>	<u>Expiration Date</u>	<u>Amount Approved (SDR Million)</u>	<u>Amount Drawn (SDR Million)</u>
Stand-by	8/02/2002	11/01/2003	67.60	31.60
Stand-by	5/29/1998	5/29/2001	94.42	94.42

VI. Projected Obligations to Fund:(SDR Million; based on existing use of resources and present holdings of SDRs):

	<u>Forthcoming</u>				
	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>
Principal	26.22	32.10	22.05	13.35	
Charges/Interest	1.79	1.66	0.97	0.54	0.35
Total	28.01	33.76	23.02	13.89	0.35

VII. Safeguards Assessment

Under the Fund's safeguards assessment policy, the Central Bank of Bosnia and Herzegovina (CBBH) is subject to an assessment with respect to the Stand-By Arrangement, which was approved on August 2, 2002 and is scheduled to expire on November 1, 2003. A safeguards assessment of the CBBH was completed on October 28, 2002. The assessment concluded that the safeguards in place were generally adequate, but certain weaknesses were identified in the internal audit and control functions. The authorities indicated their broad agreement with the recommendations in the report.

VIII. Exchange Rate Arrangements

The currency of Bosnia and Herzegovina is the convertible marka (KM), introduced on August 11, 1997. On September 5, 2002, the State parliament approved an amendment to the CBBH law that changes the peg of the KM from the DM to the Euro, under a currency board arrangement. The KM is pegged to the euro at KM 1 = 0.5113 euro. Small denominations of KM notes have been in circulation since June 22, 1998; large denominations and coins were introduced in August 1998, and December 1998, respectively. The convertible marka (KM) is the currency used for operations and transactions with the Fund for Bosnia and Herzegovina.

Bosnia and Herzegovina maintains restrictions on payments and transfers for current international transactions resulting from measures taken with respect to frozen foreign currency deposits as identified in SM/02/44.

IX. Last Article IV Consultation

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

X. Resident Representative

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

XI. Technical Assistance, 1999- February 2003

Department	Timing	Purpose
FAD	December 1995	Diagnostic
	February 1996	Income tax policy
	February 1996	Customs and tax administrations
	April-May 1996	Tax administration
	November 1996	Diagnostic mission to Repub. Srpska
	December 1998	Fiscal management at the State level
	November 1999	Consumption and inter-Entity trade taxation and policy
	August 2000	Treasury systems
	September-October 2000	Value-added tax
	July 2001	Treasury Systems
	April 2002	Value-added Tax
	April 2002	Treasury systems
	February 2003	Treasury systems
LEG	May 1996	Tax administration law
LEG/TRE/SEC	December 1995	Assistance with succession to membership
MAE	December 1995	Institution-building and banking legislation

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

BOSNIA AND HERZEGOVINA: IMF-WORLD BANK RELATIONS

PARTNERSHIP IN BOSNIA AND HERZEGOVINA'S DEVELOPMENT STRATEGY

Bosnia and Herzegovina's Development Agenda

1. The authorities of Bosnia and Herzegovina (BiH) recognize the importance of maintaining satisfactory macroeconomic performance while accelerating structural reforms. As demonstrated through the PRSP preparation process, Government has embarked on reforms to address several key economic challenges, including: (i) creating a predictable and coherent investment environment within a single economic space; (ii) promoting private sector activity within an improved business environment; and (iii) strengthening governance whilst combating corruption.
2. Submitted to the World Bank and the IMF in December 2001 for information, not linked to any Bank or IMF operation, Government's I-PRSP emphasized the development of an entrepreneurial society within a single economic space while combating corruption and strengthening governance. As with the I-PRSP, the major focus of the ongoing full PRSP preparation process is the economy's heavy reliance on foreign assistance, high formal unemployment and the low level of domestic production. It further emphasizes corruption problems across many sectors and the poor quality of public services. The strategy also points to greater cooperation between the Entities if progress is to be made on expanding the economy and integrating BiH's political and economic structures into a wider Europe. The central theme of the strategy is that poverty can only be effectively combated through greatly expanded private sector activity.
3. BiH's recently completed poverty profile, developed on the basis of the recently completed Living Standards Measurement Study, confirms the importance of generating new private sector jobs to poverty alleviation and improving employment prospects for the young and secondary household earners; but also points to the need to raise wages among the working poor and general skills levels in the workforce, while protecting children and households headed by inactive adults. As a result, the upcoming PRSP is expected to address issues covering the effective implementation of pension and health reform, the reorientation of the social safety net to protect children and the non-pensioned elderly, a strengthened education system and improved productivity in the productive sectors.
4. The Coordination Board for Economic Transition and EU Association, charged with overseeing the implementation of the I-PRSP and the preparation of the PRSP, adopted an action plan in 2002 to improve the business environment. The action plan covers a wide variety of areas which impact on both new and existing investment, ranging from judicial reform to institutional changes to rationalize and improve processes governing business entry, operation and exit. Its aim is to create discernible changes in the business environment in the short term so as to ameliorate investor attitudes to BiH.
5. Mindful that perceptions of wide spread corruption not only discourage sound investment but constitute a serious problem for the most vulnerable in society, the

Coordination Board earlier also adopted in 2002 a comprehensive anti-corruption action plan. The plan covers: (i) legislative improvements; (ii) institutional strengthening activities; and, (iii) educative activities. The plan is under implementation with notable achievements having been made in improved tax and customs collections.

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

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

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

9. Preparation of the full PRSP started in early 2002. After extensive consultation across both Entities the authorities completed the first draft of their full PRSP in November 2002, presenting it to stakeholders for review. This draft document forms the basis of a further round of consultations under the auspices of the newly formed governments following the October 2002 elections. The PRSP is expected to be finalized by the middle of 2003.

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

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

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

IMF-World Bank Collaboration in Specific Areas

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

Strengthening Institutions and Governance

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

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

16. The PEIR emphasizes that: (a) while notable achievements have been made in improving the performance of certain public institutions, fragmented governance structures with ill-defined goals, hamper nation building and efficiency benefits from decentralization. The costs, both economic and social are substantial because fragmentation hinders the efficient use of public resources; and (b) in order to achieve more coherent and harmonized policy formulation and implementation, the State's role as an integrative force needs to be strengthened, while rationalizing the public sector's overall role in the economy. In government's efforts to rationalize public expenditures while enhancing the delivery of services, the authorities plan to seek Bank adjustment support in an *Economic Management Structural Adjustment Credit (EMSAC, FY04)*. Preparation of the program which this Credit would support has started in close collaboration with the IMF.

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

Fostering Private Sector-Led Growth

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

19. The World Bank closely coordinates with the IMF through discussions on issues of private sector development. Most notably, collaborative efforts have focused on ensuring that bankruptcy laws are modernized. With initial rounds of labor market and

banking reform completed (supported by two recently closed IDA adjustment credits), such collaboration proved integral to the successful implementation of Bank assistance over the short term period. During the period July 2002 to December 2003 the Bank will focus on helping the authorities follow through on the remaining three elements of their strategy for private sector development: (i) privatization; (ii) improving the business enabling environment; and (iii) SME development.

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

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

22. **SME development** is critical to expanding private sector activity and job opportunities. Increased competition in the banking sector and falling interests rates are improving SME access to finance in the FBiH. Banking sector reforms in the RS, however, started later than those in FBiH and are less advanced. A recently approved *Private Sector Development Project (FY02)* will, therefore, provide much needed project financing to SME's in the RS. Several donor programs provide firm-based technical assistance for private sector development throughout BiH, such as the IFC sponsored SEED initiative. Small-scale operators in the agriculture and forestry sectors have less access to these programs because of the risks associated with their operations. At the same time they are a vulnerable population group in terms of the country's poverty profile requiring sustained assistance. Further lending, leveraging other donor assistance, for a *Forest Development and Conservation Project* and a new *Small Scale Commercial Agriculture Development Project* will, therefore, be presented to the Bank's Board in FY03.

23. **IFC's strategy** in BiH is multidimensional, encompassing all sectors of the economy, but particularly inherited competitive industries such as SMEs, wood, agribusiness, and areas of the economy identified as having potential in the aftermath of the conflict, such as banking and infrastructure. In the financial sector, IFC's focus has been to build and strengthen financial intermediaries, including assisting in privatization, establishing greenfield banks and working with local financial institutions in their efforts to develop into high quality banks. During FY01-03 eight projects (US\$37.4 million) were committed to finance projects in: pharmaceutical sector; (ii) micro finance institutions; credit lines to banks to support SMEs; bank privatization; and post-privatization support in the cement sector. IFC also assists the SME sector through a multi-donor South East Europe Enterprise Development (SEED) initiative, officially launched in September 2000 and operating in Albania, BiH, FYR Macedonia, Serbia and Montenegro and Kosovo. SEED provides firm-level support to the SME sector through investment advisory services and advice to address constraints in the business environment; capacity building programs for SMEs and Business Development Service Providers and information and knowledge relevant to the private sector.

