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I. INTRODUCTION

1. ***The Stand-By Arrangement with Bosnia and Herzegovina was approved on May 29, 1998 and extended three times, on May 28, 1999, March 31, 2000, and December 22, 2000.*** The arrangement expires on May 29, 2001. In the attached letter dated May 9, 2001 (Appendix I), the Bosnian authorities request a waiver of the performance criterion on domestic borrowing for end-March 2001 and the completion of the sixth and seventh (final) reviews. The outstanding and projected use of Fund credit is shown in Table 1.
2. ***The fourth and fifth reviews of the Stand-By Arrangement were completed by the Executive Board on December 22, 2000.*** Executive Directors commended Bosnia and Herzegovina for its fiscal restraint and strict adherence to the currency board rules; and for its commitment to increase transparency by establishing treasuries and by bringing all military expenditure on-budget by 2002. Directors noted, however, the small share of domestic budgetary expenditure devoted to capital formation and cautioned that this was not viable over the medium term, as the off-budget foreign-financed component of reconstruction assistance was expected to decline. Noting the progress made in the areas of labor market reform and privatization, they urged the authorities to press ahead with further measures to improve the environment for private sector development, including through reform of the tax system and the legal framework governing banking sector activities, through anti-corruption measures, and through the extension of the privatization program to large-scale enterprises. Directors also stressed the importance of a successful launch, in early 2001, of the new payments and clearing mechanism.

II. RECENT DEVELOPMENTS

3. ***After protracted negotiations, and the intervention of the Office of the High Representative (OHR), coalition governments have now been formed in both Entities and the State.¹*** The long political interregnum slowed implementation of the program, but the new governments appear reform-oriented and eager to regain momentum. To muster parliamentary majorities, the new governments rely on the support of a large number of coalition partners; they are therefore vulnerable to defections. In the Federation, the Croat nationalist party, HDZ, was not invited to participate in the government and Croat nationalists reacted by starting to take steps that would, in effect, create a third Entity. This effort is being resisted by OHR and by the Federation government.
4. ***Real GDP growth decelerated from 10 percent in 1999 to an estimated 5 percent in 2000 (Figure 1, Table 4).*** The slowdown which was broad based, was in part related to a deceleration of growth in the electricity (largely hydro-electricity) and water supply sectors, and to a decline in agricultural production, owing to a drought in the second half of the year.

¹ Elections took place in November 2000. Governments were formed only in January 2001 in Republika Srpska, February in the State, and March in the Federation of Bosnia and Herzegovina.

Growth is expected to recover to 8 percent in 2001 as these sectors recover with the return of normal weather patterns. However, production remains at less than half of its pre-war level, and unemployment continues to be widespread.

5. ***Inflation in BiH was kept in check by the currency board arrangement, but the cross-Entity inflation differential remained significant.*** The average inflation rate in the Federation increased slightly from -0.7 percent in 1999 to 2 percent in 2000, and from 14 percent to 14½ percent in the Republika Srpska (RS). The inflation differential largely reflected a convergence of absolute price levels due to increasing economic integration. The country-wide average inflation rate increased in 2000 from 3¼ to 5½ percent.

6. ***The cross-Entity inflation differential reflects differing trends in external competitiveness.*** From 1998–2000, the real effective exchange rate (REER) in the RS appreciated by 13 percent, whereas in the Federation it depreciated by 6 percent. The differential results from the ongoing convergence in costs. Comparative dollar wage data suggest that wages in 2000 were still about 30 percent higher in the Federation than in the RS. Compared with other countries in the region, dollar wages in the RS are comparable to Romania and slightly below Slovakia, whereas Federation average dollar wages are comparable to those in Hungary (Figure 2).

7. ***Exports recovered in 2000, owing in part to a reopening of the Yugoslav market (Table 9).*** At the same time, imports continued to decline as a result of reductions in donor finance for reconstruction and a drop in consumer imports consistent with the slowdown in general economic activity. Net services also declined in 2000, in part due to lower foreign assistance. Overall, the current account deficit (excluding transfers) narrowed by 1 percentage point of GDP to 22.2 percent.

8. ***As regards fiscal performance, the implementation of 2000 budgets was broadly in line with the rebalanced budgets in the Federation and in the State; in the RS, however, uncontrolled spending late in the year led to an accumulation of budgetary arrears.***

9. ***In the Federation, external grants and loans exceeded projections, providing additional resources which more than compensated for a small (2 percent) shortfall in tax revenue (Table 7).*** Consequently the government was able to finance somewhat higher-than-budgeted expenditures. Expenditure ceilings were breached in many areas (including wages, goods and services, military, reconstruction spending and transfers to cantons and municipalities); on the other hand, transfers to war invalids were below the budgeted amount. On the revenue side, excise collection accounted for most of the revenue shortfall, while trade taxes performed better than expected.

10. ***In the RS, expenditure control deteriorated significantly during the Fall 2000 election season (Table 8).*** Expenditure ceilings on goods and services, reconstruction, subsidies and transfers to the pension fund were breached by large margins; at the same time

KM 115 million (4½ percent of GDP) of expenditure arrears were accumulated.² In a related development, tax offsets were granted indiscriminately and rose to an unprecedented KM 101 million (14 percent of tax revenues) for the year, much of which was channeled through the Goods Reserve Directorate (GRD).³ Revenues (including offsets) exceeded the budgeted amount by 6 percent, but since up to half of the tax offsets involved taxes payable in previous years, it is likely that revenue collection on an accrual basis was actually within 1 or 2 percent of target.⁴ On a cash basis, the fiscal deficit declined from 3.9 percent of GDP in 1999 to 1.0 percent of GDP in 2000. However, taking into account arrears, the deficit was equivalent to 5.5 percent of GDP.

11. *Since the 2001 budgets had not yet been passed, the authorities' expenditure ceilings for the first quarter of 2001 were derived from the 2000 budget.* In practice, however, expenditure was constrained—in both entities—by seasonal declines in tax collection and external assistance (Tables 7 and 8). In the case of tax revenues, startup problems with the payments bureaus further reduced the January collection. As usual, given the prohibition on borrowing, the entities managed the seasonal shortage of resources by reducing expenditure and by lengthening payment delays, thereby incurring arrears, including for wages.

Bosnia and Herzegovina: Republika Srpska Fiscal Operations, 1999–2001
(In percent of GDP)

	1999	2000		2001
	Actual	Budget	Actual	Budget
Revenues	29.9	26.6	28.1	24.1
Expenditures	35.1	30.5	35.5	26.1
Overall balance (commitment basis, before grants)	-5.2	-3.9	-7.4	-2.0
Foreign grants	1.3	2.4	1.9	0.0
Overall balance (commitment basis, after grants)	-3.9	-1.5	-5.5	-2.0
Change in expenditure arrears (increase +)	—	—	4.5	-1.2
Overall balance (cash basis, after grants)	-3.9	-1.5	-1.0	-3.2

² Arrears included KM 60 million of wages, equivalent to three monthly payments; KM 28 million on transfers to war invalids; KM 10 million on goods and services; and KM 13 million on military expenditures.

³ The GRD, whose mandate is to maintain stocks of strategic commodities, has in recent years engaged in activities well beyond its mandate.

⁴ The authorities were unable to provide a breakdown of offsets by the tax year of the liability.

12. *The 2000 State budget outturn was broadly as anticipated.* Modest shortfalls in revenues and grants were compensated for by savings in administration expense and by under spending on the State Border Service (Table 6). Transfers from the Entities for administration and debt service expense were made as budgeted.

13. *Monetary developments in 2000 reflected increasing acceptance of the convertible marka and continued sluggishness of private sector credit (Table 12).* Money demand increased slightly, and broad money growth, at 16 percent, exceeded the growth of nominal GDP. Central bank holdings of net foreign assets (NFA) increased 20 percent in 2000, and were the main counterpart of monetary expansion,⁵ as confidence in the currency board remained high and the portfolio adjustment from foreign to domestic currency continued. The rate of increase of NFA was much smaller than 1999, however, suggesting that the portfolio adjustment is nearing completion. Private sector credit, meanwhile, grew by only 7 percent, less than the rate of growth of nominal GDP, owing to weaknesses in the legal and institutional environment and to the continued inability of commercial banks to provide financial intermediation services.

14. *The payments bureaus were closed on January 5, 2001 and replaced by a commercial bank-based clearing system.* After a two to three-week settling-in period, the new system is now performing clearing functions efficiently, although the fees charged by banks for individual transactions remain high. Treasury functions previously performed by the payments bureaus appear to have been successfully replicated, and both tax receipts and information on tax payments are received by the authorities on a timely basis. However, during the initial start-up period, a large amount of payments orders, including those made for tax payments, were incorrectly filled out and the associated funds have not yet reached the intended revenue accounts. Work on resolving the backlog is continuing and is expected to be completed soon.

15. *Bank regulation and supervision have been strengthened over the past year, although procedures continue to fall short of best practice in some areas.* The regulatory environment was strengthened by: (i) the approval of a harmonized framework to supervise other-entity branches; (ii) the enactment of legislation to provide limited immunity to supervisory agency officials; (iii) the adoption of regulations to govern non-performing loan provisions, transactions with related parties and accounting standards; and (iv) the creation of a framework for sharing information between the regulatory agencies in the Federation and in other countries, in response to the entry of several foreign banks. The Federation has also instituted a schedule for progressively increasing the minimum capital requirement for banks and introduced deposit insurance (capitalized by donor grants); in the RS the required legislation has been approved, but not yet implemented.

16. *The Federation has made significant progress in the area of bank privatization.* A plan that includes International Financial Corporation participation for privatizing the five

⁵ Gross official reserves of the Central Bank of Bosnia and Herzegovina reached US\$498 million (2.4 months of imports of goods and services) at end-2000.

banks related to the Privredna Banka Sarajevo (PBS) banking group is proceeding well and could result in a sale by end-2001. Interested investors are also assessing two banks that were tendered for sale in November 2000 and two banks that were tendered in early 2001. In the RS less progress has been made: most tenders failed to attract buyers and so far only one bank has been sold.

17. *Other structural reforms were on hold during the post-election period of uncertainty, but momentum has been regained.* The new governments have carried out a series of prior actions in advance of the sixth and seventh reviews (Box 1), as well as actions to satisfy the structural benchmarks agreed at the time of the fourth and fifth reviews (Box 2). The prior actions are described in detail in Section III and include a major reform and harmonization of the sales tax regime; measures to properly implement the amendments to the pension laws; and actions to enhance transparency by accelerating the formation of modern treasuries in both Entities. Both Entities have also established Auditor General offices, and have initiated audits of their military establishments.

Box 1. Prior Actions to Conclude the Sixth and Seventh Reviews of the Stand-By Arrangement ^{1/}

	<u>Status</u>
1. Entity and State Parliaments to pass the 2001 budgets agreed with the IMF.	Fed.: Done RS: Done State: Done
2. Enactment of amendments to the sales tax laws in each Entity as agreed with the Fund.	Fed: Pending ^{2/} RS: Done
3. Payment of the February, March and April pensions with resources collected over progressively shorter collection periods until payment in a given month is made only from funds collected in that month.	Fed: Done RS: Done
4. Both Entities to remain current with the State for debt service and administrative transfers.	Fed: Done RS: Done
5. Both Entities to provide their treasury departments with adequate staff, premises and financial resources to implement treasury reform.	Fed: Done RS: Done

^{1/} Unless specified otherwise, measures refer to the institutions of the two Entity Governments.

^{2/} To be enacted by May 18, 2001.

Box 2. Structural Benchmarks, November 2000–March 2001^{1/}

- | | |
|--|---|
| 1. Implement comprehensive excise and sales tax reform. | End-January 2001
(Done April 2001) |
| 2. Prepare strategy to raise collections of social funds by broadening the contribution base while lowering rates. | End-March 2001
(Not done) |
| 3. Entity governments to forbid the use of privatization revenues:
(a) for paying off debts of institutions that cannot meet their current obligations from current resources;
(b) by any privatization agency before it has adopted regular reporting procedures on its receipts and their use. | End-November 2000
onwards
(Done) |
| 4. Implement measures agreed with IMF staff to have interim Treasury functions in place prior to closure of the payments bureaus | End-December 2000
(Done) |
| 5. Real Time Gross Settlement System and clearinghouse to begin interbank settlement operations. | End-December 2000
(Done January 5, 2001) |
| 6. Enforce prudential regulations, mainly minimum net capital requirements, and implement strategy to bring offending banks into compliance. | Continuous |

^{1/} Measures refer to institutions of both Entities.

