

Pursuant to Article 1, paragraph (6), Article 5, paragraph (1) item b) and Article 6 of the Law on the Fiscal Council of Bosnia and Herzegovina (*Official Gazette of BiH*, 63/08), the Council of Ministers of Bosnia and Herzegovina, the Government of Republika Srpska and the Government of the Federation of Bosnia and Herzegovina hereby c o n c l u d e the following

AGREEMENT ON ADOPTION OF THE GLOBAL FRAMEWORK OF FISCAL BALANCE AND POLICIES IN BOSNIA AND HERZEGOVINA 2020-2022 BETWEEN THE COUNCIL OF MINISTERS OF BOSNIA AND HERZEGOVINA, THE GOVERNMENT OF REPUBLIKA SRPSKA AND THE GOVERNMENT OF THE FEDERATION OF BOSNIA AND HERZEGOVINA

Stating the competencies of the Fiscal Council of Bosnia and Herzegovina stipulated by the Law,

Seeking to improve fiscal policy coordination in Bosnia and Herzegovina,

Appreciating the need for timely preparation of the 2020 budget,

Aiming at fulfilment of one of the fundamental competencies of the Fiscal Council of Bosnia and Herzegovina and achieving macroeconomic stability and fiscal sustainability of all levels of governance, the Parties agreed as follows:

I

The Council of Ministers of Bosnia and Herzegovina, the Government of Republika Srpska and the Government of the Federation of Bosnia and Herzegovina hereby adopt the document entitled *Global Framework of Fiscal Balances and Policies in Bosnia and Herzegovina 2020-2022* which was accepted at the 1st session of the Fiscal Council held on 27 December 2019.

II

The Global Framework of Fiscal Balance and Policies in Bosnia and Herzegovina 2020-2022 determines 2020, 2021 and 2022 budgets in the amount of 996 million BAM, including allocation of revenues from indirect taxes in the amount of 780 million BAM.

III

The Global Framework of Fiscal Balance and Policies in Bosnia and Herzegovina 2020-2022 shall be the integral part of this Agreement.

**Chairman
of the Council of Ministers
of BiH**

Dr Zoran Tegeltija

Number: _____

**President
of the Government
of Republika Srpska**

Radovan Višković

Number: _____

**Prime minister
of the Government
of the Federation of BiH**

Fadil Novalić

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**BOSNIA AND HERZEGOVINA
FISCAL COUNCIL**



**GLOBAL FRAMEWORK OF FISCAL BALANCE AND
POLICIES IN BOSNIA AND HERZEGOVINA**



Sarajevo, December 2019

List of abbreviations

GFFBP-Global Framework of Fiscal Balance and Policies

BiH-Bosnia and Herzegovina

DEP-Directorate for Economic Planning

MEAD-Macroeconomic Analysis Department

VAT-Value Added tax

SA-Single Account

ITA-Indirect Taxation Authority

RS-Republika Srpska

BD-Brčko District

BFD-Budget Framework Document

Q (1, 2, 3, 4)-Quarter (1, 2, 3, 4)

DG ECFIN- Directorate-General for Economic and Financial Affairs of EU

EU-European Union

GDP-Gross Domestic Product

EUROSTAT-Statistical Office of the EU

ECB-European Central Bank

CPI-Consumer Price Index

IMF-International Monetary Fund

EC-European Commission

CAM-Capital Adequacy Ratio (of a bank)

NPL-Non-performing Loan

CB BiH-Central Bank of Bosnia and Herzegovina

CA-Current Account

UNCTAD-United Nations Conference on Trade and Development

FDI-Foreign direct investments

WPP-Wind power plant

UK-United Kingdom

CEFTA-Central European Free Trade Agreement

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SUMMARY

The Global Framework of Fiscal Balance and Policies in Bosnia and Herzegovina 2020-2022 (GFFBP 2020-2022) comprises three chapters. Chapter 1 of the present document is based on macroeconomic indicators and projections for the 2020-2022 period prepared by the Directorate for Economic Planning of Bosnia and Herzegovina (DEP) with a special focus on macroeconomic indicators directly influencing fiscal policy elements, in particular public revenues level. In accordance with DEP prognosis, in case of maintained favourable external environment and continuation of intensive structural reforms, the real GDP growth in the 2020-2022 period is expected at the level of 3.7 per cent, 3.8 per cent and 4.0 per cent, respectively.