Building Social Sustainability

24. The Bank is supporting a program of social reforms focused on four key issues: protecting the poor, strengthening human capital, social inclusion and ensuring environmentally sustainable development. The human cost to delayed social protection reform is starkly highlighted in the recent findings of the *Poverty Assessment* and *PEIR*. Both detail the failure of **the social safety net** to protect the poor and significant inefficiencies in social assistance cash-transfer systems. Furthermore, the existing system is financially unsustainable without significant restructuring. A delayed second *Social Sector Adjustment Credit (SOSACII)* now planned for the second half of 2003 will support the authorities in their commitment to: (i) transform veterans benefits to reflect fiscal realities and European practice by targeting benefits on the most disabled veterans and dependent families of dead soldiers; (ii) support solidarity funds for social and child assistance in both Entities, to ensure pooling of financial resources and a reduction in regional disparities of benefits to the poorest; (iii) implementing minimum benefit standards for disabled civilians, to ensure cash benefits are directed to the most disabled, and public funds cover key aids; and (iv) promote participation from NGOs and other civil society actors in the social protection system.

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

26. Key elements of Bank support over the period to December 2003 are to: to complete the process of follow-up assistance to the LSMS and the Bank's *Poverty Assessment*; ensure that findings are effectively incorporated into the **PRSP**; realistic monitorable indicators are set; and, eventually, adequate evaluation and monitoring capacities are built up for sustainable PRSP implementation.
27. Initial feedback from consultations under the PRSP, confirmed by the findings of the PEIR, indicate that government capacities to implement recent **pension and health** reforms need be strengthened and severe inefficiencies in the education system need to be addressed. A *Social Insurance Technical Assistance Project* aimed at modernizing health and pension institutions, well advanced in its preparation, is also planned for FY03.
28. The PEIR highlights wasteful expenditures and poor services and results in the **education** sector, particularly in tertiary education. Furthermore, BiH's poverty profile—indicating a high correlation between poverty and level of education in any given household—underscores the need to ensure that access to an efficient and modernized education system is greatly improved. Nevertheless, the PEIR points, to significant financing problems in the sector, largely associated with fragmented delivery and funding of services. The authorities, with the strong support of the international community, regard consolidation and rationalization of the sector as fundamental to quality improvements. To this end, a comprehensive education sector strategy is expected to be completed with Bank support by the end of this calendar year, and a new *Education Restructuring Project* is planned for the period up to December 2003.
29. BiH's poverty profile also indicates that the poor tend to be concentrated in particular semi-urban and rural communities which suffer from economic dislocation and social cleavages. Often these communities have a high concentration of IDPs and refugees. Bank assistance will continue to promote social **inclusion**, aimed at helping to ensure wider participation in post-conflict growth, ethnic reconciliation and improved delivery of services to disadvantaged groups through two projects approved by the Board over the last CAS period.
30. Strategic planning for the **environment** to safeguard sustainable development has witnessed consistent progress with the support of a recently completed *IDF grant (FY00)*. Through a process involving consultation with a wide range of stakeholders, an Environmental Action Plan (EAP) has been drafted. An initiative to deal with one of BiH's key environmental problems, the disposal of solid waste, resulted in the Board approval of a *Solid Waste Management Project (FY02)* which helps to consolidate dump sites and encourage private sector activity in waste collection.
31. As part of a regional initiative in South East Europe (SEE), the Development Learning Center in BiH is well advanced in its preparation and is expected to become fully operational in April 2003. It is expected to be a powerful tool in the training of civil servants and public policy makers in the context of BiH's civil service reform program; and in conveying critically important skills in the areas of business management and policy to aspiring entrepreneurs and local businesses.

World Bank Group Strategy and Lending Operations

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

33. Since 1996, forty-four IDA supported projects have been approved, in addition to fifteen IFC operations, and fourteen MIGA guarantees. Of the US\$962 million in IDA commitments, US\$740 million has been disbursed as of March 21, 2003. The BiH project portfolio continues to perform better than the average Bankwide portfolio. There are no problem projects and only one potential problem project. All QAG project and ESW reviews to date have rated products as satisfactory or above, bar a rating for one adjustment operation of less-than satisfactory. Similarly all 25 closed projects have received a satisfactory or better than satisfactory rating from OED. There are, however, fundamental differences in the current portfolio of active projects with those of the first generation "emergency" type operations. World Bank financing no longer covers 100 percent of eligible project costs. The active portfolio is comprised of 18 projects, including 1 adjustment operation and 17 investment loans (see Annex).

34. Adjustment operations currently under preparation include the Second Social Sector Adjustment Credit (¶24) and an Economic Management Structural Adjustment Credit (EMSAC) supporting further public administration reforms (¶16) for approximately US\$53 million each. Investment operations currently under preparation include: Social Insurance Technical Assistance (approximately US\$5 million); Small Scale Agriculture (approximately US\$12 million); Education IV (approximately US\$10 million) and a Forest Development and Conservation Project (approximately US\$4.2 million).

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

Bosnia and Herzegovina: Operations Portfolio (IBRD/IDA and Grants)

<u>Active Projects</u>		<u>Last PSR</u>		<u>Fiscal Year</u>	<u>Original Amount in US\$ Millions</u>				<u>Difference Between Expected and Actual Disbursements^{a/}</u>		
<u>Project ID</u>	<u>Project Name</u>	<u>Supervision Rating</u>	<u>Supervision Rating</u>		<u>IBRD</u>	<u>IDA</u>	<u>GRANT</u>	<u>Cancel.</u>	<u>Undlsb.</u>	<u>Orig.</u>	<u>Frm Rev'd</u>
		<u>Development Objectives</u>	<u>Implementation Progress</u>								
P044523	BASIC HEALTH	S	S	1999		10			3.71659	3.787951	
P071001	BUS ENABLG ENV SAC	S	S	2002		44			26.526	-20.04049	
P070995	COMM DEVT	S	S	2001		15			15.0641	7.285803	
P059763	CULTL HERITAGE PILOT	S	S	1999		4			2.00039	2.00077	
P058512	EDUC 3	HS	S	2000		10.6			6.50449	1.057032	
P058521	ELEC PWR 3 RECN	S	S	2001		35			35.7399	12.94897	
P070146	EMG LABOR REDEPLOYMENT PILOT	S	S	2000		15			9.26612	10.54312	
P062936	ENT EXP FACIL (BEEF)	S	S	1999		12			0.08578	0.402938	
P045134	FORESTRY	S	S	1998		7			0.12017	0.786663	0.735234
P066169	LOC INIT 2	S	S	2001		20			14.0453	14.12232	
P056192	LOCAL DEVT	S	S	1999		15			12.7508	12.4139	
P057951	MOSTAR WS & SAN	S	S	2000		12			7.21009	0.034574	
P070917	PRIV TA	S	S	2001		19.8			20.4231	6.804882	
P070243	PRIVATE SECTOR CREDIT PROJECT	S	S	2002		10			9.92328	0.543028	
P071347	ROAD MGMT SAFETY	S	S	2002		30			31.944	0.666667	
P057950	SOLID WASTE MGMT	S	S	2002		18			19.2468	-0.356315	
P070650	SOTAC	S	S	2001		3.55			3.52877	2.844608	
P070079	TRADE & TRANS FACIL IN SE EUR	S	S	2001		11			10.3414	11.73078	
Overall Result						291.95			228.437	67.57719	0.735234