III. REPORT ON THE DISCUSSIONS AND IMPLEMENTATION OF PRIOR ACTIONS

18. *Discussions focused on the budgets for 2001, and on prior actions needed for completion of the reviews.*

A. Fiscal Policy in 2001

19. *The mission and the authorities agreed on revised 2001 budgets that adhere to the framework agreed in late 2000 in the context of the previous review, with modifications to take into account developments in the intervening months.* That framework relied on conservative estimates of revenue and foreign financing to keep spending allocations within the available resource envelope, allowed for no borrowing, except on concessional terms or from selected international financial institutions, and kept recurrent spending under tight control in order to make room for increased capital expenditure. The revised budgets maintain the same revenue projections, but the foreign financing projection has been revised upwards to reflect the slippage in some external financing from December 2000 to January 2001. On the expenditure side, the new RS budget incorporates significant changes since the authorities have reduced allocations in some areas to make room for partial arrears clearance

and for other priority expenditures. Smaller changes were made in the Federation budget, mainly involving the allocation of larger-than-expected external financing.

20. *The authorities in the Federation explained that they intend to keep recurrent spending under tight control in 2001 in order to allow for increased capital spending.* In line with this intention nearly half of the KM 14.7 million of additional external financing was added to reconstruction expenditures; the rest will be used to fund new positions in tax administration and the auditor general's office, and for education.⁶ As a result, the allocation for reconstruction is now more than 50 percent higher than in the 2000 rebalanced budget. There is, however, no increase from the actual level of expenditure in 2000, which was above budget. Other changes in the budget involved moving funds from intelligence services and a contingency reserve to the general budgetary reserve.

21. *The RS authorities have made the clearance of budgetary expenditure arrears a high priority and have allocated KM 35 million (1.2 percent of GDP) for this purpose in the 2001 budget.* The option of canceling arrears was discussed, but the new government felt that this would amount to a breach of contract especially with respect to wages due civil servants (who are poorly paid), and that it would also weaken morale. The staff enquired whether the cancellation of arrears incurred in a prior fiscal year was not required by provisions in the budget laws. The authorities responded that the law neither requires nor provides for cancellation. In practice, however, a distinction has been drawn between claims arising from the performance of contracts and those arising from legislated benefits. The authorities have never cancelled valid claims arising from the performance of contracts although delays in payment have occurred due to fiscal constraints. In contrast, the authorities have in the past used provisions in the budget laws that limit budget allocations to available resources as a way of reducing the cost of unrealistic benefit entitlements. This being the case, the mission urged the authorities to pay wage arrears first, and to postpone decisions on other arrears until their validity had been assessed. The authorities intend to do so, and to prepare a plan to clear valid arrears as soon as possible.

22. *The mission asked what measures would be taken to make sure that new arrears do not emerge.* The authorities responded that expenditure control would be strengthened by accelerating the creation of a modern treasury. For the immediate future, they had tightened control over expenditure commitments by budget users and blocked two main channels of uncontrolled spending by ending the practice of tax offsets and reforming the Goods Reserve Directorate. The authorities explained that, in the first months of 2001, budgetary resources allocated for wages and war invalid benefits had been used to pay 2000 arrears first, starting with the oldest arrears. In the case of wages this had been made necessary by features of the pension legislation which penalize employees for a break in contributions. Given the seasonality of revenues and external assistance, and given the prohibition on borrowing, the payment of arrears meant that current obligations could not be paid. A rough estimate, based on information provided by the authorities, is that the stock of arrears increased by KM 24

⁶ The additional external financing corresponds to the second tranche of the World bank PFSAC II, which was disbursed in January 2001 instead of December 2000 as expected.

million in the first quarter.⁷ The authorities expect to start reducing the stock of arrears in the second half of the fiscal year, when the inflows of revenues and external assistance are larger.

23. *A second major change in the RS budget (compared with the budget agreed in fall 2000) is a KM 11 million increase in resources for the return of refugees.* The return of refugees is strongly supported by OHR and major bilateral donors, and is seen as integral to the success of the Dayton Peace Agreement. The planned expenditure is to rebuild housing and infrastructure damaged or destroyed during the war. Other changes in the budget include an additional KM 7½ million for the railways and an additional KM 6 million in transfers to war invalids.

24. *Staff worked with the RS authorities to identify measures to release the needed resources without causing excessive disruption or social pain.* In addition to KM 18 million of external financing that slipped from 2000 to 2001, KM 46 million of spending cuts were identified, including the entire KM 6 million allotment to the Goods Reserve Directorate, another KM 8 million of materials, KM 7 million of reconstruction spending, KM 11 million of transfers to social funds, and KM 3 million of wages. The mission noted that the program of spending cuts was very ambitious and that expenditure policy would have to be reexamined in the context of the midyear budget rebalancing exercise. Under the circumstances, it would not be possible to allow for any relaxation of the authorities' hiring freeze and tight wage policy. The authorities agreed. Staff queried the scale-back in reconstruction spending to a level below that in the 2000 rebalanced budget. The authorities explained that the reconstruction figures for recent years were inflated by possibly improper transactions and that they had brought a number of projects to a halt pending investigations. They assured the staff that they intend to increase the allocation to reconstruction when sound projects have been identified. As regards the cut in social spending, the authorities noted that the collection of pension contributions appeared to be recovering and this would allow adequate pension payments to be made, in line with the new pension law, with smaller transfers from the budget.⁸

25. *The State legislature approved the budget that was prepared in late 2000.* The State's revenues are projected to increase by 12 percent compared with 2000, mainly reflecting an increase in transfers from the Entities for debt service and to cover expenses related to the establishment of the State Border Service.⁹ While the State is strengthening the

⁷ To put this figure in perspective, the seasonal first quarter shortfall in revenues plus external finance was KM 44 million. Thus the authorities managed the shortfall partly by restricting expenditure and partly by accumulating arrears.

⁸ In the Federation, this partly reflected the revenue effect of social security contribution rates of military personnel and miners that were increased to the standard rates in January 2001.

⁹ The State Border Service is being formed to patrol the international borders of Bosnia to reduce the illegal importation of goods.

State Border Service and has created three new Ministries, the authorities believed that these activities could be financed, in part, by rationalizing employment, eliminating many redundant positions. The staff urged the authorities to exploit these opportunities before seeking additional sources of revenue or finance.

B. Other Fiscal Issues

26. *The authorities have reformed the sales tax regime to equalize tax rates in the two entities, broaden and unify the base, and simplify the tax system in a broadly revenue-neutral manner.* Under the reform, to be approved by the respective parliaments in May 2001, both Entities are to have a standard rate of 20 percent and a preferential rate of 10 percent. The tax base, also unified, has been broadened to include meat, fish, construction materials, and construction services. To further simplify the system and reduce cascading, the wholesale margin tax in both Entities, and the retail service charge in the Federation, have been abolished.¹⁰ The new tax regime is in line with the recommendations of the Fund technical assistance missions that visited Bosnia and Herzegovina in November 1999 and late September 2000.

27. *The sales tax remains a single stage tax, collected at the retail level.* The authorities proposed moving collection to the importer-manufacturer level, contending that this would improve enforcement; the mission's view was that it would be better to keep collection at the retail level and improve compliance by strengthening tax administration. The staff noted that retail collection was a closer approximation to consumption-based revenue generation; in addition the experience with retail collection would help develop expertise needed to introduce a VAT. The authorities agreed to keep collection at the retail level but intend to study the matter further.

28. *In the Federation, the wage tax has been reduced from 10 percent to 5 percent in order to strengthen the incentive for employment.* The authorities maintained that the impact on cantonal budgets would be small owing to a broadening of the base resulting from improved collections of this and other taxes, as well increased employment. Staff recognized the need to reduce the taxation of wages, but had reservations about the impact on revenues and recommended that collections be monitored carefully.

29. *Staff urged the authorities to accelerate the implementation of modern treasuries.* Both Entities have now made this a priority: heads of treasuries have been appointed and treasury departments have been provided with sufficient staff, budgetary resources, and premises. The Bank and Fund have supplied technical assistance on the design of treasuries; USAID is supporting the development of an information management system; and the World Bank intends to provide funds for one or more long-term advisors. It is expected that fully functioning treasuries will be in place by November 2001. Staff noted that both Entity governments are operating treasury single accounts for revenue collection, but advised that

¹⁰ The RS did not impose a retail service charge.

these be moved from commercial banks to the central bank, as suggested by FAD technical assistance missions. The authorities are considering this option.

30. ***Measures were taken in 2000 to strengthen tax enforcement.*** In the Federation, a Revenue Task Force was set up in the third quarter of 2000, with help from the EU's Customs and Fiscal Assistance Office (CAFAO) to remove smuggled alcoholic beverages, cigarettes, and other high-duty goods from the market. In the RS, the new authorities have launched a similar initiative, but without the involvement of the international community. The authorities stated that they would coordinate closely with CAFAO on the establishment in each tax administration of a large taxpayer unit, an intelligence and investigation unit, and an arrears collection unit; accordingly the 2001 budgets make provision for the new units.

31. ***Staff was provided with financial accounts of the Goods Reserve Directorates in both Entities.*** The Directorates are charged with maintaining strategic reserves of key commodities. In practice, the RS Goods Reserve Directorate has taken on other tasks and been a source of nontransparency and a channel for expenditure overruns; it was also responsible for the breach of the performance criterion on domestic borrowing. The authorities intend to close the GRD or restrict its activity to its core functions. Staff urged the authorities to reform or close the Directorate as soon as possible and therefore welcomed the ongoing investigation by the Financial Police and the replacement of the Directorate's management. Staff also received financial statements of the Goods Reserve Directorate in the Federation, and met with its staff. This Directorate appears to be functioning in an appropriate and transparent manner.

32. ***The amendments to the pension laws will be fully implemented by early June 2001.*** The amendments are intended to prevent the accumulation of pension arrears by means of a cash rationing mechanism that indexes pension entitlements in a given month to pension contributions received in that month plus budgetary transfers.¹¹ The authorities explained that collections were exceptionally low in January, however, and that the two pension funds had increased the size of the January payment by extending the collection period three weeks into February. The staff noted that this was counter to the provisions in the revised pension laws and urged the authorities to bring the implementation of the cash rationing mechanism back in line with the law by reducing this extension every month. The authorities agreed and accordingly, the March and April payments were made with progressively shorter extensions. The authorities have confirmed that the May pension payment will be financed solely from resources collected in May itself, augmented only by budgetary transfers approved in advance.

C. Monetary Issues

33. ***The authorities' key objective in 2001 is to maintain the credibility of the currency board arrangement.*** The rapid accumulation of net foreign assets at the central bank that occurred in 1999 and to a lesser extent in 2000 is expected to slow further in 2001, as the

¹¹ A description of the pension amendments is contained in EBS/00/262 (12/8/00).

portfolio shift out of foreign currencies into convertible marka nears completion. Broad money is expected to grow in line with nominal GDP, but credit to the private sector from the commercial banks will grow more slowly, reflecting the continued poor environment for private borrowing. Credit to the public sector is expected to remain unchanged in light of the injunction against borrowing from the banking system, with the exception that local governments may have access to small amounts of bank credit through a World Bank-funded on-lending program. The authorities will also seek to boost the free reserves of the central bank, and so will not transfer profits to government until statutory levels of reserves are reached.

34. *Staff congratulated the authorities on the successful closure of the payments bureaus and their replacement with a commercial bank-based clearing system, the first in any successor state of the former Yugoslavia.* Staff noted, however, that fees charged by banks are high, and that this is causing hardship for small enterprises. The authorities expressed the view that competition and moral suasion from the central bank will eventually reduce fees. In the interim, they are closely monitoring the situation.

D. Other Structural Issues

35. *After major delays, progress has been achieved in recent months in creating, with the support of the World Bank, the infrastructure necessary for carrying out the privatization of large enterprises, including the setting up of tender departments.*¹² In the Federation, 1,029 medium- and large-scale enterprises are scheduled to be privatized through the public offering of shares, which will be concluded by end-2001.¹³ In addition 298 large enterprises will be sold through tenders, 50 of which have already been announced. Of the 298 enterprises, 86 are scheduled to be sold with international community support, and ten of these have already been tendered. In the RS, 818 medium and large enterprises are scheduled to be privatized through voucher privatization, which started on November 22, 2000 and which is scheduled to be completed in one round. Tenders, aimed at attracting strategic investors, will be used to privatize a further 177 large enterprises, 52 of which will be sold with the help of domestic and international privatization experts.

¹² In the public offering of shares/voucher privatization component, shares will be acquired against certificates in the Federation and vouchers/coupons in the RS, either directly or through Privatization Investment Funds that will be run by management companies licensed by the Securities Commissions of the respective entity.

¹³ During October 2000–March 2001, citizens were able to invest their certificates directly in 547 enterprises or in 13 Privatization Investment Funds; citizen residents received certificates against general claims against the government. These funds could bid on the 547 companies offered for sale until end-March 2001. Enterprises that were not sold on the first round were to be offered for sale again on April 16 and finally on June 2001, when they will be sold for whatever is offered. The remaining 482 enterprises will be offered for sale in a similar fashion of rounds scheduled to start in July 2001. All 1,029 enterprises are expected to be sold by end-2001.