Chapter 2 discusses indirect taxes revenues, their level and structure in the previous year and projections for the following medium term period prepared by the Indirect Taxation Authority Government Board Department for Macroeconomic Analysis (MEAD). It also includes elements of distribution of these revenues between different fiscal entities in BiH based on the applicable regulations.

In 2018, total collected revenues amounted to 6.220.8 million BAM or 78.2 million BAM more than in 2017. Projections were exceeded in view of VAT revenues and revenues from excise duties on tobacco due to positive trends in VAT collection in the last quarter of 2018 and changes in the cigarettes market structure in favour of imported cigarettes, which resulted in changes to the scheme of collection of revenues from excise duties.

In accordance with the stated revenue developments, observing the necessity of decreasing total public spending in BiH and the needs and competencies of all Institutions in BiH, the envisaged amount of funds for financing the Institutions of BiH derived from indirect taxes revenues for 2020, 2021 and 2022 is 780 million BAM. The remaining amount of indirect taxes revenues will be distributed in accordance with applicable regulations.

BiH fiscal goal for 2020 is a primary surplus expressed in accordance with the Law on the Fiscal Council of BiH as the difference between current revenues and current expenditures corrected by net interest which is planned in the amount of 289.3 million BAM or 0.8 per cent of the projected GDP for 2020.

The level of public spending as a part of GDP in 2020-2022 should be decreased with the aim for the consolidated public spending at the level of BiH to remain below 40 per cent of GDP, while it will be in the range between 40.3 and 37.2 per cent of the estimated GDP in the 2020-2022 period.

Upper limits of budget indebtedness in 2020, expressed as the amount needed for total debt servicing or GDP percentage, depending on the legal solution, is estimated within frameworks prescribed by the laws regulating borrowing for each level of governance.

INTRODUCTION

The Law on the Fiscal Council of Bosnia and Herzegovina¹ (hereinafter referred to as: the Law) established the Fiscal Council of Bosnia and Herzegovina in 2008 with the aim of coordinating the fiscal policy in order to ensure macroeconomic stability and fiscal sustainability of Bosnia and Herzegovina, the Federation of Bosnia and Herzegovina, Republika Srpska and Brčko District of Bosnia and Herzegovina.

Pursuant to the Law, this body is charged with coordinating fiscal policy in BiH and is competent for adoption of the proposal of the document entitled “Global Framework of Fiscal Balance and Policies in BiH”. The Counselling Group comprising representatives of the Ministry of Finance and Treasury of Bosnia and Herzegovina, Federal Ministry of Finance, Ministry of Finance of Republika Srpska and the Finance Directorate of Brčko District of Bosnia and Herzegovina prepares and submits the GFFBP proposal to the Fiscal Council comprising Chairman of the Council of Ministers of BiH, prime ministers, state, federal and the Minister of Finance of RS and the Governor of the Central Bank and the Mayor of BD as observers².

The Global Framework of Fiscal Balance and Policies in BiH represents the most important document of fiscal coordination. It includes the following:

- ✓ Proposal of BiH Institutions, Federation of BiH, RS and Brčko District fiscal budget goals;
- ✓ Proposal of macroeconomic projections;
- ✓ Program scenario of revenues from indirect taxes;
- ✓ Proposal of distribution of indirect taxes revenues for the following fiscal year, and
- ✓ Proposal of the upper limit of indebtedness of BiH Institutions, Federation of BiH, RS and Brčko District.

In accordance with the above stated, the main objectives of the GFFBP are as follows: to define macroeconomic prognosis for Budget Framework Documents and budgets of the state, Entities and Brčko District, to establish indirect taxes revenues and their distribution and to define the total debt level.