**Statement of IFC's
Held and Disbursed Portfolio
As of 02/28/03
(In US Dollars Million)**

Approval FY Text	Institution Name	Loan	Equity	Quasi	All	Loan	Equity	Quasi	All
		IFC Held	IFC Held	IFC Held	Part Held	IFC Disb	IFC Disb	IFC Disb	Part Disb
1997/99/01/02	Bosnia Micro	3.23	1.23	0.00	0.00	0.54	1.23	0.00	0.00
2001	CPB	0.00	0.00	3.33	0.00	0.00	0.00	3.33	0.00
1985	Energoinvest	8.56	0.00	0.00	0.00	8.56	0.00	0.00	0.00
1997	Enterprise Fund	0.00	1.83	0.00	0.00	0.00	1.06	0.00	0.00
2002	FCL	10.75	0.00	0.00	2.69	0.00	0.00	0.00	0.00
2001	PBS-SPV	12.97	0.00	1.17	0.00	12.97	0.00	1.17	0.00
2002	Raiffeisen-BOS	8.07	0.00	0.00	0.00	0.00	0.00	0.00	0.00
1998	SEF Akova	1.39	0.00	0.00	0.00	1.39	0.00	0.00	0.00
1999/2001	SEF Bosnalijek	2.04	1.84	0.00	0.00	2.04	1.84	0.00	0.00
1998	SEF Lignosper	2.28	0.00	0.00	0.00	1.98	0.00	0.00	0.00
1999	SEF Lijanovici	1.73	0.00	0.00	0.00	1.73	0.00	0.00	0.00
1997	Sarajevska	1.42	0.00	0.00	0.00	1.42	0.00	0.00	0.00
1977	TKA Cazin	3.66	0.00	0.00	0.00	3.66	0.00	0.00	0.00
1998	Wood Agency-AL	4.91	0.00	0.00	0.00	0.00	0.00	0.00	0.00
1999	Wood Inga	1.73	0.00	0.00	0.00	0.35	0.00	0.00	0.00
1999	Wood Konjuh	2.46	0.00	0.00	0.00	2.19	0.00	0.00	0.00
1999	Wood Kozara	1.73	0.00	0.00	0.00	1.46	0.00	0.00	0.00
1999	Wood Podgradci	1.19	0.00	0.00	0.00	0.97	0.00	0.00	0.00
1999	Wood Vrbas	1.73	0.00	0.00	0.00	0.35	0.00	0.00	0.00
Total Portfolio		89.84	3.07	4.57	2.69	39.60	4.13	2.34	0.00

FY Approval	Project Short Nme	Loan	All
		IFC Approved	Part Approved
2002	Lukavac	9.93	2.48
2002	Raiffeisen Bank	7.44	0.00
1997	Sarajevska	0.00	3.01

BOSNIA AND HERZEGOVINA: STATISTICAL ISSUES

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

A. Real Sector

2. In recent years, efforts have been made in both Entities to improve real sector statistics, but results have been mixed. The Federation has published nominal GDP estimates by production approach since 1998, based on international standards recommended by the *1993 SNA*. Since 1999, RS has also published nominal GDP estimates by production approach, based on the *1993 SNA*. However, in both Entities, production estimates at constant prices and GDP by expenditure approach are still unavailable and informal sector activities are under-recorded. The preparation of a household budget survey, to serve as the basis for revising price indices and to facilitate the compilation of GDP by the expenditure approach, has been delayed. There are still no meaningful short-term business and consumer surveys. Both statistical offices compile prices and production indices using outdated methodologies, but estimates are not in a time series format. Industrial production indices are prepared in each Entity, but there is no index at the country level. Labor statistics are the weakest area for both Institutes, and data on employment, unemployment, and wage rates are based on deficient methodologies.

B. Balance of Payments

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

through the Fund's Resident Statistical Advisor. The staff has recently adopted estimates of private transfers provided by the CBBH.

C. Government Finance

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

D. Monetary Accounts

5. The CBBH reports monetary accounts to the Fund on both a countrywide and Entity basis. In 1996–2001, a number of Fund missions have assisted the authorities in establishing an integrated system for compiling countrywide monetary statistics meeting Fund standards. The latest mission in December 2001 reviewed in particular the recent institutional changes and accounting developments that have important implications for monetary statistics and assisted in revising and updating the current monetary data compilation procedures. The mission recommended improvements in, among other areas, the presentation of IMF-related accounts in monetary statistics. A follow-up monetary statistics mission has been scheduled for FY2004 to assist CBBH in resolving data issues arising from recent developments in the financial sector, including designation at end-2002 of the CBBH as the fiscal agent responsible for BIH's financial transactions with the IMF, and progress in privatization of banks in BIH.

Bosnia and Herzegovina: Core Statistical Indicators
(As of April 15, 2003)

	Exchange rates 1/	Inter-national Reserves	Central Bank Balance Sheet	Reserve Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance 2/	Government Balance	GDP	External Debt/ Debt Service
Date of Latest Observation	Apr 10, 2003	Feb 28, 2003	Feb 28, 2003	Feb 28, 2003	Feb 28, 2003	Feb, 2003	Feb, 2003	December 2002	Q42002	2002	2001	Dec 2002
Date Received	Apr 10, 2003	Apr 3, 2003	Apr 3, 2003	Apr 3, 2003	Apr 3, 2003	Apr 4, 2003	Apr, 2003	Feb, 2003		February 2003	Nov 2002	Feb 2003
Frequency of Data	Daily	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Quarterly	Quarterly	Annual	Monthly
Frequency of Reporting	Daily	Monthly	Monthly	Monthly	Monthly	Monthly/ On mission	Monthly	Quarterly	Quarterly	Quarterly	Annual	
Source of Update	CBBH 3/	CBBH 3/	CBBH 3/	CBBH 3/	CBBH 3/	CBBH /	Entity Statistics Institutes	Partner country data from <i>Direction of Trade Statistics</i>	CBBH	Federation and RS Finance Ministries	Entity and State Statistics Institutes	States' Treasury
Mode of Reporting	Website	Report to the Fund via email	Report to the Fund via email	Report to the Fund via email	Report to the Fund via email	Report to the Fund	Report to the Fund	Internal Fund database	e-mail	Report to the Fund	Report to the Fund	Report to the Fund
Confidentiality	Public	Public	Public	Public	Public	Public	Public	Public	Public	Public	Public	Public
Frequency of Publication	Daily	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Quarterly	Quarterly	Annual	N/A

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

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

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

Sarajevo and Banja Luka, Bosnia and Herzegovina
April 24, 2003

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

Dear Mr. Köhler:

The new governments that have formed at the State and Entity levels following the October 5 elections acknowledge the achievements made by its predecessors during the initial phase of the IMF-supported program. Moreover, we fully endorse the goals and commitments of the economic program. In particular, we are committed to promote sustained economic growth and improved living standards through continued macroeconomic stability and further implementation of structural reforms necessary to create a fully-functioning market economy and enhance competitiveness. In this context, we strongly back the maintenance of the currency board arrangement, further fiscal consolidation, and continued structural reforms. In support of this program, we are requesting completion of the second and third reviews under the Stand-By arrangement (SBA).

The attached Supplementary Memorandum of Economic Policies assesses economic developments and policy implementation through December 2002 under the program, and lays out the concrete policy measures to be taken during 2003.

As noted in the attached memorandum, overall policy implementation through December 2002 has been strong, but some policy objectives were not realized. While we regret that two performance criteria and one structural benchmark for end-December 2002 were not observed, we are pleased to note that corrective action has been taken. Accordingly, we are confident that the difficulties will not recur and that all the end-March 2003 performance criteria will be fully adhered to. As the board date for the second review takes place after March 31, we understand that it is the end-March performance criteria, rather than the end-December performance criteria which are controlling.

We expect the fourth review under the arrangement to be conducted with the Fund as scheduled after mid-August 2003. It will focus on the rebalanced budgets for 2003 of the Entity and State governments, and initiatives to translate the substantial medium-term reform agenda into concrete measures. Both will be implemented by our new administrations during the remainder of the program and in the framework of a possible successor extended arrangement to the SBA.

We believe that the policies described in the memorandum are adequate to achieve the objectives of our economic program, but we stand ready to take additional measures to meet these goals should the need arise. During the period of the arrangement, we will consult with the Fund on the adoption of any such measures that may be necessary in accordance with the

Fund's rules on such consultations and we will provide the Fund with any information it requests for monitoring progress in program implementation.

We are committed to transparency in our economic policies, and we authorize the Fund to publish this letter and the SMEFP following Executive Board consideration of the second and third reviews under the Stand-By Arrangement.