36. *Staff discussed with the authorities the procedures to be followed and principles to be adhered to in allocating privatization proceeds.* The fundamental principles that were agreed by the authorities were that privatization proceeds should not be used to finance recurrent expenditures, and that parliament should exercise oversight of expenditure of proceeds through the budget process. In addition, each privatization agency would report regularly to the relevant ministry of finance. Staff agreed that privatization receipts may be used to clear the stock of pension arrears accumulated over the last few years, but only after the authorities have verified that the amount of pension arrears is assessed in line with the law.¹⁴

37. *Bosnia gained significantly greater access to foreign markets in the fourth quarter of 2000 and in early 2001, and is preparing for accession to the World Trade Organization (WTO).* In November 2000, imports from BiH were granted tariff free entry into the EU. The free trade agreement with Croatia became effective on January 1, 2001, with tariffs on goods originating in BiH being reduced by 30 percent this year, by a total of 40 percent in 2002, by 60 percent in 2003, and by 100 percent in 2004 onward. Similar free trade agreements are being negotiated with FYR Macedonia (expected to be in force later this year), Slovenia, and FRY. Accession to the WTO is moving ahead with strong support from the United States and the European Union and is expected in the first half of 2002. In preparation for WTO accession, the State government is amending customs legislation so that all import surcharges will be subsumed under the Customs Tariff Law as compound tariffs, which is consistent with WTO rules.

E. Performance Criteria

38. *The authorities have requested a waiver for a breach of the performance criterion prohibiting domestic borrowing (Table 3).* In the first quarter of 2001, the government borrowed KM 10 million from a commercial bank to provide a financial bridge to taxes that had been collected but could not be spent owing to start-up problems with the new payment system. This loan, which breached the end-March 2001 performance criterion on bank borrowing by government, was repaid in full on April 23, 2001.

39. *All other quantitative performance criteria under the program were met as of end-March 2001.* At all levels of government, ceilings on contracting or guaranteeing nonconcessional external debt were observed; no external payments arrears were

¹⁴ In the Federation, arrears of the extrabudgetary pension funds were provisionally estimated at KM 208 million (3.2 percent of GDP) whereas in the RS they were estimated at KM 123 million (4.8 percent of GDP).

accumulated; the central bank's holdings of free reserves exceeded the minimum level required under the program; and no external payment arrears were accumulated.¹⁵

40. ***The authorities felt strongly that it would be important to put in place a successor Fund arrangement in order to maintain the momentum of reform and prevent the loss of IMF support.*** They agreed with the mission's suggestion that the next step would be to negotiate a new Stand-By Arrangement in order to provide time to reach agreement on a multi-year program and sought the staff's comments on their draft Economic Development Strategy document, which could be the basis for an eventual IPRSP. Since it is important to establish a track record in advance of a multi-year program, the mission emphasized that the authorities should avoid delays in meeting the agreed targets in the current program, and in the proposed second Stand-By Arrangement.

IV. EXTERNAL FINANCING, SAFEGUARDS ASSESSMENT, AND CAPACITY TO REPAY THE FUND

41. ***Potentially large financing gaps exist for the remainder of 2001 and for 2002, indicating an urgent need to strengthen the adjustment effort and to mobilize donor support (Table 10).*** A donor conference is expected to take place in the second half of 2001 to confirm existing financing commitments and mobilize further official bilateral support for the period ahead. Preliminary estimates by the World Bank indicate that the financing gap for 2001 will likely be closed.

42. ***Under its current arrangement with the Fund, Bosnia and Herzegovina is subject to the transitional procedures governing safeguards assessment.*** These procedures require the Central Bank of Bosnia and Herzegovina (CBBH) to demonstrate, by providing certain documentation to the Fund staff, that it publishes annual financial statements that are independently audited in accordance with internationally accepted standards. The CBBH cooperated fully in providing Fund staff with the required documentation.

43. ***The staff has reviewed the documentation provided and noted that the CBBH approves the financial statements within three months of the financial year-end and publishes them along with the audit opinion in the Bank's Annual Report.*** The financial statements are audited by an international accounting firm in accordance with internationally accepted standards. Based on the review, the staff has concluded that no further steps are recommended at this stage. However, staff will monitor developments with respect to actions taken on recommendations made in the 1999 external auditor's management letter.

44. ***Bosnia and Herzegovina should be able to discharge its obligations to the Fund in a timely manner.*** During 2000 and so far in 2001, aside from some technical delays in making payments to a bilateral creditor, Bosnia and Herzegovina remained current on its external debt-service obligations and the revised budgets fully cover all remaining

¹⁵ Free reserves are defined to be the difference between the net foreign exchange reserves of the Central Bank of Bosnia and Herzegovina and its domestic monetary liabilities.

obligations for this year. As regards servicing obligations to the Fund, these are met mostly out of deposits held in Bosnia and Herzegovina's SDR account, and the Bosnian authorities have agreed to continue holding half of each IMF disbursement in this account.

45. *A favorable medium-term external outlook depends on Bosnia and Herzegovina's ability to strengthen international competitiveness.* Bosnia and Herzegovina has a narrow export base and remains highly dependent on imports and generous, though declining, external donor support. In the period ahead, rapid export growth will be needed to ensure a viable balance of payments position and to serve as an engine of growth for the country. To this end, the investments under the Priority Reconstruction Program, and the implementation of structural reforms should help sustain productivity growth, and improve competitiveness. Consequently, the authorities are determined to implement prudent macroeconomic policies, and to avoid fueling unrealistic expectations in the private sector by granting government wage increases that are out of line with available resources. They have agreed to consult with the Fund prior to granting any further wage increases in the future.

V. STAFF APPRAISAL

46. *Strict adherence to currency board rules has allowed Bosnia and Herzegovina to consolidate its progress towards macroeconomic stability in spite of fiscal slippages.* Inflation remains in the low single digits despite significant changes in relative prices. Official reserves are rising, though more slowly than in the past, signaling that the portfolio shift into convertible marka has matured. GDP growth is continuing to decline from exceptionally high levels, suggesting that the postwar rebound from the wartime collapse is nearly complete, even though production is still less than half its prewar level and unemployment is still high. Clearly, additional efforts will be required to restore living standards to prewar levels.

47. *Weak fiscal discipline and poor expenditure control continue to be a major source of macroeconomic risk.* While painful corrective measures were enacted in mid-2000, the expenditure ceilings in the rebalanced 2000 budgets were not adhered to in either entity. Overruns in the Federation were modest and were covered by larger-than-expected financing flows, while in the RS spending exceeded ceilings by large margins, leading to significant budgetary arrears. The overruns undermine the budget process and thus threaten medium-term macroeconomic stability.

48. *The Ministries of Finance need fully functioning modern treasuries in order to monitor and control expenditures.* Treasury reform, which has been subject to lengthy delays in the past, should be assigned the highest priority with the goal of completing the reform by end-October 2001. The Fund and the Bank have provided technical assistance on treasury design, and the authorities are urged to proceed in line with this advice. Financial resources have been identified and staff has been appointed to manage the reform.

49. *The decision by the RS government to clear wage arrears in an orderly way is welcome.* The authorities should not, however, undertake to settle claims that do not arise from explicit and well documented legal commitments. Consequently, no decision to clear non-wage arrears should be made until the inventory of arrears has been completed and their

validity fully established. The clearance of arrears should be accompanied by steps to ensure that new arrears do not emerge. Controls over commitments by spending units must be strictly enforced. In addition, the RS authorities should hold strictly to their decisions to grant no further tax offsets and to reorganize or close the Goods Reserve Directorate. Finally, it will be necessary to bring major non-budgetary expenditures—including military revenues and spending—on-budget, starting with the 2002 budget.

50. *As regards pensions, the provision that brings entitlements in line with available resources¹⁶ should be fully implemented in order to prevent the emergence of new pension arrears.* This provision will ensure that pensioners are paid each month and that no new pension arrears are accumulated. Over the medium term, this provision could be modified once pension entitlements are set at affordable levels and if collection are strengthened by reducing the scope of the gray economy. Privatization receipts can be used to eliminate pension arrears, but the authorities should first recalculate the stock of arrears to ensure that amounts paid are not based on inflated calculations of the pension entitlements.

51. *The reform of the sales tax regime will simplify and harmonize the tax system, remove significant distortions, and reduce tax competition between the Entities.* Collection is to remain at the retail level, which is more difficult to enforce, but is appropriately consumption-based and will create a pool of expertise needed for the eventual implementation of a VAT. The challenge will be to enforce tax collection and the authorities will therefore need to strengthen tax administration. Funding for modernizing tax administration has been allocated in the 2001 budgets; and the authorities are urged to take advantage of the technical assistance currently offered for this purpose by the international community.

52. *The closure of the payments bureaus on January 5, 2001 was an impressive achievement and should contribute significantly to banking sector development and profitability.* The new system appears to be functioning well but, for prudential reasons, the Entity governments should consider moving their treasury accounts to the central bank.

53. *After a long preparation period, large-scale privatization is due to begin soon.* The successful transfer of the majority of productive assets to the private sector, and the attraction of foreign managers into BiH, will improve the potential for growth. The authorities should make every effort to ensure the success of this program, and to support it in the face of opposition from entrenched interests.

54. *Bank regulation, bank supervision, and aspects of the regulatory environment were strengthened in 2000, but further improvements are needed to create a properly functioning and healthy banking system.* The authorities should therefore continue to improve their supervisory capacity by fully utilizing the technical assistance offered by the international community.

¹⁶ See EBS/00/262 (12/8/00).

55. *Since the formation of governments in the first quarter of 2001, the authorities have implemented the five prior actions agreed with staff (Box 1) and, as at March 31, 2001, they had also met all quantitative performance criteria except for that governing domestic borrowing.* Since the borrowing that caused this breach has now been repaid, staff recommends that the Executive Board approve both the authorities' request for a waiver of the performance criteria on domestic borrowing and their request to complete the sixth and seventh reviews of the Stand-By Arrangement.

Figure 1. Bosnia and Herzegovina: Selected Financial and Economic Indicators
(1996-2000)