Therefore, GFFBP establishes a comprehensive framework for individual BFDs and the macroeconomic projections underlining BFDs are based on GFFBP.

BiH GFFBP 2020-2022, prepared in accordance with the Law, includes all the above stated elements. Agreement upon these elements represents a precondition of budget planning by the bearers of fiscal policy in BiH, i.e. the essence of the overall fiscal coordination in BiH.

¹ *Official Gazette of BiH*, 63/08

² The Fiscal Council is not an independent guardian as is the case in certain EU members. It is a coordinating body establishing the basis on which the state, FBiH, RS and BD prepare their own budgets.

I BiH MACROECONOMIC FRAMEWORK

The table below presents estimates and projections of macroeconomic indicators in BiH up until end-2022 representing the basis for preparation of indirect taxes total revenues projections. These are elaborated in detail later in this document, including potential risks to achievement of the projected macroeconomic scenario.

Table 1.1. BiH macroeconomic indicators (official data for 2017, the latest available data for 2018 and 2019-2022 projections)

Indikator	Zvanični podaci*		Projekcije			
	2017	2018	2019	2020	2021	2022
Nominalni BDP u mil KM	32.326	34.016	35.346	36.893	38.720	40.699
Nominalni rast u %	4,1	5,2	3,9	4,4	5,0	5,1
BDP deflator (prethodna godina = 100)	101,1	101,6	100,9	100,8	101,3	101,3
Realni BDP u mil KM (prethodna godina = 100)	31.986	33.490	35.041	36.590	38.226	40.185
Realni rast u %	3,0	3,6	3,0	3,5	3,6	3,8
Inflacija mjerena indeksom potrošačkih cijena u %	1,3	1,4	1,0	1,2	1,4	1,5
Potrošnja u mil KM	30.852	32.106	32.992	33.982	35.027	36.268
Realni rast u %	1,0	2,2	1,6	1,6	1,7	1,8
Vladina potrošnja u mil KM	6.369	6.611	6.776	6.918	7.056	7.268
Realni rast u %	1,5	0,9	1,0	0,6	0,5	0,5
Privatna potrošnja u mil KM	24.482	25.496	26.216	27.064	27.971	28.999
Realni rast u %	0,8	2,5	1,8	1,9	2,0	2,1
Investicije (bruto) u stalna sredstva u mil KM	5.653	6.310	6.857	7.556	8.240	9.095
Realni rast u %	5,8	9,2	8,3	9,7	8,9	8,8
Vladine investicije u mil KM	728	859	954	1.240	1.450	1.653
Realni rast u %	1,4	15,4	9,4	28,1	15,3	11,2
Privatne investicije u mil KM	4.924	5.451	5.903	6.316	6.790	7.442
Realni rast u %	6,4	8,3	8,1	6,7	7,6	8,3
Uvoz u mil KM	17.701	18.635	19.476	20.799	22.420	24.344
Nominalni rast u %	13,2	5,3	4,5	6,8	7,8	8,6
Realni rast u %	7,7	3,2	2,5	4,2	5,6	5,0
Izvoz u mil KM	12.574	13.559	14.291	15.466	17.084	18.845
Nominalni rast u %	18,0	7,8	5,4	8,2	10,5	10,3
Realni rast u %	11,8	5,9	3,4	6,0	7,5	7,1
Nacionalna bruto štednja u % BDP-a	15,9	16,5	17,2	18,0	19,2	20,1
Bilans tekućeg računa u mil KM	-1.473	-1.376	-1.470	-1.609	-1.605	-1.763
Rast u %	6,2	-6,6	6,9	9,5	-0,3	9,8
Bilans tekućeg računa u % BDP-a	-4,6	-4,0	-4,2	-4,4	-4,1	-4,3

*Posljednji revidirani raspoloživi podaci.

Source: DEP, BFD-Macroeconomic projections 2020-2022, September 2019.