Sincerely yours

Adnan Terzic /s/
Chair
of the Council of Ministers
Bosnia and Herzegovina

Ahmet Hadzipasic /s/
Prime Minister
Federation of Bosnia and
Herzegovina

Dragan Mikerevic /s/
Prime Minister and
Acting Minister of Finance
Republika Srpska

Ms. Ljerka Maric /s/
Minister of Finance
of BiH Institutions
Bosnia and Herzegovina

Dragan Vrankic /s/
Minister of Finance
Federation of Bosnia and
Herzegovina

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

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

**SUPPLEMENTARY MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES
FOR BOSNIA AND HERZEGOVINA**

1. We begin our terms of office at a critical time. Though output is growing, the post conflict-boom is clearly over, activity remains well below pre-war levels, refugees from abroad continue to return in large numbers, and unemployment and the external current account deficit remain unsustainably high. Furthermore, the reconstruction phase of Bosnia's development is well advanced and our nation's focus is shifting increasingly towards preparations for eventual accession to the European Union. In the four year term allotted to us, much needs to be done to address these challenges.
2. Our economic program, as supported by the Stand-By Arrangement, is the foundation of our efforts to respond to these challenges. We endorse the program's goals, its three central elements—the currency board arrangement, fiscal consolidation, and structural reforms—and the specific commitments incorporated in it as reflected in the two earlier Memoranda of Economic and Financial Policies. We will act as necessary to secure its completion and on that basis, we look forward to negotiations for a successor arrangement.
3. Much has been achieved under the program so far:
 - The currency board has strengthened. Reserves rose from three to five months of import cover in the six months to end-2001, and at end 2002, they still provide 4.7 months of imports and more than cover base money.
 - The consolidated fiscal deficit was reduced from 5.8 percent of GDP in 2001 to 4.3 percent in 2002. This was faster progress than envisaged under the program and occurred despite the heavy one-off costs of military demobilization in both Entities. Also ahead of program commitments, 0.3 percent of GDP of succession monies used in the demobilizations has been reconstituted. Pensions, social benefits, and government wages have been regularly paid on time and in full, ending the hitherto frequent accrual of arrears in these areas. Strengthened tax administration and effective treasury control were key to these successes.
 - Succession and privatization receipts have been put in escrow in anticipation of a restructuring of domestic claims on government and efforts to quantify the claims are making good progress.
 - Both Entities and the State approved budgets for 2003 which anticipate a consolidated fiscal deficit target of 2.2 percent of GDP in 2003. We supported those budgets in our legislatures before assuming office.
 - Fiscal structural reforms have advanced. All structural benchmarks concerning indirect taxation have been observed following implementation by Brcko District of the road fee effective January 1 2003, the excise attribution mechanism is now working, and the ASYCUDA++ customs information system is in place nationwide.

Treasury systems operate at central governments and have begun operations in two Canton so far. In addition, free trade agreements have been concluded with our neighbors, and WTO accession is anticipated in 2004.

- In December 2002, consistent with the currency board arrangement and international accounting standards, the Central Bank assumed responsibility to act as fiscal agent for Bosnia and Herzegovina vis-à-vis the IMF, taking this task over from the State Ministry of the Treasury. Good progress has been made in implementing the recommendations of the IMF safeguards assessment report, notably by strengthening the financial reporting framework, the internal audit mechanism, and internal control mechanisms at the Central Bank.
 - Industrial production has reportedly strengthened following the end-2001 trough, led by manufacturing. After falling 20 percent in 2001, RS manufacturing output rose 4 percent in 2002, while in the Federation, manufacturing production rose by 13¼ percent in 2002, a little below its growth in 2001. In both Entities, a strong increasing trend is indicated in the latter part of 2002.
4. As a result, we have inherited a policy framework that is in good shape. But it is not without problems:
- Bank credit to the private sector has expanded rapidly in 2002, boosting imports and the external current account deficit. Though this originates in deposit growth which reflects a welcome strengthening in confidence in the KM and in banks, the consequent credit expansion has increased external pressures and raises some prudential concerns. Both need to be addressed.
 - Though the RS budget deficit outturn was stronger than anticipated in the rebalanced 2002 budget, both performance criteria ceilings on gross borrowing from domestic banks were exceeded at end-December 2002 by modest amounts. The breach for central government reflected temporary (two week) bank borrowing by the Roads Directorate, while the breach for the extra budgetary funds occurred largely because the planned transfers of debt from the funds to the central government was not executed in time.
 - Monitoring of fiscal developments in cantons remains inadequate, and cantons may have overshot their programmed deficit for 2002.
 - The structural benchmark requiring application of banking regulations was breached in two areas. First, the minimum capital requirement of KM 15 million, effective January 1, 2003, was not met by 7 of 30 banks in the Federation and by 2 of 10 banks in the RS. Second, many banks have not observed the foreign exchange exposure regulations. Furthermore, some key banking regulations do not conform with international standards, notably in respect of core capital, capital for market risk, and

consolidated banking supervision, and the regulation defining limits on foreign exchange exposures is insufficiently comprehensive.

- Though indirect tax legislation has been harmonized, there are risks of further disharmonization in the legislation and implementation of these taxes arising from the fact that they are legislated at Entity and Brcko District level. Furthermore, there are indications of evasion of customs and sales tax duties.
- The reserve requirement regulations of the central bank do not apply to foreign currency liabilities of banks. This is discriminatory and disadvantages the KM inappropriately.
- A bilateral agreement with Japan to reschedule official debt in accordance with the 1998 Paris Club agreement has not yet been reached.

5. Furthermore, major challenges lie ahead in the immediate future. In 2003, Bosnia and Herzegovina faces the deceleration of economic growth in Europe which will dent our export prospects there as well as the inflow of remittances from that region. In addition, international oil prices have sharply increased. With economic growth, employment, and exports already too low, these external factors will aggravate our underlying difficulties in the near term. And tensions in the middle east raise risks of shocks to capital flows emanating from that region and elsewhere to finance the external current account deficit.

6. In this context, we feel it necessary to act decisively and promptly.

7. Our first action has been to clarify our policy commitments. We have made clear in public that:

- We are committed to eventual EU accession.
- We are committed to the continued operation of the currency board.
- We are committed to continue the strong fiscal consolidation that was delivered by our predecessors and which is anticipated to continue under the IMF supported program.
- We are committed to implementing a range of structural reforms which will unlock the productive potential of the people of Bosnia and Herzegovina, while also securing their social needs as those reforms are implemented.
- We are committed to pursuing these goals, supported by the Stand-By Arrangement.

These commitments confirm our determination to maintain the exchange rate regime which has secured low inflation, to fiscal policies which will place downward pressure on the external deficit while releasing resources to finance new fixed investment, and to structural reforms which will support the currency board while boosting prospects for economic

growth. Our strong reaffirmation of these principles is aimed to reassure our citizens and markets that policies will remain on track, notwithstanding short-term adverse external developments.

8. Second, we have prepared and taken concrete steps to address the immediate shortfalls in the inherited policy framework.

- We feel it necessary to ensure that the growth of credit slows, and that related prudential concerns in banks are addressed. To this end, we will amend the central bank law to implement the following reforms, which will be prior actions for completion of the second and third reviews.
 - We will amend the definition of assets eligible to meet reserve requirements to exclude cash in vaults. KM assets held with the Central Bank will be the only assets eligible as required reserves.
 - Relatedly, we will incorporate foreign currency deposits and foreign liabilities in the base for calculating reserve requirements of banks, and this has been announced.
 - We will amend the range which limits the reserve requirement ratio from 10-20 percent, to 0-20 percent.

We will seek to implement these amendments under urgent parliamentary procedures and we will lower the applied rate of reserve requirement in consultation with IMF staff. Any subsequent change in the rate will be done in consultation with IMF staff, for the duration of the program.

- We are concerned that the prospective deceleration of credit to the private sector has not been sufficiently reflected in the revenue estimates in the 2003 budgets. We propose to maintain spending authorizations below budgeted levels and will, each quarter, determine these authorizations in consultation with IMF staff, so as to ensure that spending remains at least KM 75 million (0.7 percent of GDP) below the budgeted level, with this sum split 2/3:1/3 between the Federation and RS, respectively.
- Arrangements have been announced for an orderly transition from the current governing board of the central bank to the new board, given that the terms of the incumbents end in August this year. The new governing board will be nominated by April 2003 and will be composed of appropriately qualified individuals committed to the currency board.
- We have taken several corrective actions in the RS to avoid a recurrence of the slippages which marred fiscal performance at end-December.

(a) The Roads Directorate has already repaid its loan.

(b) We have transferred loans from the extra budgetary funds to the central government, lowering their borrowing towards the end-March ceiling.

(c) We have issued a decree, valid for six months and renewable, effective February 18, 2003, which bars all central government institutions, extra budgetary funds, and municipalities from new bank borrowing, unless in the latter case, borrowing occurs under IBRD programs. The decree also requires municipalities to report monthly to the Ministry of Finance on the stock of outstanding borrowing. Any amendments to the decree will be made following agreement with staff of the IMF. The decree anticipates new regulations for this borrowing, and they will require prior approval by the Minister of Finance for all borrowing by central government institutions, extra budgetary funds, and municipalities.