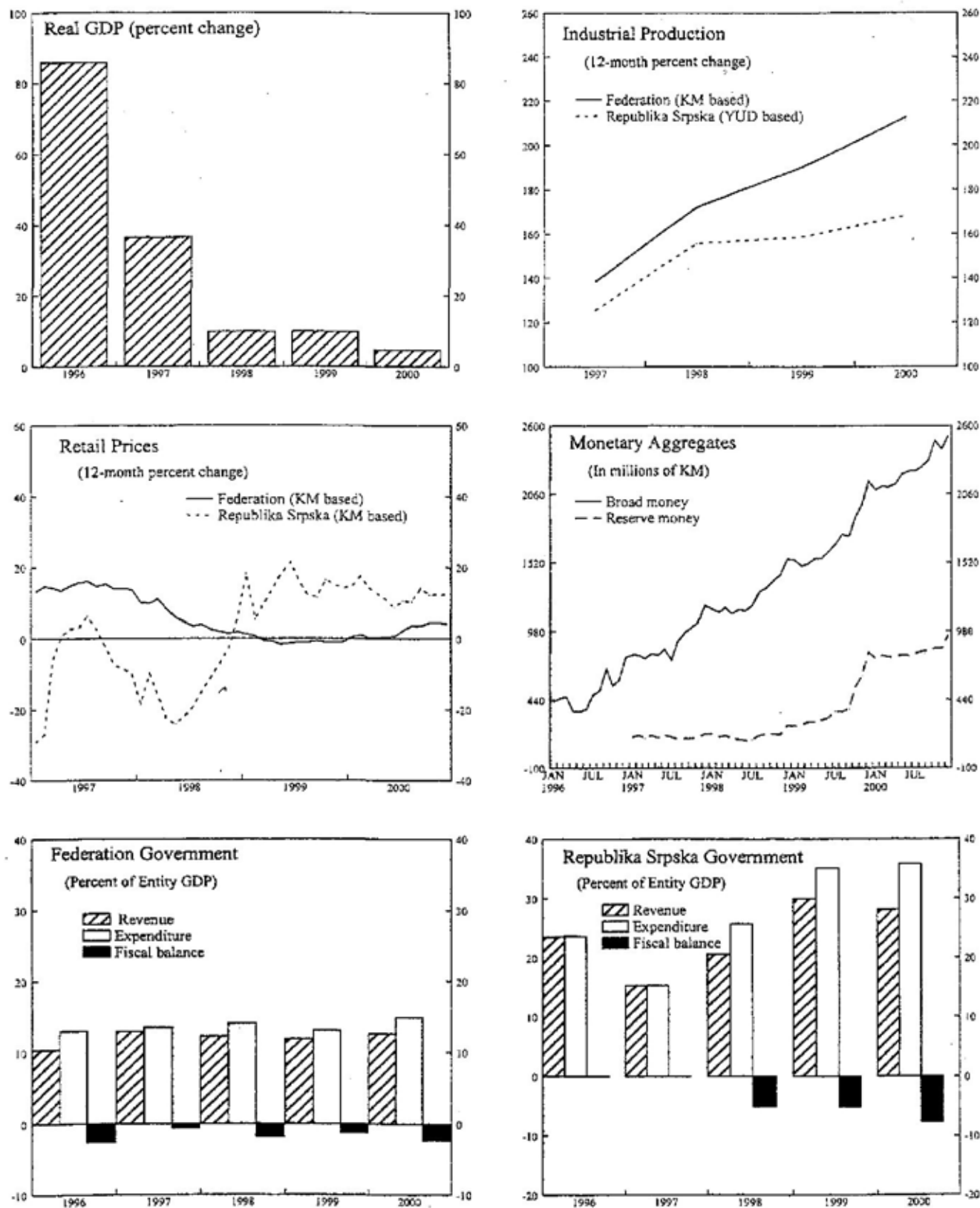
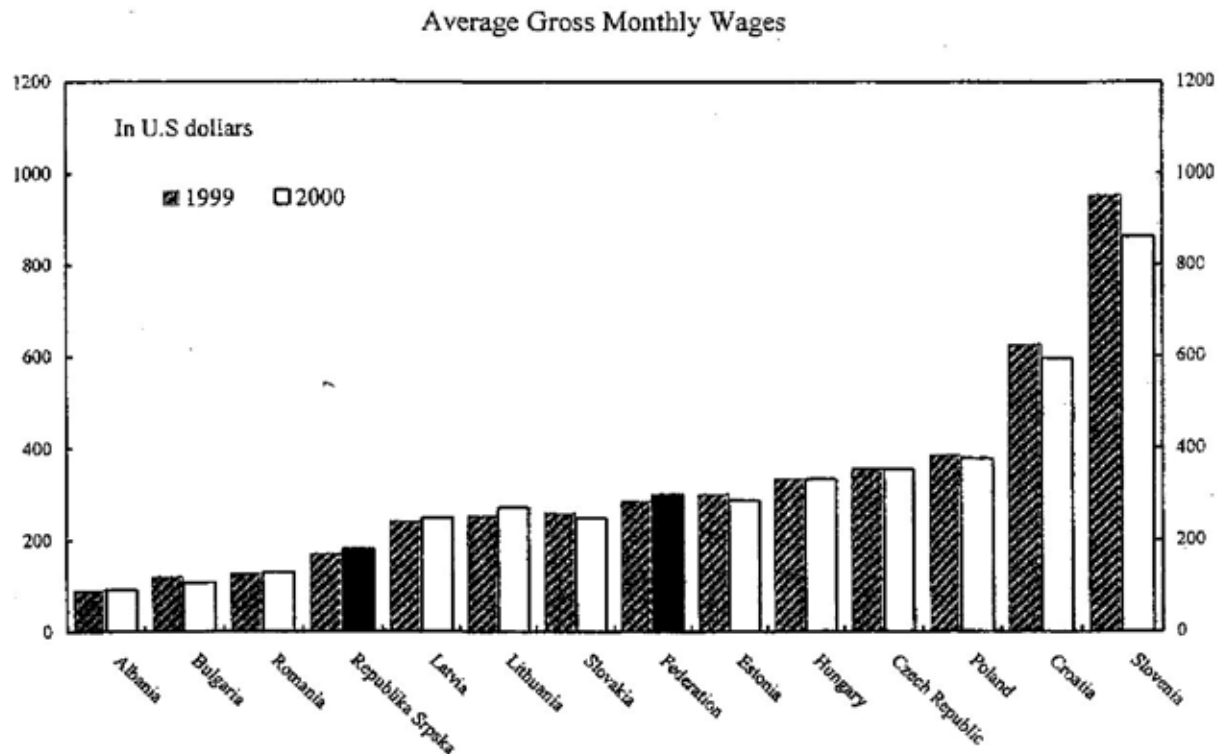
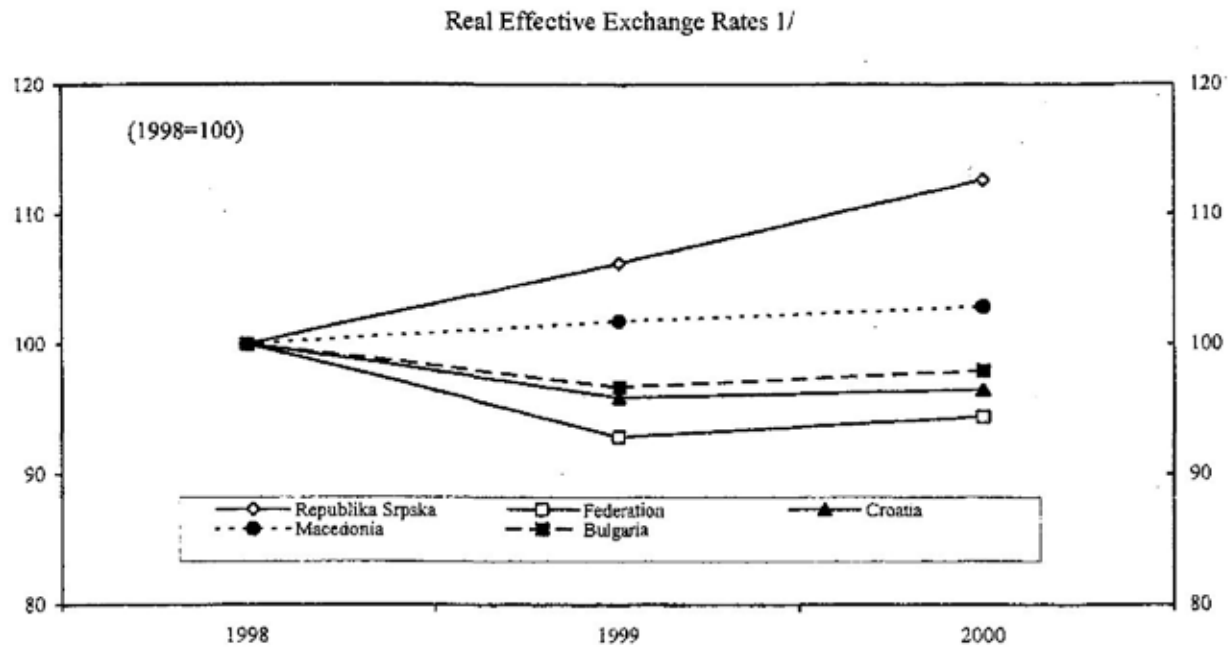


Figure 2. Bosnia and Herzegovina: Indicators of Competitiveness, 1998-2000



Sources: IFS, and IMF staff estimates.

1/ Data on real effective exchange rate (REER) for Bulgaria, Croatia, and Macedonia are from the IFS. For the Republika Srpska and the Federation, the REER is calculated using cost of living indices and bilateral trade data reported in the statistical bulletins of the two Entities, and CPI and bilateral exchange rate data from the IFS. Estimates for 2000 are based on January to December data.

2/ Ratio of cost of living based price of services to price of goods. Data on the cost of living index is taken from the statistical bulletins of the two Entities. Estimates for 2000 are based on January to December data.

Table 1. Bosnia and Herzegovina: Projected IMF Position During the
Stand-By Arrangement, December 1998-May 2001 1/

	1998	1999				2000				2001	
	Dec.	Jan.-Mar.	Apr.-Jun.	Jul.-Sep.	Oct.-Dec.	Jan.-Mar.	Apr.-Jun.	Jul.-Sep.	Oct.-Dec.	Jan.-Mar.	Apr.-May
	(In millions of SDRs)										
Purchases	0.0	0.0	14.5	14.5	0.0	0.0	11.0	0.0	16.2	0.0	14.0
Repurchases	0.0	3.8	3.8	3.8	3.8	3.8	3.8	3.8	3.8	0.0	0.0
Total Fund credit outstanding	54.5	50.7	61.4	72.1	68.4	64.6	71.8	68.0	80.4	80.4	94.4
	(In percent of quota) 2/										
Total IMF credit outstanding	32.2	30.0	36.3	42.7	40.4	38.2	42.4	40.2	47.5	47.5	55.8

Source: IMF staff estimates and projections.

1/ Position under tranche policies.

2/ The quota for Bosnia is SDR 169.1 million.

Table 2. Bosnia and Herzegovina: Schedule of Proposed Purchases
Under the Stand-by Arrangement

Amount of Purchase	Availability	Conditions include:
SDR 13.99 million	May 15, 2001	Completion of sixth and seventh reviews and observance of end-March 2001 performance criteria ¹

Source: Staff estimates.

¹ The Stand-By Arrangement expires on May 29, 2001.

Table 3. Bosnia and Herzegovina: Quantitative Performance Criteria Under the IMF Stand-By Arrangement, December 1999-March 2001
(In millions of convertible marka)

	Stock as of Dec. 31, 1999 Actual	Performance criteria				
		2000		2001		
		December 31		March 31		
		Target	Actual	Target	Adjusted Target 1/	Actual
<u>Cumulative change from end-December 1999</u>						
Ceiling on gross domestic banking system credit 2/						
General government	22	-7	-19	6	17	-16
State 3/	-15	-7	-7	6	17	-3
Federation	34	0	-12	0	0	-15
Republic Srpska adjusted for NBRIS	3	0	-1	0	0	2
<u>Stocks, end of period</u>						
Minimum stock of "Free reserves" of the CBBH 4/	30	43	49	43	43	56
<u>Cumulative change from end-December 1999</u>						
Ceilings on contracting or guaranteeing of new official non-concessional external debt 5/						
One year and under	0	0	0	0	0	0
Over one year	0	0	0	0	0	0
Of which : 1-5 years	0	0	0	0	0	0
Nonaccumulation of external payments arrears.	0	0	0	0	0	0

Sources: Letter of Intent; monetary and fiscal data from the CBBH and Entity Ministries of Finance, creditor data; and IMF staff estimates.

1/ Adjusted upward by KM 10.9 million to reflect delay of February 2001 IMF disbursement to May 2001.

2/ Including credit extended by National Bank of Bosnia Herzegovina; and excluding Treasury IMF account. Includes off-budget items.

3/ Target for State holdings of banking system credit is adjusted for timing and volume of IMF SDR disbursements. SDR holdings are evaluated at the program exchange rate of SDR 0.37037/KM.

4/ Defined as total foreign exchange assets minus monetary liabilities minus liabilities to nonresidents.

5/ Subject to exceptions as noted in Annex IV of the MEFP.

Table 4. Bosnia and Herzegovina: Main Economic and Financial Indicators, 1996-2001 1/

	1996	1997	1998	1999	2000	2001 Proj.
Population (millions)	4.1	4.2	4.2	4.3	4.3	...
Nominal GDP (millions of KM) 2/						
BiH 2/	4125	6116	7,336	8,323	9,115	10,350
Federation 2/	3049	4748	5,602	6,142	6,561	7,331
Republika Srpska 2/	1076	1368	1,734	2,181	2,554	3,020
Industrial production (percent change) 3/						
Federation	88	36	24	11	12	...
Republika Srpska	39	27	23	2	6	...
Wages (KM/month) 4/						
Federation	296	493	524	551	597 7/	...
Republika Srpska 5/	85	138	...	...	392 7/	...
	(Percent change)					
Real GDP (annual average)	86	37	10	10	5	8
CPI (twelve-month average)						
Federation (in KM terms)	-25	14	5	-1	2	4
Republika Srpska (DM/KM-based index) 6/	17	-7	-14	14	15	9
	(Change in percent of opening broad money)					
Money and credit 8/						
Broad money	96	52	31	40	16	14
Foreign assets (net)	60	-11	1	38	10	3
Domestic assets (net)	36	63	30	2	6	11
	(in percent of GDP)					
Fiscal balances						
Federation						
Revenue	10	13	12	12	13	12
Expenditure	13	14	14	13	15	14
Balance 9/	-3	-1	-2	-1	-2	-2
Republika Srpska 10/						
Revenue	24	15	21	30	28	24
Expenditure	24	15	26	35	31	27
Balance 9/ 10/	0	0	-5	-5	-3	-3
	(in millions of U.S. dollars; unless otherwise indicated)					
External current account balance 11/ 12/	-1,306	-1,482	-986	-1,058	-963	-1,013
Exports 12/	336	575	697	649	732	877
Imports 12/	-1,882	-2,333	-2,656	-2,502	-2,348	-2,485
CBBH gross reserves 13/						
In millions of U.S. dollars	235	80	175	456	499	526
In months of merchandise imports	1.2	0.4	0.8	2.2	2.5	2.5
External debt 14/						
(In percent of GDP)	132	119	72	68	59	55
Short-term debt	...	...	...	...	...	...
Debt service (in percent of exports of goods and nonfactor services)	53	16	12	12	13	12
Memorandum items:						
Exchange rates (period average)						
Convertible marka (KM) per deutsche mark	...	...	1.0	1.0	1.0	1.0
BiH dinar per deutsche mark 15/	100	100	...	...	...	...
FR Yugoslav dinar per deutsche mark 16/	3.5	3.9	6.4	...	...	...