1.1. Real sector

1.1.1. BiH GDP developments in 2018 and projections for 2019

In accordance with the official BHAS data (national accounts statistics), the real GDP growth in BiH in 2018 was 3.6 per cent (measured in accordance with the expenditures method), representing continuation of the economic growth trend in the previous years. This economic growth is achieved as the result of strengthened domestic and export demand due to markedly favourable external economic environment. Bearing in mind the structure of BiH economy within which final spending and investments represent key economic growth components, it is reasonable to expect that the same stand for the highest contribution to the economic growth in 2018. Along these lines, in 2018, final spending increased by 2.2 per cent and contributed to the economic growth at the level of 2.1 percentage points. At the same time, investments and their contribution to the economic growth increased by 9.2 per cent and 1 percentage point, respectively. On the other hand, favourable international economic environment in 2018 resulted in increases in total export by approximately 6.0 per cent and in import by 3.2 per cent, which finally led to decrease in the trade deficit by 3.6 per cent and positive contribution to the economic growth at the level of 0.5 percentage points³.

In accordance with preliminary data of BHAS on the statistics of national accounts, expenditures method, it is estimated that in Q1, BiH achieved a 2.3 per cent economic growth in comparison with the same period of the previous year, while the seasonally adjusted value was 0.6 per cent⁴ in comparison with Q4 2018. This represents continuation of the economic growth trend recorded in the previous year, while the registered growth rate was somewhat lower in comparison with the previous year. Deceleration of BiH economic growth trend in comparison with the previous year is largely a consequence of wakened economic developments in the international economic environment in the first half of 2019 which resulted in deceleration of gross domestic product, predominantly in the European Union (EU) countries. Namely, in accordance with preliminary EUROSTAT data for the first half of 2019, economic growth in EU28 countries was 1.5 per cent lower than in the same period of the previous year. This represents a significantly lower growth rate in comparison with the previous year. If observed by countries, the most significant weakening of economic growth in the first half of 2019 was recorded in Germany and Italy, where registered growth rates amounted to 0.7 and -0.1 per cent, respectively, in comparison with the same period of the previous year⁵.

On the other hand, if BiH economic growth is observed on the basis of available data (national accounts for Q1 2019 and short-term economic indicators for the first half of 2019), the first signs of deceleration of GDP growth in comparison with the previous year are obvious. Namely, the 2.3 per cent economic growth in Q1 2019 is significantly lower than the Q1 2018 rate when the growth was registered at the rate of 3.1 per cent. Bearing in mind that the external environment represented one of the key determiners of BiH economic growth in the previous period, it is not difficult to conclude that the deceleration in 2019 is the direct consequence of weakened economic activity in the EU countries.

Available short-term data on BiH economic criteria in the first half of 2019, such as decrease in the industrial production index of 4.5 per cent, goods import stagnation -0.1 per cent, slower employment growth in comparison with the previous year and the low level of construction works indicate

³ BHAS, announcement entitled *2018 BiH gross domestic product, expenditure method, first results*, 23 July 2019.

⁴ BHAS, announcement entitled *Gross domestic product, expenditure method and data for a three-month period*, 28 June 2019.

⁵ EUROSTAT, news release *GDP main aggregates and employment estimates for second quarter 2019*, 137/2019.

deceleration of economic growth by the end of 2019. It is worth noting that negative consequences of weakening external economic activities in are far more obvious in export-oriented processing industries and export of goods from Bosnia and Herzegovina. Therefore, end-2019 DEP projections expect that the total export growth will be by 3.4 per cent lower, i.e. significantly lower than in the previous year. Despite weakened export demand, it is expected that the export of goods will increase by 2.5 per cent (twice lower growth rate than in the previous year), while at the same time it is expected that the export of services will increase by about 6 per cent. On the other hand, if the pretty non-elastic BiH private spending structure by the end-2019 is observed, it can be expected that the trend of import growth will be 2.5 per cent in the end of 2019. In view of the significantly higher import basis, this approximation of export and import growth rates would result in mild increase of the foreign trade deficit and neutral contribution of foreign trade to economic growth.