(d) We have confirmed that the housing fund will conduct all its activities using commercial banks as intermediaries.

(e) We have initiated procedures to reconcile central bank and government data on central government and extra budgetary fund borrowing from banks each month in order to strengthen surveillance of these matters.

(f) Stronger-than-budgeted contribution receipts will allow a lower-than-budgeted transfer to the pension fund in the first quarter and this saving will allow a reduction in government bank borrowing to within the end-March ceiling.

- We have established a commission to prepare a reform of the framework of indirect tax and customs legislation and administration. This framework will anticipate unification of the customs administrations and a single state level VAT. It will secure a professional tax administration, support macroeconomic stability, and tie decision-making on indirect tax policy closely to responsibility for expenditure policy. The commission has begun its deliberations and will complete its work on the framework before mid-year. Completion of these framework tasks will be a structural benchmark under the program. Once those tasks are completed, the commission will turn its attention to preparation of a VAT law.
 - We have reopened discussions with the Japanese authorities on the outstanding issues on the bilateral rescheduling agreement under the 1998 Paris Club agreement.
 - We have initiated steps to obtain an international credit rating.
9. Further actions are anticipated.
- We will amend by end-June 2003 our regulations on banks' foreign currency exposures to include assets and liabilities indexed to foreign currencies and this amendment will be considered as a structural performance criterion. In addition, as a prior action for completion of the second and third reviews, we will collect all bank by bank data on foreign currency exposure including all indexation by mid-March,

2003. We will require all banks to conform with the newly defined regulation after a phase-in period, the length of which will be determined in consultation with IMF staff before promulgation of the new regulation.

- As a prior action for the completion of the second and third reviews, all banks that fail to meet the minimum capital requirement of KM 15 million will have their licenses withdrawn, or will be placed under administration, unless they are engaged in a restructuring program under the auspices of the International Financial Institutions. Thus, the legal exemptions to this requirement will be revoked; and banks under administration will not be brought out of administration until they have met the KM 15 million requirement.
- We will amend our regulations on banks' core capital to bring them into line with Basel core principles and EU standards, subject to a phase in period of 9 months after the regulations take effect. These amendments will be considered as prior actions for completion of the second and third reviews.
- Our banking agencies will take the corrective actions specified in law and in the regulations when banks do not conform to banking regulations.
- We will engage in a dialogue with IMF staff concerning banking regulations on market risk and consolidated supervision. This discussion will aim to identify appropriate changes in our regulations in these areas to bring them into line with international standards.
- Efforts to strengthen further the strong safeguards in the Central Bank will continue focusing on completing our assessment of the risks in each of the operations of the Bank

10. Third, we remain committed to the principles for rebalancing the 2003 budgets that were outlined in the first review of the program. In particular, we intend to maintain the revenue projections as currently embedded in the 2003 budgets—supported by the additional measures described above—and limit overall budgeted government spending to the amount specified in the 2003 budgets, while offsetting any possible increases in spending by one level or sector of government through commensurate expenditure cuts in other parts of the government. All adjustments to the 2003 fiscal framework will be undertaken in consultation with IMF staff. If bank credit growth remains excessive and tax revenues are accordingly above our projections, we will assign the revenue overperformance to further deficit reduction. And if the external current account balance does not strengthen appropriately, we stand ready to take further policy measures as needed, including further fiscal consolidation. In any event, we will fully reconstitute during 2003 all succession money used to finance the 2002 demobilization programs and will continue to place all privatization receipts into escrow accounts and only make withdrawals from those accounts following prior consultation with IMF staff.

11. We recognize the need to strike a balance between the social needs of the population and the maintenance of a sound fiscal stance. In this light, we will:

- review expenditure policies for war veterans, with the objective to at least maintain the level of benefits for those in most need, while seeking to reduce misuse of these benefits.
- review the much-abused provisions allowing war invalids to import vehicles duty-free and take steps to strengthen the administration.
- allocate higher than programmed pension contribution collections in the RS, and the benefits of structural reforms on the spending side, between reductions in central government transfers to the pension fund and increased average pensions.

12. We will continue to strengthen fiscal operations at local government levels.

- In the Federation, we will ensure that all own-revenue users in the cantons, including universities, education, and health facilities, will be part of the cantonal treasury systems, and the central government will issue a decree to this effect by the end of March.
- Monitoring and coordination of cantonal fiscal activities will be strengthened through
 - (a) establishing a committee of all canton Ministers of Finance and the Federation Minister of Finance to meet monthly to review cantonal fiscal issues.
 - (b) strengthening data reporting by means of a of template agreed with Fund staff, to be completed monthly, with a four week lag, commencing immediately. The data will be promptly forwarded to Fund staff.
- In the RS, we have begun preparations for establishing treasury systems in 5 municipalities, with the objective to have the treasury systems operational in these municipalities by end-September 2003.

13. In anticipation of a plan to restructure domestic claims on government by mid-2003 we have, with FAD assistance, initiated the establishment of individual-by-individual databases on outstanding expenditure arrears at entity central governments and at the larger cantons. We will continue the quantification of potential war claims and our audit institutions will scrutinize identified spending arrears. Moreover, in consultation with IMF staff, we will prepare proposals for the restructuring and clearance of the identified claims using the privatization and succession monies which have been put in escrow for this purpose.

14. In the context of the adverse external trends and our proposed policy responses to them described above, we anticipate GDP growth of 3¼ percent (3¼ percent in the Federation and 1¼ percent in the RS) and inflation below 1 percent in 2003, alongside a

strengthening in the external current account deficit of 3-4 percentage points of GDP. This is consistent with a decline in projected external debt to 46 percent of GDP.

15. These initiatives mark only part of our initial efforts. In addition, we will deepen structural policy reforms. These reforms aim to stimulate economic growth and employment, while reducing the external current account imbalance and supporting the currency board.

- Following passage of the bankruptcy law in 2002, the first bankruptcies in the RS are anticipated from March 2003. Application of the law will not be postponed. The draft amendments to the Federation bankruptcy law will be submitted to parliament by end-April.
- Privatization slowed in 2002 and needs to be revived. The recent RS legislation requiring RSNA approval of major privatizations as well as supermajorities in company boards to approve capital increases may be impeding progress and will be reviewed as a matter of priority. In the Federation, efforts will focus on strengthening the independence and managerial capacity of the privatization agency.
- The business environment is strengthening under the auspices of the World Bank BEAC. The blueprint for the collateral registry system will be completed by end-March in preparation for a full launch a year later, and initiatives to lower the time taken for business registration will continue.
- Efforts to strengthen the legal system are well underway. The numbers of judicial posts and courts are being lowered, and all judges are subject to reappointment to ensure their competence and integrity.

16. All these efforts will need to be considerably deepened to entrench a single economic space and to create the conditions for sustained economic growth. We will liaise closely with the donor agencies involved to determine how best to develop these initiatives further. In particular, we will investigate as a matter of priority how to improve the management of state-owned companies while they remain in state hands, how to increase the flexibility of wage setting arrangements, and how to strengthen the operation of privatization investment funds. Design and implementation of these reforms will form the focus for the fourth review of the program.

17. On this basis, we request conversion of the indicative targets into performance criteria for end-June as set out in Table 1. As the board date for the second and third reviews takes place after March 31, we understand that it is the end-March performance criteria, rather than the end-December performance criteria which are controlling.

Table 1. Bosnia and Herzegovina: Quantitative and Structural Performance Criteria
Under the 2002-2003 Stand-by Arrangement
(In millions of KM, unless otherwise noted)

	2002		2003			
	End-Dec. Prog 1/	Est.	February Est.	End-March Prog 1/	End-June 2/	End-September 3/
A. Quantitative performance criteria						
Ceiling on gross credit of the banking system to the consolidated general government						
the State government 4/	0	0	0	0	0	0
the RS government and municipalities	10	14	10	10	10	10
the RS extra-budgetary funds	2	6	2	2	2	2
the Federation government	20	11	18	20	20	20
the Federation cantons	10	10	8	10	10	10
the Federation municipalities	8	4	4	8	8	8
the Federation extra-budgetary funds	0	0	0	0	0	0
Ceiling on contracting or guaranteeing of new concessional external debt with original maturity of more than one year by the public sector 5/ 6/	445	187	...	445	445	445
Ceiling on contracting or guaranteeing of new non-concessional external debt by the general government 5/6	0	0	...	0	0	0
Ceiling on contracting or guaranteeing of new external debt by the general government with an original maturity of up to and including one year 4/	0	0	...	0	0	0
Ceiling on the outstanding stock of external payments arrears 7/	0	0	...	0	0	0
B. Structural Performance Criteria						
Continued adherence of the Currency Board Arrangement as constituted under the law, incorporating the amendments described in paragraph 10 of the MEFP (EBS/02/91, 5/30/02), and paragraph 24 of the SMEFP (EBS/02/203, 12/4/02).		Met	Met			
Amend regulations on banks' foreign currency exposures by end-June 2003 to include assets and liabilities indexed to foreign currencies.						