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

1/ Data refer to the entire country, unless otherwise indicated.

2/ The GDP series since 1994 has been revised compared to SM 98/96 as more reliable figures produced by the entity statistics institutes became available.

3/ Annual production, percent change over previous year.

4/ Data refer to average of monthly gross wages paid in the year (first eleven months of 1999), not to average earnings in the period; only firms paying wages in a particular month are included in the data.

5/ Until end-1997 FR Yugoslav dinar (YUD) wages converted into DM using the parallel market exchange rate described in footnote 17.

Thereafter, reliable estimates are not available owing to problems with exchange rate conversion.

6/ Until mid-1998 prices were observed in YUD and converted into DM/KM at exchange rates described in footnote 17.

7/ Data as of June 2000; employment and wages for the Federation as of May 2000.

8/ Country-wide monetary aggregates. In percent of beginning of year broad money stock.

9/ Cash basis, before grants.

10/ Excludes municipal government operations.

11/ Excluding official transfers.

12/ Data for 1994-99 are rough estimates for the whole territory of Bosnia and Herzegovina.

13/ Excluding earmarked funds and blocked accounts as well as foreign exchange held by Payments Bureaus.

14/ Projected external debt and debt service for 1998 exclude debt relief.

15/ Official rate. Parallel rate not collected by the Central Bank of BiH. The BH dinar was replaced by the convertible marka (KM) in mid-1998.

16/ YUD/DM exchange rate in the parallel market in the Belgrade, as reported by the National Bank of FRY through end-1998.

Table 5. Bosnia and Herzegovina: Consolidated General Government and Entities, 1997-1999 1/

	1997	1998	1999				Republika Srpska
			Consolidated BiH	State	Consolidated	Federation Federal Government	Cantons Municipalities, and Social Funds 2/
	(In millions of KM)						
Total revenue	2,398	3,148	3,987	216	2,973	724	2,265
Tax revenue	1,615	2,035	2,274	0	1,713	677	1,037
Taxes on goods and services	976	1,190	1,309	0	1,057	312	745
Sales tax	687	816	892	0	745	0	745
Excises	289	374	417	0	312	312	0
Trade taxes	349	407	492	0	347	347	0
Taxes on income	284	377	310	0	248	18	230
Other taxes	7	60	164	0	62	0	62
Budgetary non-tax revenues	109	201	396	216	272	47	241
Transfers from other levels of government	0	0	0	185	0	0	16
Other	109	201	396	31	272	47	225
Extra-budgetary social funds	674	912	1,317	0	987	0	987
Total expenditure	2,429	3,657	4,568	216	3,327	1,078	2,264
Wages and contributions	293	679	898	33	656	92	564
Goods and services	73	240	439	25	252	32	220
Military	348	371	395	0	292	291	0
Debt service	75	87	157	157	0	0	0
Reconstruction expenditure	109	149	150	0	108	26	82
Subsidies	8	20	26	0	14	14	0
Other transfers to households	745	373	439	0	338	216	122
Of which: Transfers to war invalids	271	346	281	0	208	208	73
Transfers to the state government	...	...	0	0	84	84	0
Transfers to cantons or municipalities	9	...	0	0	0	16	0
Social fund expenditure	...	912	1,345	0	987	0	987
Other expenditure and unallocated 3/	770	505	360	0	318	28	290
Foreign loan financed projects	...	320	359	0	278	278	0
Balance	-31	-509	-581	0	-354	-355	1
Financing	31	509	581	0	354	355	0
Domestic financing	0	0	0	0	0	0	0
Foreign financing	31	509	581	0	354	355	0

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

1/ Including State, both Entity level governments, the Federation's local governments (cantons and municipalities), extra-budgetary social funds, and off-budget foreign project loans, but excluding Republika Srpska local governments.

2/ Cantonal and municipal data are preliminary.

3/ Includes district, canton, and municipal expenditures for which insufficient data is available to permit allocation among the categories.

Table 6. Bosnia and Herzegovina: State Fiscal Operations, 1997-2001

	1997	1998	1999	2000		2001	
				Revised Budget	Actual	Oct. 2000 Budget	Approved Budget
(In millions of KM)							
Revenues	50.0	138.0	218.3	269.9	263.0	295.3	295.3
Own revenues	20.0	20.0	31.4	27.6	20.6	27.6	27.6
Transfers from entities	30.0	118.0	186.9	242.3	242.4	267.7	267.7
Administrative budget	15.0	30.0	28.2	44.6	44.6	55.6	55.6
Federation	15.0	21.0	18.3	29.7	29.7	37.1	37.1
Republika Srpska	0.0	10.0	9.9	14.9	14.9	18.5	18.5
Debt service	15.0	89.0	158.7	197.7	197.8	212.1	212.1
Federation	15.0	44.0	...	123.6	123.8	130.2	130.2
Republika Srpska	0.0	45.0	...	74.1	74.0	81.9	81.9
Expenditures	110.0	138.0	218.3	280.9	266.9	304.3	304.3
Administrative	35.0	51.0	59.6	66.2	63.1	72.2	72.2
Salaries	...	...	32.6	25.0	23.6	32.4	32.4
Materials and other expenses	...	...	27.1	41.2	39.5	39.8	39.8
Refugees	...	...	...	1.4	1.5	4.3	3.1
Other	...	...	...	39.8	38.0	35.5	36.7
Border service	...	...	...	17.0	6.0	20.0	20.0
Wages	...	...	...	...	...	12.6	9.8
Other	...	...	...	...	...	7.4	10.2
Debt service	75.0	87.0	158.7	197.7	197.8	212.1	212.1
Foreign grants 1/	60.0	0.0	0.0	11.0	3.9	9.0	9.0
Overall balance	0.0	0.0	0.0	0.0	0.0	0.0	0.0
(In percent of GDP)							
Memorandum items:							
Revenue	0.8	1.9	2.6	3.0	2.9	2.9	2.9
Debt-service	0.2	1.2	1.9	2.2	2.2	2.0	2.0

Sources: Council of Ministers of Bosnia and Herzegovina; and IMF staff estimates.

1/ Includes KM 6 million from the Dutch government and KM 3 million from the U.S. government in 2001.

Table 7. Bosnia and Herzegovina: Federation Fiscal Operations, 1997-2001

	1997	1998	1999	2000		2001		
				Revised Budget	Actual	Budget Oct. 2000	Approved Budget	Jan.-March Actual
(In millions of KM)								
Total revenue	610.5	682.0	723.7	837.3	826.8	872.7	872.7	180.3
Tax revenue	565.3	645.1	676.5	785.0	768.0	813.4	813.4	166.5
Excises	279.8	323.1	312.1	371.0	313.6	335.0	335.0	78.7
Trade taxes	285.5	311.6	346.7	386.5	431.9	453.5	453.5	80.0
Profit tax	0.0	10.4	17.7	27.5	22.5	24.9	24.9	7.8
Nontax revenue	45.2	36.9	47.2	52.3	58.8	59.3	59.3	13.8
Total expenditure	641.1	781.8	800.5	954.5	976.4	983.7	997.7	193.5
Wages and contributions	69.6	77.3	92.5	94.5	103.0	105.0	108.2	18.1
Goods and services 1/	21.4	37.0	32.4	24.3	29.8	32.0	32.3	8.1
Military 2/	253.5	276.0	291.4	305.5	309.6	290.2	290.2	57.7
Reconstruction expenditure 3/	17.5	42.6	26.0	30.9	47.2	40.6	46.6	11.6
Subsidies	3.2	20.4	14.1	15.8	14.0	8.2	11.2	2.9
Other transfers to households	226.7	235.8	215.9	269.0	255.0	276.5	278.6	59.7
Transfers to pension fund	15.8	21.9	6.5	8.6	8.8	8.8	8.8	2.0
Transfers for health	1.4	1.3	0.1	1.0	0.7	1.0	1.0	0.2
Transfers for education	10.4	3.3	1.4	1.5	4.9	2.8	4.9	0.4
Transfers to war invalids	175.5	209.3	207.9	258.0	240.7	263.9	263.9	57.0
Transfers to the state government	29.9	65.0	84.0	153.3	153.5	167.8	167.8	22.3
Administration	15.4	20.6	18.3	29.7	30.0	37.0	37.0	5.0
Debt service	14.5	44.4	65.7	123.6	123.5	130.8	130.8	17.3
Transfers to cantons and municipalities	3.7	7.0	15.9	15.0	25.1	10.0	10.0	5.7
Net lending	0.0	0.0	0.0	0.0	-7.0	0.0	0.0	0.0
Other expenditure and unallocated	15.6	20.8	28.4	46.2	46.2	53.3	52.8	7.5
Refugees	2.5	6.4	3.8	23.5	23.3	25.0	25.0	3.0
Refund of prelevmani duties	...	...	...	...	...	10.0	5.0	0.0
Other	13.1	14.4	24.6	22.7	22.9	15.0	20.0	4.5
Overall balance (before grants)	-30.6	-99.9	-76.8	-117.2	-149.6	-111.0	-125.0	-13.1
Foreign grants for budget support	2.0	34.9	14.7	51.0	61.1	0.0	0.0	0.0
Overall balance (after grants)	-28.6	-65.0	-62.2	-66.2	-88.5	-111.0	-125.0	-13.1
Financing	28.6	65.0	62.2	66.2	88.5	111.0	125.0	13.1
Domestic financing	0.0	0.0	0.0	0.0	-14.7	0	0.0	0.0
Foreign loans for budget support	28.6	65.0	62.2	66.2	103.2	111.0	125.0	13.1
(In percent of GDP)								
Memorandum items								
Revenue	12.9	12.2	11.8	12.8	12.6	11.9	11.9	2.5
Expenditure	13.5	14.0	13.0	14.5	14.9	13.4	13.6	2.6
Balance (before grants)	-0.6	-1.8	-1.3	-1.8	-2.3	-1.5	-1.7	-0.2
Balance (after grants)	-0.6	-1.2	-1.0	-1.0	-1.3	-1.5	-1.7	-0.2
Foreign project loans (million KM)	...	256.0	278.0	...	186.1	188.0	217.0	...

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

1/ Includes goods reserve.

2/ Does not include off-budget assistance from other countries.

3/ Includes allocation for railroads and other capital expenditures.