However, despite weakening indicators in the production-export sector, it is expected that in the end of 2019 BiH domestic demand (expenditure and investments) will result in the economic growth of about 3 per cent in comparison with the previous year⁶. Since private spending amounts to approximately 75 per cent of GDP in BiH, it may be concluded that developments under this component essentially determine developments of economic growth in the country. Therefore, on the basis of indicators such as a Q1 2019 1.6 per cent growth in the number of employed and retired persons, as well as their income (although still very modest) and current foreign inflow, it is expected that private spending might increase by 1.8 per cent by the end of 2019. It is expected that this private expenditure growth will be accompanied by public spending growth of 1 per cent, which should result, by the end of the year, in the increase of final spending by 1.6 per cent. In addition to increased spending, it is expected that in 2019, increase in investments of 8.3 per cent through investments of private and public sector should contribute to the expected economic growth during 2019.

The expected private investment growth and public investment growth at the rate of 9.0 per cent, as the result of increased implementation of projects in electric energy sector and transport infrastructure will surely have a positive impact on GDP growth. Of course, it should be noted that the share of public investments in total investments as well as in GDP is rather modest and that the public investments growth rate is prone to frequent oscillations. The stated oscillation should be connected to their financing sources. The largest share in financing investment projects comprises of foreign financing sources (credits and grants). When it comes to domestic financing sources, these relate to budget funds and in smaller part to own funds of participants in project implementation.

1.1.2. 2020-2022 GDP developments assumptions

Referent international institutions dealing with economic growth projections such as IMF, WB and EC announce overcoming of global economic challenges such as trade disputes and BREXIT, limiting economic growth strengthening in the 2020-2022 period. Therefore, in accordance with the latest available IMF projections, this period is expected to record the average economic growth of the world economy at the rate of more than 3.0 per cent on an annual level, while the prognosis for the rate of EU countries' economic growth is around 2.0 per cent. The more favourable external environment and the improved business environment in the country should represent preconditions of the 2020-2022 economic growth projections in BiH.

In this regard, it is projected that BiH economy will grow in 2020 at the rate of 3.5 per cent, while the growth rates in 2021 and 2022 should be 3.6 and 3.8 per cent, respectively. It is assumed that domestic demand will support to the economic growth during this period. Namely, increased total economic

⁶ DEP projection, September 2019

activity in the country, in addition to the expected increase in industrial production and civil works, accompanied by increased employment and export revenues, as well as increase in foreign inflows should result in increase in available income of citizens and thus in private consumption that will provide key support to economic growth as this was the case in previous years. Therefore, it is expected that the 2020-2022 private spending will grow at the rate of 2% (2020: 1.9 per cent, 2021: 2.0 per cent, 2022: 2.1 per cent). On the other hand, bearing in mind the high level of public spending under GDP in BiH and activities invested through fiscal consolidation process, it is expected that this period will see gradual stabilisation of public finance through decreasing of public expenditures and simultaneous increase in public revenues in order to limit public spending growth. Therefore, it is expected that the 2020-2022 private spending will grow at the rate of 0.5% (2020: 0.6%, 2021: 0.5%, and 2022: 0.5%). If taken into account that this period should see the projected economic growth rate would be higher than public expenditure growth, its share in GDP would decrease from current 19.4 per cent to 17.9 per cent in the end of 2022.