Sources: BIH Authorities; and IMF staff estimates.

1/ Targets for end-December 2002 and end-March 2003 are performance criteria.

2/ Targets are proposed as performance criteria.

3/ Targets are indicative.

4/ Excluding letters of credit at the state level for CIPS financing up to KM 40 million. Actual borrowing for CIPS was KM 8 million at end-December 2002.

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

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

7/ This will apply on a continuous basis.

Table 2. Bosnia and Herzegovina: Revised Structural Benchmarks, September 2002-June 2003

	Implementation Date	Lead Institution
I. Prior Actions		
1. Banking regulations will be brought in line with Basle Core Principles and European directives in regard to core capital requirements, as specified in paragraph 9 of the Supplementary Memorandum of Economic and Financial Policies (SMEFP).		IMF
2. All banks that fail to meet the minimum capital requirement of KM 15 million will have their licenses withdrawn or will be placed under administration, unless they are engaged in a restructuring program under the auspices of the International Financial Institutions, as specified in paragraph 9 of the SMEFP.		IMF
3. Collect all bank by bank data on foreign currency exposure, including assets and liabilities indexed to foreign currencies, as specified in paragraph 9 of the SMEFP.		IMF
4. Amend definitions of assets eligible to meet reserve requirements to exclude cash in vaults, include foreign currency deposits and foreign liabilities in the base for reserve requirements, and expand the permissible range for reserve requirements to 0-20 percent, as specified in paragraph 8 of the SMEFP.		IMF
II. Structural Benchmarks		
1. The Entities will make transfers to the State, at least according to the agreed cumulative monthly schedule reported in Annex 1 of the MEFP.	continuous	IMF
2. All privatization receipts accruing to the central governments of the RS and the Federation, and to the Cantons in the Federation will be placed in escrow accounts alongside all succession monies pending a comprehensive strategy to clear arrears.	continuous	IMF
3. The Entities and the Brcko District will implement laws establishing the excise attribution mechanism as previously agreed with the World Bank and thereby avoid the double taxation on excises.	continuous	World Bank
4. There will be no new free trade zones.	continuous	IMF
5. Any changes to the current indirect tax system should retain or strengthen the principle of harmonization.	continuous	IMF
6. The Federation pension fund will adhere to the cut-off dates for contribution collections at the end of each month as specified in the 2000 pension law. The RS pension fund will adhere to the cut-off date of the 10th of each month for contributions collections.	continuous	IMF
7. (a) The base of the Brcko District sales tax will remain aligned with that in the Entities.	continuous	IMF
(b) The two rates of sales tax in the Brcko District will be 8 and 18 percent unless changes are agreed with IMF staff.	continuous	IMF
8. A comprehensive strategy to clear arrears will be prepared. All arrears, including frozen foreign currency deposits, will be audited by the Supreme Auditor Institutions.	End-June-2003	IMF
9. Bosnia and Herzegovina will not clear domestic government payment arrears that were accrued before end-2000, pending a comprehensive strategy to clear arrears.	continuous	IMF
10. There will be no offset operations for tax liabilities that are incurred after 2001.	continuous	IMF
11. Banking supervision will be strengthened by enforcing the current prudential regulations, by taking appropriate remedial actions according to the regulations in cases where institutions breach regulations.	continuous	IMF/World Bank
12. The commission on Value Added and Customs Administration will propose a framework of legislation governing all indirect tax legislation and administration.	End-June 2003	

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

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

I

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

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

II

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

The transfer to the budget of the BiH institutions shall be paid on a monthly basis, ensuring that 1/12 (one twelfth) of the total transfer shall be remitted for every current month. Payments will be made at the latest by the 20th of each month for the liability of the previous month. All payments made after this day shall be considered arrears. The parties will agree on a timeframe for the full payments of obligations dating from 2001 and 2002.

III

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

In Sarajevo, April 24, 2003.

Ljerka Maric /s/

Minister of Finance and Treasury of BiH Institutions

Dragan Vrankic /s/
Minister of Finance
Federation of Bosnia and Herzegovina

Dragan Mikerevic /s/
Prime Minister and acting Minister of Finance
Republika Srpska

BOSNIA AND HERZEGOVINA

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

April 2003

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

I. DEFINITIONS

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

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

Definitions:

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

Application of performance criteria:

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

- The ceilings on the stock of gross credit from the banking system to the general government will be defined in terms of seven sub-ceilings that sum to the ceiling for the general government. These seven sub-ceilings will be on the stock of gross credit from the banking system to the State government, the Federation of Bosnia and Herzegovina government, the Republika Srpska government and municipalities, the Federation Cantons, the Federation municipalities and the extrabudgetary funds. For the purposes of program monitoring, compliance with the ceiling on banking system credit to general government will require that each of these seven sub-ceilings be observed independently.
- The sums on-lent by commercial banks from long-term loans contracted by the government with international financial institutions and bilateral development institutions shall be excluded from the stock of gross credit of the banking system.

B. Operation of the Central Bank of Bosnia and Herzegovina

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

Definitions:

- *Net foreign exchange reserves* are defined as the value of foreign assets less the value of foreign liabilities, including assets and liabilities denominated in convertible currencies or convertible marka.
- *Foreign assets* are defined as (a) monetary gold and (b) monetary authorities claims on nonresidents including currency bank deposits, government securities, other bonds and notes, financial derivatives, equity securities, and nonmarketable claims arising from arrangements between central banks or governments.
- *Foreign liabilities* are defined to include: (i) foreign exchange and convertible marka balances on the books of the CBBH due to nonresidents, including foreign central banks (ii) credit balances due to foreign central banks, governments, and foreign financial institutions; (iii) forward and repurchase contracts of different types providing for future payments in foreign exchange by the CBBH to nonresidents; and (iv) any other liabilities due to nonresidents.
- *Monetary liabilities* are defined as the sum of (a) currency in circulation, (b) credit balances of resident banks at the CBBH, and (c) credit balances of other residents at the CBBH.
- *Capital and Reserves* are defined as (a) initial capital and reserves of the CBBH, (b) shares, and (c) accumulated profits of the CBBH since the beginning of its operation on August 11, 1997.

- **Free reserves of the CBBH** are defined as foreign exchange reserves not utilized as backing for the currency. They therefore consist of the stock of CBBH net foreign exchange reserves less the stock of CBBH monetary liabilities.

Application of performance criteria:

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

C. Ceiling on External Payments Arrears

Definitions:

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

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

Application of performance criteria:

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

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

Definitions:

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

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

Application of performance criteria:

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

E. Ceiling on Contracting or Guaranteeing of New Concessional Debt

Definitions:

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

Application of performance criteria:

- Debt and leases will be valued in U.S. dollars at the exchange rates prevailing at the time the contract or guarantees become effective.

- For program purposes, the following will be included in the calculation of the amount of external debt contracted or guaranteed: (i) borrowing from the IMF, the World Bank, EBRD, EIB, IFC, or bilateral co financing of lending by these institutions; and (ii) concessional loans.

II. DATA REPORTING

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

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

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

Monthly data reporting

The Bosnia and Herzegovina authorities will send to the Fund the following data no later than 2 weeks after the end of each month:

- (i) Transfer payments by Entities to the State;

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

- (i) Debt service payments by the State to creditors;
- (ii) Pension funds payment data and cut-off dates for contributions collection;
- (iii) Stock of free reserves of the CBBH;
- (iv) The balance sheet of the CBBH;
- (v) The stock of reserves, including excess reserves at commercial banks.
- (vi) Balances held in escrow accounts;

The Bosnia and Herzegovina authorities will send to the Fund the following data no later than 4 weeks after the end of each month:

- (i) Revenues, expenditures and financing data for all levels of government (including the State, Entities, and Cantonal (for FBiH));
- (ii) Revenues, expenditures, and financing data for the extrabudgetary funds (including health funds, unemployment funds, and (in the RS) the children's fund);
- (iii) Monthly Statistical Data on Economic and Other Trends review published by the Federation's Office of Statistics and Monthly Statistical Review published by the Republika Srpska Institute of Statistics;
- (iv) Data sheets issued by the Republika Srpska Institute of Statistics reporting on data that are not included in their Monthly Statistical Review.