Table 8. Bosnia and Herzegovina: Republika Srpska Fiscal Operations, 1997-2001

	1997	1998	1999	2000		2001		
				Revised Budget	Actual 1/	Budget Oct. 2000	Approved Budget	Jan.-March Prel.
	(in millions of KM)							
Total revenue	209.3	356.8	652.2	678.7	718.9	727.6	727.7	138.9
Tax revenue	197.0	294.5	559.3	581.2	614.5	632.6	631.7	121.3
Taxes on goods and services	100.1	148.7	251.6	286.9	317.1	304.6	304.6	60.5
Sales tax 2/	90.4	97.8	146.7	166.0	170.3	181.1	181.1	43.9
Excises	9.8	50.9	104.9	120.9	146.9	123.5	123.5	16.5
Trade taxes	63.0	95.0	144.9	164.3	167.1	187.3	187.3	25.4
Taxes on income 3/	28.2	38.1	62.8	67.6	70.8	75.5	75.5	16.3
Personal income tax	5.4	6.3	10.5	5.6	7.9	8.3	8.3	1.8
Wage withholding	21.7	30.4	42.5	50.0	47.2	49.8	49.8	11.2
Corporate income tax	1.2	1.4	9.9	12.0	15.7	17.4	17.4	3.2
Other taxes and revenues	5.6	12.7	100.0	62.4	59.4	65.3	64.3	19.1
Nontax revenue 4/	12.3	62.3	93.0	97.5	104.5	95.0	96.0	17.6
Total expenditure	209.3	446.0	765.8	778.0	793.0	806.5	824.6	154.0
Wages and contributions	24.9	154.6	209.0	228.4	206.1	251.2	248.2	54.2
Goods and services	30.5	49.5	162.0	112.2	153.3	114.7	100.5	11.4
Goods reserve 5/	6.6	9.2	58.2	6.0	33.9	6.0	0.0	0.0
Other 6/	23.9	40.3	103.7	106.2	119.4	108.7	100.5	14.2
Military	73.4	70.0	89.2	69.9	70.3	62.9	66.9	11.4
Banking fees	0.4	0.6	1.8	1.0	1.1	0.3	0.3	0.1
Transfers to social funds	6.1	0.1	28.1	26.3	36.7	27.4	16.0	7.4
Reconstruction expenditure 7/	9.3	12.0	42.3	51.0	73.3	56.7	56.9	8.6
Of which: Railways	9.3	12.0	20.3	20.0	29.4	22.0	29.4	5.2
Subsidies 8/	0.0	0.0	12.0	26.0	36.6	27.0	24.5	2.9
Other transfers to households	15.1	79.1	94.5	121.0	94.3	121.8	140.1	31.9
War invalids	14.8	40.1	72.6	99.0	80.0	99.0	105.2	30.5
Refugees	...	...	18.2	16.0	9.3	17.3	28.0	0.0
Other 9/	0.3	39.0	3.6	6.0	5.0	5.5	6.9	1.4
Transfers to other levels of government	1.2	55.6	94.4	91.0	91.6	103.5	103.5	19.7
Transfers to the State	0.0	55.0	92.5	89.0	89.1	101.0	101.0	19.3
Administration	0.0	10.0	10.1	14.9	14.9	19.0	19.0	4.0
Debt service	0.0	45.0	82.4	74.1	74.2	82.0	82.0	15.3
Transfers to municipalities	1.2	0.6	2.0	2.0	2.5	2.5	2.5	0.3
Net lending	...	...	...	0.0	7.0	0.0	0.0	0.0
Clearance of arrears	...	...	...	...	...	...	35.0	...
Other expenditures and unallocated	48.6	24.5	32.4	51.3	29.7	41.0	32.7	6.3
Budgetary reserve	21.6	12.0	14.0	12.0	11.6	12.0	12.0	1.0
Offsets 10/	...	...	...	16.8	...	0.00	0.0	0.0
Other	27.0	12.5	18.4	22.5	18.1	29.0	20.7	5.4
Overall balance (cash basis, before grants)	0.0	-89.2	-113.5	-99.3	-74.1	-78.9	-96.9	-15.1
Foreign grants for budget support	0.0	31.1	27.7	61.6	48.2	0.0	0.0	0.0
Overall balance (cash basis, after grants)	0.0	-58.1	-85.8	-37.7	-25.9	-78.9	-96.9	-15.1
Change in expenditure arrears (increase +) 11/	...	...	...	...	114.8	0.0	-35.0	...
Overall balance (commitment basis, after grants)	0.0	-58.1	-85.8	-37.7	-140.7	-78.9	-61.9	...
Financing	0.0	58.1	85.8	37.7	25.9	78.9	61.9	15.1
Domestic	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-11.4
External loans for budget support	0.0	58.1	85.8	37.7	25.9	78.9	61.9	26.5
	(in percent of GDP)							
Memorandum items								
Revenue	15.3	20.6	29.9	26.6	28.1	24.1	24.1	4.6
Expenditure	15.3	25.7	35.1	30.5	31.0	26.7	27.3	5.1
Balance (cash basis, before grants)	0.0	-5.1	-5.2	-3.9	-2.9	-2.6	-3.2	-0.5
Balance (cash basis, after grants)	0.0	-3.3	-3.9	-1.5	-1.0	-2.6	-3.2	-0.5
Balance (commitment basis, after grants)	0.0	-3.3	-3.9	-1.5	-5.5	-2.6	-2.1	...
Foreign financed project loans (in millions of KM)	52.2	64.4	80.9	135.3	111.8	113.1	113.1	113.1

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

1/ Adjustments made to the cash outcome comprise: (i) elimination of unrealized revenue gains (losses) due to a depreciation (appreciation) of the domestic currency (KM 1 million and KM 34.9 million, respectively); (ii) inclusion of expenditures related to government lending (KM 7 million); and (iii) removal of a KM 84 million item recorded under expenditure, but which was in fact an accounting error with no correspondence to real or committed expenditure.

2/ Including sales tax, military surcharges, and railway surcharges.

3/ Including personal income tax, wage withholding tax, and corporate income tax.

4/ Including fees, fines, and other special revenues.

5/ Includes gross spending of the goods reserve up to 1999.

6/ Including one-third of education expenditure (up to 1999) and other materials costs.

7/ Including railway and other capital expenditure.

8/ For water, forestry, and agriculture.

9/ Including transfers to health insurance funds, refugees and displaced persons, students, and social institutions.

10/ In 2000, KM 100 million of offsets is allocated to the various expenditure items.

11/ In 2001, the stock of arrears will be reduced by KM 35 million.

Table 9. Bosnia and Herzegovina: Balance of Payments, 1998-2005
(In millions of U.S. dollars; unless otherwise indicated)

	1998	1999	2000	2001	2002	2003	2004	2005
			Est.	Proj.	Proj.	Proj.	Proj.	Proj.
Trade balance	-1,959	-1,852	-1,617	-1,608	-1,549	-1,478	-1,316	-1,210
Exports, f.o.b.	697	649	732	877	1,070	1,328	1,681	2,133
Imports, f.o.b.	-2,656	-2,502	-2,348	-2,485	-2,620	-2,805	-2,997	-3,343
Reconstruction	-499	-495	-431	-428	-330	-285	-247	-214
Humanitarian (in-kind)	-26	0	0	0	0	0	0	0
Other	-2,132	-2,007	-1,918	-2,057	-2,290	-2,520	-2,750	-3,129
Services, net	378	324	264	236	211	189	142	109
Receipts	563	552	460	435	401	381	357	352
Expenditure	-185	-228	-196	-199	-190	-192	-225	-244
Net factor income	330	273	225	200	201	199	199	215
Earnings	409	353	318	306	301	294	287	299
Interest payments	-79	-81	-93	-105	-99	-95	-88	-84
Unrequited transfers, net	461	284	218	180	180	175	178	176
Receipts	468	292	225	188	187	183	185	183
Official grants	197	86	53	22	25	20	20	15
Private	271	206	172	166	162	163	165	168
Outflows	-7	-8	-8	-8	-8	-7	-7	-7
Current account balance	-789	-971	-909	-991	-957	-914	-797	-710
Excluding official transfers	-986	-1,058	-963	-1,013	-982	-934	-817	-725
Foreign investment (net)	100	90	150	164	246	320	368	441
Capital transfers for reconstruction	517	520	388	347	254	213	209	143
Foreign loans (net)	122	147	180	225	150	104	84	62
Disbursements	194	205	244	285	237	192	171	143
Reconstruction	147	140	186	217	187	167	171	143
Other	47	65	58	68	50	25	0	0
Amortization	-73	-58	-64	-60	-86	-88	-87	-81
Multilateral and Paris Club creditors	-30	-15	-20	-17	-42	-44	-43	-33
Others	-42	-42	-44	-43	-44	-44	-44	-47
Commercial banks	129	-203	-146	-10	-10	-15	-20	-65
Other capital	0	400	249	197	200	200	200	200
Capital account balance	868	954	821	924	840	822	841	781
Errors and omissions	-197	233	73	0	0	0	0	0
of which: valuation adjustment	-82	165	73	0	0	0	0	0
Overall balance	-117	215	-15	-68	-117	-92	43	70
Financing	117	-215	15	8	-156	-204	-155	-82
Net foreign assets (increase, -)	-24	-245	-14	-8	-141	-170	-131	-86
Central bank	-24	-245	-14	-8	-141	-170	-131	-86
Net use of Fund resources	33	18	17	10	-23	-42	-30	-4
Purchases/loans	33	39	37	18	0	0	0	0
Repayments/repayments	0	-21	-20	-8	-23	-42	-30	-4
Short-term liabilities (reduction, -)	0	0	0	0	0	0	0	0
Arrears (reduction, -)	-815	-20	-946	0	0	0	0	0
Multilateral creditors	0	-20	0	0	0	0	0	0
Paris Club creditors	-815	0	0	0	0	0	0	0
London Club	0	0	0	0	0	0	0	0
Other creditors	0	0	-946	0	0	0	0	0
Debt Rescheduling (of Arrears)	815	20	946	0	0	0	0	0
Multilateral creditors	0	20	0	0	0	0	0	0
Paris Club creditors	815	0	0	0	0	0	0	0
London Club	0	0	0	0	0	0	0	0
Other creditors	0	0	946	0	0	0	0	0
Debt Relief, current maturities (cashflow)	108	12	12	6	8	7	7	8
Multilateral creditors	0	0	0	0	0	0	0	0
Paris Club creditors	36	8	5	3	3	3	2	0
London Club	73	4	8	3	5	5	5	8
Total financing gap	0	0	0	-60	-274	-296	-112	-11
Memorandum items:								
Current account balance (in percent of GDP)	-18.9	-21.4	-20.9	-20.4	-16.5	-13.8	-10.6	-8.6
Excluding official transfers	-23.7	-23.3	-22.2	-20.8	-16.9	-14.1	-10.9	-8.8
External debt/GDP (in percent)	71.6	68.2	59.4	58.9	58.3	56.4	51.6	46.3
Gross official reserves (in months of imports)	0.7	2.0	2.4	2.4	2.7	2.8	2.9	2.9

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

Table 10. Bosnia and Herzegovina: External Financing Requirements and Possible Sources of Financing, 1998-2001

(In millions of U.S. dollars)

	1998	1999	2000	2001
Merchandise trade balance	-1,959	-1,852	-1,617	-1,608
Services balance	378	324	264	236
Net factor income	330	273	225	200
Of which: Interest due	-79	-81	-93	-105
Private transfers, net	264	198	164	159
Current account balance, excluding official transfers	-986	-1,058	-963	-1,013
Amortization of medium and long term obligations 1/	-73	-58	-64	-60
Changes in arrears (- is reduction)	-815	-20	-946	0
Of which: Multilateral	0	-20	0	0
London Club	0	0	0	0
Paris Club	-815	0	0	0
Other	0	0	-946	0
London Club rescheduling and debt relief	73	4	8	3
Paris Club rescheduling and debt relief	851	8	5	3
Multilateral rescheduling and debt relief	0	20	0	0
Change in official reserves (- is increase)	-24	-245	-14	-8
Change in commercial bank NFA (- is increase)	129	-203	-146	-10
Errors and omissions	-197	233	73	0
Gross external financing requirement	-1,042	-1,319	-2,048	-1,085
Official transfers	197	86	53	22
Capital transfers for reconstruction	517	520	388	347
Official loans for balance of payments support 2/	0	11	0	0
Disbursement for reconstruction	147	140	186	217
Foreign direct investment	100	90	150	164
Other capital	0	400	249	197
Financing gap after project and humanitarian flows	-80	-73	-1,021	-138
IMF	33	18	17	10
World Bank adjustment lending	47	54	58.3	68.4
Gross financing gap (-)	0	0	-945	-60
Other rescheduling and debt relief 3/	0	0	946	0
Remaining gap	0	0	0	-60

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

1/ Includes IMF repurchases.

2/ Excludes multilateral creditors.

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

Table 11. Bosnia and Herzegovina: External Debt at end-2000 1/ 2/
(In millions of U.S. dollars)

	Stock of Debt	Projected Debt Service Payments				
	2000	2001	2002	2003	2004	2005
Total debt outstanding	2,583.7	...	...	...	...	...
Total debt service	...	173.6	208.9	224.7	205.2	168.1
Amortization	...	68.3	109.5	129.7	117.3	84.4
Multilateral	1,330.7	17.3	53.0	73.9	62.1	34.8
IMF	105.6	8.0	23.2	41.8	30.4	3.8
World Bank 3/	1,132.7	5.5	23.6	24.2	23.9	23.1
Other	92.4	3.7	6.3	7.9	7.9	7.9
Paris Club 4/	485.2	8.2	12.2	11.5	10.9	2.4
London Club 4/	370.9	42.3	42.3	42.3	42.3	45.3
Other creditors 5/	396.9	0.5	2.0	2.0	2.0	2.0
Interest	...	105.3	99.4	95.1	88.0	83.6
Multilateral	...	48.5	49.7	49.0	45.6	42.1
IMF	...	6.9	6.2	4.6	2.5	1.4
World Bank 3/	...	37.9	40.1	41.5	40.6	40.8
Other	...	3.6	3.7	3.3	2.9	2.5
Paris Club 4/	...	16.5	10.2	9.8	9.5	9.3
London Club 4/	...	19.4	18.0	14.7	11.3	8.6
Other creditors 4/ 5/	...	21.0	21.1	21.1	21.2	21.2

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

1/ Debt service to London Club and Paris Club after rescheduling.

2/ Excludes an estimated US\$54 of payments arrears at end-1997 for gas supplied from the Russian Federation, which is in dispute. Includes non-allocated debt of the former SFRY allocated on the basis of the Fund key of 13.2 percent of the non-allocated debt of the former SFRY. Includes debt for which status of public liability has not been verified or finalized.