In comparison with previous years, investments could grow more significantly during this period, therefore contributing more to GDP growth. It is expected that total investments will increase at an average annual growth rate of 9 per cent between 2020 and 2022 (2020: 9.7%, 2021: 8.9%, and 2022: 8.8%). Although this investments growth rate might seem optimistic, it is worth noting that investments are still moderately represented in BiH GDP structure at only 18 per cent. It is expected that private investments, representing a major portion of total investments (approximately 80 per cent of total investments) will increase during this period, in addition to a more significant contribution of public investments. It is considered that the expected status of an EU candidate country, in addition to improvement of business environment through reform processes could spark interest of both domestic and foreign investors for investments in BiH. At the same time, in view of BiH economy structure and position, it is regarded that public investments will encourage economic growth in the medium term. Road infrastructure construction projects and projects in energy sector, as well as availability of funds of international financial institutions would, with adequate and timely implementation, could result in increased public investments at the rate of more than 15 per cent at an annual level. Therefore, public investments level under GDP in BiH should increase, as well.

Favourable external environment and improved industrial base and increased competency in BiH represent key preconditions of projections of external trade exchange with the world. In addition to an enviable degree of implementation of stated assumptions in the 2020-2022 period, it is expected that the external trade exchange with the world will increase. It is expected for the import to grow at an average rate of approximately 7 per cent, at which the projected increase in goods and services would be mostly balanced. Therefore, as the result of export growth, the share of export in GDP would rise from 40 per cent in 2020 to 46 per cent in the end of 2022. At the same time, it is expected for export to develop at a somewhat slower rate of 4.9 per cent in the same period. More significant growth of import of goods (average annual growth rate of import of goods is 4.9 per cent) in comparison with growth of import of services (average annual growth 2.6 per cent) in view of expected private spending growth and in particular investments which are in the most part fed by import of goods. As the result of import growth, the share of import in GDP should increase from 55 per cent of GDP in 2020 to approximately 60 per cent in the end of 2022. Slightly stronger growth of import in comparison with growth of import in the medium term should result in gradual decrease in foreign trade deficit, i.e. its gradual stabilisation as a share in GDP at the rate of approximately 14 per cent. Under assumption of implementation of a basic scenario of economic developments in the neighbouring countries and BiH during the observed period, it is expected that the import-export coverage ratio will increase and reach the rate of approximately 77 per cent.

Risks related to achievement of stated projections may be classified into two groups, foreign and domestic. Currently available, but non-conclusive research by international institutions imply weakening of economic activity and business confidence, i.e. economic expectations in 2019. Materialisation of these risks, as well as the possibility for the same to continue in the medium term is the biggest risk to the basic scenario presented in this report. On the other hand, domestic challenges, i.e. BiH domestic risks BiH pose a more significant threat. Domestic risks are represented by the complicated decision-making process and slow dynamics of implementation of economic reform. Possible delays in formation of government and implementation of reforms might have an adverse impact on the planned dynamics of public investments implementation, which would surely have an impact on total economic growth.

When it comes to medium term risks for the 2020-2022 period, these relate to migration of BiH population, especially young, educated and qualified human resources, which might result in decreased productivity and slower-than-projected GDP growth.

1.2. Industrial production 2019 - 2022

In accordance with preliminary BHAS 2018 data, the physical volume of industrial production grew at the rate of 1.6 per cent in comparison with the previous year and was accompanied by increase in the number of employed persons under the same⁷.

However, if the physical volume of industrial production is observed more closely, it is not difficult to conclude that this growth rate was twice lower in comparison with the previous year when the growth rate was registered at 3.1 per cent. This is the consequence of weakened economic activity in the external environment in the second half of the year, which resulted in stagnation of BiH processing industry. This trend of weakening of industrial production continued in the first half of 2019. Namely, in accordance with available BHAS Q1 2019 data, BiH saw decrease of the physical volume of industrial production by 4.5 per cent in comparison with the same period of the previous year. This enabled continuation of a very unfavourable trend of weakening of the physical volume of industrial production in BiH during each month of the first half of 2019⁸. Although this decrease at the level of the period is partially a consequence of a markedly high basis from the previous year, it seems that evident slowing down of economic activity in main trade partners such as Germany and Italy was the key reason. Overview of industrial production across sectors is not significantly different than BiH total industrial production developments since a decrease in production is recorded in all sectors. The most important production decrease was recorded in the electric energy production sector, at the rate of 12.4 per cent, while decrease in mining and processing industries was at the level of 2.9 and 1.8 per cent. These industrial sector developments are a consequence of an unfavourable processing industry characterised by a low level of production of low technology intensity products which mainly depend on market developments in main trade partners. Therefore, industrial production developments by the end of 2019 will depend on developments in these trade partners and possible improvement of production in the electric energy production sector in Bosnia and Herzegovina.