The Bosnia and Herzegovina authorities will send to the Fund the following data no later than 6 weeks after the end of each month:

- (i) Foreign exchange exposure indicators by bank in each entity, including indexed loans.
- (ii) Data on gross credit of the banking system to the consolidated general government broken down by bank as defined in I A. above.
- (iii) The commercial bank survey and monetary survey;
- (iv) Report on privatization revenues, including revenues received as prepared by the privatization agencies.
- (v) Interest rates data.

Quarterly data reporting

The Bosnia and Herzegovina authorities will send to the Fund the following quarterly data within one month of the end of each quarter.

- (i) Summary of government guarantees on quarterly basis;
- (ii) Summary of government loans and degree of concessionality (grant element);
- (iii) Summary of short-term loans by government on quarterly basis;

The Bosnia and Herzegovina authorities will send to the Fund the following within 6 weeks of the end of each quarter.

- (i) Banking supervision indicators by bank in each Entity, including capital adequacy ratios, core and supplementary capital, selected liquidity indicators, non-performing loans and provisions for impaired loans and other assets.

The Bosnia and Herzegovina authorities will send to the Fund the following quarterly data within two months of the end of each quarter.

- (i) Budget execution data by individual canton;
- (ii) Report on privatization revenues, including revenues received and use of funds;
- (iii) Execution of foreign-financed investment projects.

INTERNATIONAL MONETARY FUND

BOSNIA AND HERZEGOVINA

Second and Third Reviews Under the Stand-By Arrangement

Supplementary Information

Approved by Carlo Cottarelli and G. Russell Kincaid

June 2, 2003

1. This statement summarizes developments and data releases since the staff report was issued. The information does not alter the thrust of the staff appraisal.

End-March 2003 performance criteria

2. All end-March 2003 performance criteria were observed (attached table).

Prior actions for the completion of the second and third reviews

3. All prior actions have been completed.
 - The necessary decrees to align banking regulations with EU directives and Basle Core Principles in regard to the treatment of accrued losses in the definition of core capital requirements were published in the Republika Sprska (RS) on April 23, 2003 and in the Federation on May 9, 2003. After a phase-in period, these will take full effect from end-December 2003.
 - All end-March 2003 bank-by-bank data on foreign exchange exposures, including assets and liabilities indexed to foreign currencies, have been collected and provided to staff.
 - The central bank law was amended in April 2003 to permit the envisaged changes in the required reserves regime. The regulations implementing these changes took effect on June 1, 2003.
 - As of May 28, 2003, the bank minimum capital regulations were met.

The central bank

4. In May 2003, the authorities nominated a new board for the central bank to take over when the term of the present board expires in August. The new board includes the current governor.

5. Following consultations with staff, the central bank announced its intention to lower the rate of reserve requirements from 10 percent under the old base to 5 percent under the expanded base effective June 1, 2003. Along with the exclusion of cash in vaults from assets eligible to meet the reserve requirement, this represents a monetary tightening equivalent to some 9 percent of reserve money and 4 percent of broad money. The impact of this adjustment will be kept under close review.

Fiscal developments

6. During the first four months of the fiscal year, developments in the Entity budgets have been broadly as expected under the program, and both the Federation and the RS are on track to remain within the expenditure ceilings set for end-June 2003 without incurring new arrears. The state government budget overperformed vis-à-vis the program during the first quarter of this fiscal year largely due to temporary factors.

7. The Indirect Tax Policy Commission (ITPC) has made much progress in preparing the framework for unification of customs administrations and the introduction of the VAT. Discussions of the ITPC have so far focused on the specific design of the single customs administration, expected to begin operations on July 1, and the framework legislation covering the institutional features of the Indirect Tax Administration (e.g., governing board), indirect revenue allocation, and the design of the VAT.

Economic developments

8. Inflation continues to be low; pries declined by ½ percent in Q1 2003. The growth of industrial activity meanwhile appears to have eased, from 7½ percent in 2002 down to 4½ percent in Q1 2003 over the same period the previous year. Agricultural activity has also been adversely impacted by a drought in the Republika Srpska and some parts of the Federation, though the extent of this effect is as yet uncertain.

9. Amendments to the Federation bankruptcy law, intended to modernize the existing legislation and harmonize it with legislation in the Republika Srpska, were passed on April 24, 2003. The World Bank endorsed the thrust of the legislation but has reservations over the hierarchy of claims established in the new law which they will discuss further with the authorities.

10. On April 29, 2003, Bosnia and Herzegovina signed a bilateral agreement with Japan to reschedule official debt in accordance with the 1998 Paris Club agreement. All bilateral agreements under the auspices of the Paris Club agreement have now been concluded.

Political developments

11. A new Minister of Finance for the Republika Srpska, Mr. Branko Krsmanovic, was appointed in May. Mr. Krsmanovic has confirmed his commitment to implement the understandings under the stand-by arrangement.

Table 1. Bosnia and Herzegovina: Quantitative and Structural Performance Criteria Under the 2002-2003 Stand-By Arrangement
(In millions of KM, unless otherwise noted)

	2002		2003			
	End-Dec.		End-March		End-June	End-September
	Prog 1/	Act.	Prog 1/	Act.	2/	3/
A. Quantitative performance criteria						
Ceiling on gross credit of the banking system to the consolidated general government						
the State government 4/	0	0	0	0	0	0
the RS government and municipalities	10	14	10	8	10	10
the RS extra-budgetary funds	2	6	2	1	2	2
the Federation government	20	11	20	18	20	20
the Federation cantons	10	10	10	8	10	10
the Federation municipalities	8	4	8	4	8	8
the Federation extra-budgetary funds	0	0	0	0	0	0
Ceiling on contracting or guaranteeing of new concessional external debt with original maturity of more than one year by the public sector 5/ 6/	445	187	445	197	445	445
Ceiling on contracting or guaranteeing of new non-concessional external debt by the general government 5/6/	0	0	0	0	0	0
Ceiling on contracting or guaranteeing of new external debt by the general government with an original maturity of up to and including one year 4/	0	0	0	0	0	0
Ceiling on the outstanding stock of external payments arrears 7/	0	0	0	0	0	0
B. Structural Performance Criteria						
Continued adherence of the Currency Board Arrangement as constituted under the law, incorporating the amendments described in paragraph 10 of the MEFP (EBS/02/91), and paragraph 24 of the SMEFP (EBS/02/203).		Met		Met		
Amend regulations on banks' foreign currency exposures by end June 2003 to include credits indexed to foreign currencies					...	

Sources: BIH Authorities; and IMF staff estimates.

1/ Targets for end-December 2002 and end-March 2003 are performance criteria.

2/ Targets are proposed as performance criteria.

3/ Targets are indicative.

4/ Excluding letters of credit at the state level for CIPS financing up to KM 40 million. Actual borrowing for CIPS was Km 8 million at end-December 2002. and KM 15 million at end-March 2003.

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

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

7/ This will apply on a continuous basis.



Press Release No. 03/81
FOR IMMEDIATE RELEASE
June 6, 2003

International Monetary Fund
Washington, D.C. 20431 USA

IMF Approves US\$34 Million Under Stand-By Credit for Bosnia and Herzegovina

The Executive Board of the International Monetary Fund (IMF) today completed the second and third reviews of Bosnia and Herzegovina's economic performance under the Stand-By Arrangement for the period August 2002-November 2003. The decision enables Bosnia and Herzegovina to draw SDR 24 million (about US\$34 million) from the IMF immediately.

The Stand-By Arrangement, which was approved on August 2, 2002, totals SDR 67.6 million (about US\$96 million). So far, Bosnia and Herzegovina has drawn SDR 31.6 million (about US\$45 million).

Following the Executive Board discussion, Eduardo Aninat, Deputy Managing Director and Acting Chairman, said:

“Bosnia and Herzegovina has continued to make commendable progress under its Fund-supported program. In completing the second and third reviews under the program, Executive Directors were encouraged in particular by the good fiscal and economic growth performance, with both exceeding initial expectations, and the new governments’ strong commitment to build on the reform efforts undertaken by the previous governments.