3/ Figures reflect clearance of IBRD arrears on June 14, 1996, and the prepayment of unmatured loans as part of the debt consolidation.

4/ A restructuring agreement with London Club creditors became effective as of January 1, 1998. An agreement on Naples terms was reached with the Paris Club in October, 1998. Bilateral agreements with all countries but Japan have been completed.

5/ Mainly commercial creditors (i.e., supplier and trade creditors).

Table 12. Bosnia and Herzegovina: Monetary Survey, December 1996-December 2001

	1996	1997	1998	1999	2000				2001	
	Dec.	Dec.	Dec.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Dec. Proj
(In millions of convertible marka) 1/										
Net foreign assets	-1,973	-2,056	-2,041	-1,453	-1,561	-1,521	-1,498	-1,233	-1,191	-1,161
Net foreign assets, CBBH	228	73	162	698	680	687	750	840	852	869
Assets	355	144	292	881	858	884	943	1,068	1,078	1,115
Liabilities	-138	-71	-130	-183	-178	-197	-193	-228	-226	-246
Net foreign assets, commercial banks 2/	-2,201	-2,129	-2,203	-2,155	-2,241	-2,209	-2,247	-2,073	-2,043	-2,030
Assets	901	1,299	1,172	1,134	1,115	1,218	1,260	1,276	1,353	1,284
Liabilities	-3,102	-3,428	-3,375	-3,289	-3,356	-3,427	-3,507	-3,350	-3,396	-3,314
Net domestic assets	2,749	3,234	3,588	3,623	3,676	3,759	3,822	3,747	3,687	4,031
Claims on central government (net) 3/ 4/ 5/	-278	-116	-60	9	2	46	46	103	79	130
Monetary authorities 5/	-108	71	114	159	158	176	178	193	187	232
Deposit money banks	-170	-188	-174	-150	-156	-130	-132	-90	-108	-102
Other claims	3,263	3,840	4,201	4,147	4,213	4,330	4,395	4,419	4,445	4,738
Claims on private sector 2/	3,260	3,835	4,192	4,130	4,204	4,321	4,382	4,410	4,438	4,729
Other items (net) 2/	-237	-489	-553	-533	-539	-617	-619	-776	-837	-837
Broad money	775	1,178	1,547	2,165	2,115	2,237	2,324	2,514	2,497	2,870
Money	187	252	310	1,100	1,141	1,205	1,297	1,404	1,391	1,604
Currency outside banks	96	113	162	515	504	531	546	652	663	744
Demand deposits 5/	91	139	147	585	637	674	751	753	728	860
Quasi-money 6/	588	926	1,237	1,065	974	1,033	1,027	1,109	1,106	1,267
Time and saving deposits in domestic currency	7	10	8	22	37	55	64	77	60	91
Foreign currency deposits	581	917	1,229	1,043	937	977	963	1,033	1,046	1,175
Demand deposits	466	554	762	465	399	447	444	558	602	635
Time and saving deposits	115	363	467	577	538	531	519	475	444	541
(Change in percent of opening broad money)										
Foreign assets (net) 2/	60	-11	1	38	-5	-3	-2	10	12	3
Foreign assets	131	23	2	36	-2	4	9	15	19	2
Foreign liabilities	-71	-33	0	2	-3	-7	-11	-5	-7	1
Domestic assets (net)	36	63	30	2	2	6	9	6	3	11
Claims on central government (net) 3/ 4/ 5/	-46	21	5	4	0	2	2	4	3	1
Monetary authorities 5/	-26	23	4	3	0	1	1	2	1	2
Deposit money banks	-20	-2	1	2	0	1	1	3	2	0
Other claims (net) 2/	135	74	31	-4	3	8	11	13	14	13
Broad money 6/	96	52	31	40	-2	3	7	16	15	14
Money	33	8	5	51	2	5	9	14	13	8
Quasi-money	63	44	26	-11	-4	-1	-2	2	2	6
Memorandum items:										
Broad money, annual percentage change	96	52	31	40	40	39	35	16	18	14
Claims on private sector, annual percentage change	19	18	9	-1	3	5	60	7	6	7
Foreign currency deposits as a percent of broad money	75	78	79	48	44	44	41	41	42	41

Sources: Data provided by the Central Bank of Bosnia and Herzegovina; and IMF staff estimates.

1/ At the official or market exchange rates for the KM, the BH dinar, the YUD, and the kuna.

2/ Including transactions written off by Privredna Banka Sarajevo (PBS) in December 1997 without the approval of the Federation Banking Agency.

3/ Including net claims on State and Entity governments, but excluding claims on canton and municipal governments and extrabudgetary funds.

4/ Excluding USAID deposits.

5/ Includes treasury IMF deposits.

6/ Includes deposits of noncentral government and private sector.

May 9, 2001

Dear Mr. Köhler,

In the period since the most recent review, on December 22, 2000, of Bosnia and Herzegovina's Stand-By Arrangement with the IMF, we have implemented macroeconomic and structural policies in line with the program set out in the December 4, 2000 letter of intent. There was some weakening of fiscal discipline during the fall election season but the new governments, which took office in the first quarter of this year, have taken measures to reassert control over budget execution and have accelerated the implementation of structural reforms.

Delays in forming the new governments made it impossible to complete the sixth review of the program in the first quarter of 2001 as had been planned. In view of the policies implemented under the program, and described in this letter, however, we now ask the Fund to approve a waiver for the breach of the performance criterion on bank borrowing and to complete the sixth and seventh reviews under the Stand-By Arrangement.

Strict implementation of currency board rules continues to be the basis of our monetary policy; in the area of fiscal policy, the two Entities and the State have adopted budgets for 2001 in line with IMF advice.

In Republika Srpska, a significant amount of budgetary arrears, including three months of wage arrears, emerged in the fall of 2000. The government considered the option of canceling the arrears, but felt that this would amount to a breach of contract with civil servants and would weaken morale. Therefore the 2001 budget for Republika Srpska allows for a partial repayment of arrears, within the constraints of the tight fiscal position. To prevent further accumulation of wage arrears, we have frozen government employment as well as wages in order to stabilize the wage bill.

All quantitative performance criteria were met except for the ceiling on domestic borrowing, which was breached by a KM 10 million bank loan to the government. The loan was needed because taxes that had been collected were not immediately available to the government, owing to start-up problems with the new payments system. It was repaid in full on April 23, 2001.

In the area of structural reforms, major recent achievements have been: replacing payments bureaus with a modern interbank clearing system—the first among the successor states of the former Federal Republic of Yugoslavia; amending the sales tax law in order to simplify the tax, broaden the base and fully harmonize the sales tax regimes in the two entities; and fully implementing features of the amended pension laws which ensure that no further pensions arrears can emerge. In addition preparations are underway for the establishment, in the second half of this year, of modern treasuries, in line with technical assistance from the IMF and World Bank. Finally, preparations are now well advanced for privatizing banks and large state-owned enterprises. The implementation of structural benchmarks under the program is summarized in Table 1.

As agreed with the staff, we have implemented prior actions for the sixth and seventh reviews of the Stand-by Arrangement (Table 2). In addition, both Entities have also established Auditor General offices and have initiated audits of their military establishments.

After the present program expires on May 28, 2000, we intend to continue implementing sound macroeconomic policies and we will accelerate the structural reforms needed to create a basis for sustainable growth. We will therefore seek to initiate discussions with the IMF staff on a successor arrangement with the Fund.

Sincerely yours,

Council of Ministers Chairman Bozidar Matic /s/

Prime Minister Alija Behmen /s/

Prime Minister Mladen Ivanic /s/

Minister Nikola Grabovac /s/

Minister Milenko Vracar /s/

Governor Peter Nicholl /s/

Attachment

**Table 1. Bosnia and Herzegovina: Structural Benchmarks,
November 2000-March 2001¹**

1. Implement comprehensive excise and sales tax reform.	End-January 2001 (Done April 2001)
2. Prepare strategy to raise collections of social funds by broadening the contribution base while lowering rates.	End-March 2001 (Not done)
3. Entity governments to forbid the use of privatization revenues: (a) for paying off debts of institutions that cannot meet their current obligations from current resources; (b) by any privatization agency before it has adopted regular reporting procedures on its receipts and their use.	End-November 2000 onwards (Done)
4. Implement measures agreed with IMF staff to have interim Treasury functions in place prior to closure of the payments bureaus.	End-December 2000 (Done)
5. Real Time Gross Settlement System and clearing house to begin interbank settlement operations.	End-December 2000 (Done January 5, 2001)
6. Enforce prudential regulations, mainly minimum net capitals requirements, and implement strategy to bring offending banks into compliance.	Continuous

^{1/} Measures refer to institutions of both Entities.

**Table 2. Bosnia and Herzegovina: Prior Actions
to Conclude the Sixth and Seventh Reviews of the Stand-By Arrangement¹**

	<u>Status</u>
1. Entity and State Parliaments to pass the 2001 budgets agreed with the IMF.	Fed.: Done RS: Done State: Done
2. Enactment of amendments to the sales tax laws in each Entity as agreed with the Fund.	Fed: Pending RS: Done
3. Payment of the February, March and April pensions with resources collected over progressively shorter collection periods until payment in a given month is made only from funds collected in that month.	Fed: Done RS: Done
4. Both Entities to remain current with the State for debt service and administrative transfers	Fed: Done RS: Done
5. Both Entities to provide their treasury departments with adequate staff, premises and financial resources to implement treasury reform.	Fed: Done RS: Done

¹ Unless specified otherwise, measures refer to the institutions of the two Entity Governments.

Bosnia and Herzegovina: Fund Relations

As of March 31, 2001

I. Membership Status: Joined: 12/14/1992; Article XIV

II. <u>General Resources Account:</u>	<u>SDR Million</u>	<u>%Quota</u>
Quota	169.10	100.0
Fund Holdings of Currency	249.53	147.6
III. <u>SDR Department:</u>	<u>SDR Million</u>	<u>%Allocation</u>
Net cumulative allocation	20.48	100.0
Holdings	6.97	34.0
IV. <u>Outstanding Purchases and Loans:</u>	<u>SDR Million</u>	<u>%Quota</u>
Stand-by arrangements	80.43	47.6

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	05/29/1998	05/29/2001	94.42	80.43

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

	<u>Overdue</u>		<u>Forthcoming</u>			
	<u>03/31/2001</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>
Principal		6.1	17.6	31.4	22.7	2.8
Charges/Interest		3.3	3.8	2.7	1.3	0.6
Total		9.4	21.4	34.1	24.0	3.4

VII. Exchange Arrangement

The currency of Bosnia and Herzegovina is the convertible marka (KM), introduced on August 11, 1997. The KM is pegged to the deutsche mark (DM) at KM 1 = DM 1 under a currency board arrangement. 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 DM continues to circulate in all areas of the country, the Croatian kuna continues to be used in the Croat-majority area, and the Yugoslav dinar is used in the Republika Srpska. The convertible marka (KM) is the currency used for operations and transactions with the Fund for Bosnia and Herzegovina.

The Central Bank of Bosnia and Herzegovina does not maintain restrictions on payments for current international transactions or capital account transactions, with the exception of restrictions on transactions related to internationally-mandated economic sanctions. Corresponding regulations have not, however, been issued by the Entities.

VIII. Last Article IV Consultation

Bosnia and Herzegovina is on the standard twelve-month cycle. The last Article IV consultation was concluded on March 8, 2000.

IX. Resident Representative

Mr. Bruno de Schaetzen has been the Fund's resident representative in Bosnia and Herzegovina since July 6, 1998.

X. Technical Assistance, 1995–September 1999

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
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 bureau
	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 payment 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
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.