“The immediate challenge ahead arises from the strong expansion in credit growth to households and the associated sharp deterioration in the external current account balance. To stem the credit boom, the authorities have appropriately tightened liquidity, and have adopted a range of regulatory reforms as well as prudent adjustments to the expenditure ceilings in the 2003 budgets. Continued vigilance and readiness to take timely corrective action will, however, be needed.

“Fiscal consolidation is the cornerstone of the program, and further efforts will help ensure progress toward a strong and viable macroeconomic framework. The new administrations have acted swiftly to establish their fiscal credentials by holding expenditure below budget ceilings in the first half of the year, and by committing not to exceed the consolidated deficit and spending targets of the original 2003 budgets when those budgets are revised. Prudent expenditure management and tax administration reform will be the pillars of the fiscal adjustment effort in 2003. The authorities have also laid the groundwork for the settlement of domestic claims on the government.

“The currency board arrangement will continue to help ensure monetary stability and low inflation in a context of prudent fiscal policies and sustained structural reform. The timely nomination of a new central bank board is an important step in ensuring that market confidence is maintained. Recent initiatives to strengthen the banking system through privatization and the application of international regulatory standards, and to enhance the role of bank credit in corporate investment, are welcome, and the authorities are encouraged to continue their efforts in these areas.

“Over the medium term, Bosnia and Herzegovina faces the challenges of sustaining economic growth and improving employment prospects significantly while preparing for a prospective decline in reconstruction aid inflows. This will require ambitious reforms, in particular in the enterprise sector, to stimulate private sector led growth and support export competitiveness. Efforts to further strengthen privatization, the business environment, labor markets, the legislative framework for credit extension, and bankruptcy procedures will be among the priorities to meet these challenges successfully. To improve the quality of economic analysis, the authorities are committed to strengthening the statistical framework,” Mr. Aninat said.

**Statement by Jeroen Kremers, Executive Director for Bosnia and Herzegovina
June 6, 2003**

The authorities of Bosnia and Herzegovina (BiH) would like to thank staff for its support and continuous policy discussions. Following the October 2002 elections, new administrations have been formed both on the state and on the two entities' level. The new governments, even though they consist of new parties, expressed their strong commitment to continue with the economic reforms undertaken by the previous governments. The signing by the new governments of the Supplementary Memorandum of Economic Policies, which assesses economic developments and policy implementation through December 2002 under the program, and lays out the concrete policy measures to be taken during 2003, proves this commitment.

Program Implementation

The authorities' performance under the Stand-By Arrangement remains strong, and substantial progress has been made towards implementing program objectives. GDP growth in 2002 reached 3.8 percent compared to 2.3 percent expected under the original program. Inflation was 0.3 percent in 2002 and is expected to continue to be low in 2003. Foreign investment is estimated by authorities to have grown from \$130m. in 2001 to \$300m. in 2002, and is projected to grow further in 2003. Partly because of better than projected economic activity, but also because of considerable fiscal discipline, the consolidated budget deficit was 4.3 percent of GDP in 2002, lower than the 5.5 percent projected originally under the program. While government revenues rose by 3.8 percent from 2001 to 2002, expenditure rose by only 1.2 percent.

Of the 11 **quantitative performance criteria** all but two were observed by end-December 2002, and many by a large margin. The two non-observant, the RS government and extra budgetary funds borrowing from banks, were short-termed (a few weeks) and not symptomatic of macroeconomic problems. By March 2003 all criteria were observed.

Of the 11 **structural benchmarks** all but one were implemented by end-December 2002. The one that was not implemented, concerned the strengthening and subsequent implementation of a banking supervision prudential regulations on minimum capital. During the last five months, the authorities made an enormous effort to deal with 9, out of a total 40 banks in BiH, which were not compliant with the strengthened minimum capital regulation. As every banking supervisor knows, to implement regulation which requires increasing the minimum capital substantially (from KM 10m. to KM 15m.) is not an easy task. Yet, as of end-May 2003, all banks in BiH are compliant with the regulation.

Another banking supervision regulation, a limit on foreign currency exposure, was not observed by a significant number of banks. The authorities, together with the staff, decided to strengthen the regulation by including in the foreign currency exposure assets and liabilities indexed to foreign currencies. This amendment would be considered as a structural performance criterion. The authorities completed, as a prior action to the current 2nd and the

3rd reviews, collection of data on exposure under the new definition. By March 2003 all structural benchmarks were observed.

The Medium-Term Prospects

BiH is determined to join the EU in 2009. It understands that, in order to achieve this it has to become a self-sustaining state: to guard the peace without 12,000 NATO led soldiers, and to exist without the current large-scale foreign financial assistance. Bosnia enjoys a preferential trade status with the European Union. Yet, to utilize the trade potential, there is a need to build fully functioning agencies, such as a chief veterinarian office or standards agency, to ensure that products meet EU requirements. Bosnia has a rich potential to grow early-season fruits and vegetables and organic food, but needs to upgrade its laboratories and research centers to promote and increase local production. Moreover, there has been a shortage of storage capacity and no organized planning for exports of these products. Some progress is being made, however. In April 2003, the central government appointed a veterinary team to prepare a legal framework for inspection of goods.

The international community helps BiH with its structural reforms. One of such initiatives is the "Bulldozer Committee" which proposed a large variety of structural changes. The package of 50 Bulldozer reforms was enacted within 187 days from the launch of the initiative last year. This represents an economic reform every four days. It is the result of the work of many, both in the private sector, in the political bodies and in the international community, who have helped to inform, gather, filter, design, present, and lobby for these reforms. Apart of solving key bottlenecks in the business environment, this effort has created a true dialogue between the private sector and the governing bodies, thus reinforcing the civic society in the country.

BiH has no unified customs administration. However, there is progress, and the process of unifying the customs administration is supposed to end by August 1, 2003. Custom tax and excises on imported oil and oil products will be paid at the borders, thus disabling embezzlements and increasing the revenues.

As regards legal reforms, the State Court of BiH has started work and the new State Prosecutor's Office has filed its first indictment in April 2003.

As regards governance, the Parliaments are in the process of establishing new 'ethics' committees which will contribute to the process of strengthening faith in the political system. In the F BiH, the reaction to the Electra Privreda audits has been positive: all the recommendations have been implemented and the income of the company soared. The audit of the Telecom Srbske is expected to be completed at the beginning of July 2003. The authorities believe that better governance will improve the growth of the economy and will lower unemployment.

To strengthen and widen the ownership over social reforms, the governments of both entities organized "A dialogue on social reforms". The aim of this campaign is to find the best solutions for social problems through dialogue with the citizens.

The challenges ahead are enormous, yet it is useful to point out one key achievement, which will have a beneficial effect on the prospects of BiH. Since signing the Dayton Agreement, a total number of 944,300 refugees and displaced persons have returned to their pre-war municipalities. In the first three months of 2003, 12,447 returned and the process is continuing. Property Law implementation reached 82 percent in the Federation, 72 percent in the RS, and 81 percent in Brcko District. As many as 28 municipalities finalized their property claims, and it is expected that by the end of 2003 every municipality will resolve all property claims.

Given the authorities' commitment to carry on with structural reforms and improvement of governance, the staff's medium-term projections of GDP growth of 7-8 percent are realistic.

Macroeconomic Policies

Macroeconomic policies of the authorities continue to center on maintenance of the currency board arrangement and fiscal discipline.

As regards monetary policy, the authorities announced that they will continue with the currency board, which served BiH well. Inflation remains very low, confidence towards the KM is strong and gross official reserves are at a comfortable level. In May 2003, the authorities nominated the new governing board of the central bank, including the current Governor, and by this timely nomination it ensured an orderly transition from the current governing board to the new one. To deal with a rapid growth of banking credit to the households, the authorities proposed, and the staff agreed with the proposal, to widen the base for calculating reserve requirement of banks and to change the definition and the rate of reserve.

As regards fiscal policy, the authorities approved the 2003 budgets, which anticipate cutting by half the consolidated fiscal deficit of 2002.

The current account deficit remains one of the major problems. However deceleration of the growth of banking credit to households, fiscal discipline, and structural reforms should all work to lessen the magnitude of this problem.

Statistical Issues

The pilot test of a household budget survey is planned for June 2003, and the main survey should start in September 2003. The survey will help to improve data on GDP and CPI. The Institute of Statistics of Italy will assist in conducting the survey, and the Italian government will help with financing. I would like to thank the Italian Chair for helping to solve some of the administrative problems which delayed the survey.