BOSNIA AND HERZEGOVINA: RELATIONS WITH THE WORLD BANK GROUP

1. Bosnia and Herzegovina became a member of the World Bank Group on April 1, 1996, after having agreed to assume its share of the loans made by the Bank to, or with the guarantee of, the Socialist Federal Republic of Yugoslavia (SFRY);¹ and having agreed with the Bank on a plan to eliminate arrears on those loans.²
2. In parallel with efforts towards membership and resolution of arrears, the Bank initiated, in collaboration with the government of Bosnia and Herzegovina, the IMF and international donors, preparatory efforts for a program of post-war reconstruction and economic recovery. The external financing requirement of this program was estimated at US\$5.1 billion over 3–4 years. At pledging conferences in December 1995, April 1996, July 1997, May 1998, and May 1999—co-chaired by the European Commission and the World Bank—some 60 donor countries, multilateral institutions and other donor agencies pledged over US\$5.1 billion of assistance on highly concessional terms to support Bosnia and Herzegovina in the implementation of the Priority Reconstruction Program. An updated assessment of donor pledges as of December 1999 indicates pledges having risen to US\$5.4 billion.
3. As of February 28, 2001, the World Bank Group had committed US\$770 million, in support of 38 IDA credits/World Bank Trust Funds and disbursed US\$599 million. As of February 2001 US\$39 million had been committed in 17 IFC operations, and US\$30 million disbursed. The IDA-financed projects/credits have supported rehabilitation and reconstruction in a wide range of sectors, including agriculture, industry, energy, water supply, transport, education and health, employment creation through demobilization support, micro-credit and public works; and structural adjustment through public sector reform and privatization.
4. The current Bank assistance program, presented to the Bank's Board on May 18, 2000 has the following objectives: (i) strengthening institutions and governance, in particular, in the area of public finance, macroeconomic management and the strengthening of local governments; (ii) fostering private sector-led growth and employment through the creation of a business-friendly enabling environment, privatization and ongoing banking and labor-market reforms; and (iii) building social sustainability through the development of a social protection strategy focused on the most needy, based on improved capacities for collating and analyzing poverty data, and strengthening human capital through education and health programs. After an initial post-war strategy aimed at reconstruction, the Bank's strategy has shifted to assisting Bosnia and Herzegovina in its move towards sustainable growth. In this context, a Second Public Finance Structural Adjustment Credit (PFSAC II) aimed at enhancing inter-entity coordination, priority setting for public spending and improving budget and debt management; and, an Enterprise and

¹ Allocation of these loans among the successor republics of the SFRY is based on project benefits located within the internationally recognized territory of each republic. An apportionment formula has been used for unallocated debt, i.e., debt related to balance of payments support where single republics could not be identified as a beneficiary.

² The plan involved consolidation of outstanding balances plus arrears into a package of new IBRD loans (the consolidation loan package). The consolidation loan package became approved June 13, 1996 and effective in June 14, 1996, paving the way for regular IDA lending.

Bank Privatization Adjustment Credit (EBPAC) are under implementation; while a social sector adjustment operation focused on labor market reform and social protection was approved by the World Bank's Board in February 2001.

5. The Bank and the IMF have worked in very close partnership since the beginning of the reconstruction effort. Regular exchange of information, joint missions and joint chairmanship of the macroeconomic sector task force in Sarajevo have benefited both institutions.

STATUS OF BANK GROUP OPERATIONS IN BOSNIA AND HERZEGOVINA

A. STATEMENT OF BANK LOANS ^{b/}

(As of March 31, 2001)

				US\$ Million (Less Cancellations)	
Loan No.	Year	Borrower	Project	Loan	Undisbursed
<u>Loan/Credits/ Grants</u>					
<u>IBRD^{b/}</u>					
4038-BOS	1996	Bosnia and Herzegovina	Consolidation Loan A	28.6	0.0
4039-BOS	1996	Bosnia and Herzegovina	Consolidation Loan B	284.9	0.0
4040-BOS	1996	Bosnia and Herzegovina	Consolidation Loan C	307.1	0.0
			Total	<u>620.6</u>	<u>0.0</u>
			Of which: Repaid	<u>24.9</u>	
			Total Now Held by the Bank	595.7	0.0
<u>TFBH^{c/} (Under Disbursement)</u>					
TF-024030	1996	Bosnia and Herzegovina	Emergency Recovery Credit	45.0	0.0
TF-024031	1996	Bosnia and Herzegovina	Emergency Farm Reconstruction	20.0	0.0
TF-024032	1996	Bosnia and Herzegovina	Emergency Water Supply	20.0	0.0
TF-024033	1996	Bosnia and Herzegovina	Emergency Transport	35.0	0.7
TF-024034	1996	Bosnia and Herzegovina	Emergency District Heating	20.0	0.0
TF-024035	1996	Bosnia and Herzegovina	Emergency War Victims Rehabilitation	5.0	0.0
TF-024040	1996	Bosnia and Herzegovina	Emergency Education Reconstruction	5.0	0.0
			Total	<u>150.0</u>	<u>0.7</u>
<u>IDA</u>					
2897-BOS	1996	Bosnia and Herzegovina	Emergency Education Reconstruction	5.0	0.0
2896-BOS	1996	Bosnia and Herzegovina	Emergency War Victims Rehabilitation	5.0	0.0
2902-BOS	1997	Bosnia and Herzegovina	Emergency Housing Repair	15.0	0.0
2903-BOS	1997	Bosnia and Herzegovina	Emergency Power Reconstruction	35.6	0.0
2904-BOS	1997	Bosnia and Herzegovina	Emergency Public Works and Employment	10.0	0.4
2905-BOS	1997	Bosnia and Herzegovina	Emergency Landmines Clearance	7.5	0.3
2906-BOS	1997	Bosnia and Herzegovina	Emergency Demobilization and Reintegration	7.5	0.3
2914-BOS	1997	Bosnia and Herzegovina	Transition Assistance Credit	90.0	0.0
N001-BOS	1997	Bosnia and Herzegovina	Emergency Industry Re-Start Guarantee	10.0	0.0
N002-BOS	1997	Bosnia and Herzegovina	Emergency Microenterprise/Local Initiatives	7.0	0.3
N003-BOS	1997	Bosnia and Herzegovina	Essential Hospital Services	15.0	1.5
N032-BOS	1998	Bosnia and Herzegovina	Transport Reconstruction II	39.0	1.6
N035-BOS	1998	Bosnia and Herzegovina	Education Reconstruction II	11.0	0.5
3028-BOS	1998	Bosnia and Herzegovina	Reconstruction Assistance Project	17.0	0.4
3029-BOS	1998	Bosnia and Herzegovina	Emergency Natural Gas	10.0	0.0
3070-BOS	1998	Bosnia and Herzegovina	Emergency Pilot Credit (RS)	5.0	0.0
3071-BOS	1998	Bosnia and Herzegovina	Power II	25.0	6.6
N040-BOS	1998	Bosnia and Herzegovina	Forestry	7.0	5.1
3090-BOS	1998	Bosnia and Herzegovina	Public Finance I (Structural Adjustment)	63.0	0.0
3191-BOS	1999	Bosnia and Herzegovina	Local Development	15.0	14.3
3202-BOS	1999	Bosnia and Herzegovina	Basic Health	10.0	8.7
3262-BOS	1999	Bosnia and Herzegovina	Enterprise and Bank Privatization Project	50.0	24.5
3257-BOS	1999	Bosnia and Herzegovina	Enterprise Export Facility Project	12.0	9.2
3269-BOS	1999	Bosnia and Herzegovina	Pilot Cultural Heritage Project (LIL)	4.0	3.0
3258-BOS	1999	Bosnia and Herzegovina	Second Public Finance (Structural Adjustment)	72.0	20.4
3351-BOS	2000	Bosnia and Herzegovina	Education Development Project III	10.6	10.1
3385-BOS	2000	Bosnia and Herzegovina	Mostar Water and Sanitation	12.0	11.8
3400-BOS	2000	Bosnia and Herzegovina	Emergency Labor Redeployment	15.0	14.8
Q2370-BOS	2000	Bosnia and Herzegovina	Trade and Transport Facilitation in SEE	11.0	10.9
34650-BOS	2000	Bosnia and Herzegovina	Social Sector SAC(SOSAC I)	20.0	20.0
3439-BOS	2000	Bosnia and Herzegovina	Social Sector Structural Adjustment Credit - TA	3.55	3.55
			Total	<u>619.8</u>	<u>168.2</u>
			Grand Total	769.8	168.9

a/ The status of these projects is described in a separate report on all Bank/IDA financed projects in execution, which is updated twice yearly and circulated to the Executive Directors on April 30 and October 31.

b/ Consolidation Loans A, B, and C were approved on June 13, 1996 and became effective on June 14, 1996.

c/ Trust Fund for Bosnia and Herzegovina.

B. STATEMENT OF IFC INVESTMENTS

(As of June 30, 2000)

<u>Obligor</u>	<u>Type of Business</u>	<u>IFC Held</u>			
		----- USD Million -----			
		<u>Loan</u>	<u>Equity</u>	<u>Quasi</u>	<u>Total</u>
Tvornica Kartona i Ambalaze Cazin	Timber, Pulp and Paper	3.21	0.00	0.00	3.21
SOUR Energoinvest	Industrial Equipment and Machinery	7.64	0.00	0.00	7.64
Horizonte BiH Enterprise Fund	SME Investment	0.00	1.74	0.00	1.74
Microenterprise Bank	Microcredit	0.00	0.85	0.00	0.85
Sarajevska Pivara	Beverage Manufacturing	2.80	0.00	0.00	2.80
SEF Akova	Meat Packing and Processing	1.83	0.00	0.00	1.83
Wood Agency Credit Line	Furniture and Other Wood Products	4.30	0.00	0.00	4.30
SEF Lignosper	Furniture Manufacturing	2.00	0.00	0.00	2.00
SEF Kopex	Industrial and Consumer Services	1.86	0.00	0.00	1.86
SEF Lijanovici	Abattoir, Meat Processing	2.17	0.00	0.00	2.17
SEF Bosnalijek	Pharmaceutical	0.00	0.00	2.14	2.14
Wood Konjuh	Wood Products	2.17	0.00	0.00	2.17
Wood Kozara	Wood Products	1.52	0.00	0.00	1.52
Wood Podgradci	Wood Products	1.08	0.00	0.00	1.08
Wood Inga	Wood Products	1.52	0.00	0.00	1.52
Wood Vrbas	Wood Products	1.52	0.00	0.00	1.52
Total Gross Investments		33.58	2.59	2.14	38.32
Participations, Cancellations, Terminations, Exchange Adjustments, Repayments, and Arrears (Principal Only)		10.84	0.00	0.00	10.84
Total Commitments Now Held by IFC		22.74	2.59	2.14	27.47
Total Undisbursed		7.66	1.01	0.00	8.67
Total Outstanding		15.08	1.58	2.14	18.80

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 and RS). However, in response to the need to create a state agency with responsibilities for compiling country-wide statistics in accordance with internationally accepted methodologies, consolidating data produced by the Entity Statistical Institutes, and acting as primary coordinating agency for contacts with international agencies, the Bosnia and Herzegovina Agency for Statistics (BIHAS) was established in August 1998. The BHAS started operating in late 1998 with limited budget resources, and EC and bilateral support. Inter-Entity cooperation has improved noticeably since then and progress toward restoring adequate statistical capabilities has been noticeable, especially in data dissemination and the compilation of monetary and balance of payments data. Under donor supervision, a comprehensive program of technical assistance in statistics is under implementation. 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 a wide range of statistics on the basis of the comprehensive review of key macroeconomic statistics 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. Preparations are under way for introducing a country page for Bosnia and Herzegovina in *International Finance Statistics (IFS)*.

A. Real Sector

2. Since the last Article IV discussions, noticeable efforts have been made in both Entities to prepare national accounts estimates based on international standards recommended under the 1993 SNA, although there are large differences in the Entities' relative capabilities. Production and income aggregates at constant prices and compilation of GDP by final demand are still unavailable and informal sector activities are under-recorded. Both statistical offices compile prices and production indices following sound methodological procedures, although the underlying weights for the indices are seriously outdated. 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. Until recently, information needed for country-wide balance of payments statements was assembled only at the time of EU1 missions using ad hoc basis data from donors or relevant Entity agencies. However, work is taking place at the CBBH, with Fund technical assistance, to compile comprehensive balance of payments statistics at the Entity and State levels. Annual balance of payments statistics for 1998 and 1999 have been compiled according to the international standards set out in the fifth edition of the Fund's *Balance of Payments Manual* and provided to the Fund's Statistics Department. Discussions are currently underway with the authorities on finalizing these statistics for publication in the *International Financial Statistics* monthly publication. Continued technical assistance will be provided through the Fund's Resident Statistical Advisor.

C. Monetary Accounts

4. Considerable efforts have been successfully devoted by the Fund during six missions in 1996–99 to establishing an integrated system of country-wide monetary statistics meeting Fund standards. Currently, the CBBH reports regularly to the Fund monthly data on country-wide as well as regional monetary accounts. A monetary and financial statistics mission that took place during October–November 2000 reviewed the implementation of new chart of accounts for commercial banks in Republika Srpska; reviewed the status of the bank privatization to ensure the appropriate treatment of banks in liquidation in monetary statistics; and reviewed the implementation of recommendations made by the monetary statistics mission of June–July 1999. The mission revised monetary data compilation procedures to account for recent institutional and accounting developments in the financial sector and further advanced the preparatory work for the introduction of a country page for Bosnia and Herzegovina in *International Financial Statistics (IFS)*.

D. Government Finance

5. Until recently, the responsibility for compiling country-wide GFS was still unclear. However, the Governor of the CBBH has agreed that the CBBH undertake the responsibility of compiling country-wide estimates of GFS. In this connection, the Research and Development Department of the CBBH will start consolidating annual GFS data from both Ministries of Finance beginning with annual data for 2000.