In accordance with available projections of referent international institutions in the 2020-2022 period, it is expected for economic condition to stabilise in both closer and wider international economic environment. It is therefore expected that these international developments should have a positive implications in the region and consequently in BiH. These external developments, in addition to

⁷ BHAS, announcement entitled *Bosnia and Herzegovina industrial production volume index*, 25 January 2019.

⁸ BHAS, announcement entitled *Bosnia and Herzegovina industrial production volume index for June, 2019-Preliminary data*, 25 July 2019.

internal dynamics reflected in improvement of business environment should result in increased production in BiH processing industry which is highly export-oriented. This will require increase in investments (foreign and domestic), higher usage of capacities, increased employment and finally increase in the physical volume of industrial production in BiH. In addition, planned infrastructure and energy investments should significantly contribute to strengthening of both BiH construction sector and closely related industries. Likewise, it is expected that the energy sector, which was one of the pillars of industrial production in the previous period, will continue to positively influence production growth and strengthening of industrial production in BiH in the stated period. Bearing in mind all the stated circumstances, BiH might expect to see higher growth rates of the physical volume of industrial production, as well as more significant contribution to total economic growth rates in the country. In addition to general risks to total BiH economy, there are significantly high levels of representation of the electric energy sector in industrial structure, unfavourable weather conditions and outdated production capacities.

1.3. BiH labour market

On the basis of available data on basic indicators in the labour market, the average number of employed persons in the first half of 2019 continued to grow (2.3 per cent) in comparison with the same period of 2018 and amounted to 815.7 thousands⁹. Although the number of employed persons grew in all areas of activity, the most significant contribution to the significant growth rate in BiH was sparked by trade activities. In the area of wholesale and retail sale, reparation of motor vehicles and motor cycles, the number of employed persons increased by 2.4 per cent annually¹⁰. In the processing industry which employs the largest number of persons in Bosnia and Herzegovina, the number of employed persons grew at a slow rate (0.9 per cent annually) in the first half of 2019.

The stated growth rate was much slower in comparison with the same period of the previous year as a consequence of developments in the processing industry (see the chapter on industrial production)¹¹. Increase in the number of employed persons, the number of unemployed persons in BiH decreased. In the first half of 2019, the average number of registered unemployed persons in BiH was 418.8 thousands and is by 9.3 per cent smaller in comparison with the same period of 2018. Intensive decrease in the number of registered unemployed persons affected the lower unemployment rate. Unemployment survey rate for 2019 is at the level of 15.7 per cent. The average net salary in BiH in the first half of 2019 was 911 BAM and is nominally higher by 5.1 per cent in comparison with the same period of 2018. Due to the total level of prices, the real growth of average net salary is somewhat slower at the rate of 4.2 per cent. Bearing in mind the developments in the labour market in the first half of 2019 may be assumed that by the end of the year, the number of employed persons might be by 2.2 per cent bigger with the nominal average net salary growth at the rate of 5 per cent.

Developments in the market labour in 2020 will determine the business environment, in Bosnia and Herzegovina, in the region and in the EU. In accordance with ECB projections (June 2019) and EC projections (spring 2019), the rate of unemployment in EU and the euro area should be lower than in 2020, in addition to the growth in the number of employed persons. Since the growth in processing industry and trade in BiH employees the biggest number of persons (approximately 39%), assumptions of developments in processing and trade industries were taken into account in preparation of

⁹ Preliminary data. Source: BHAS, employed persons per business activities.

¹⁰ Out of the total number of employed persons in BiH, 18.5 per cent are employed in the stated activity.

¹¹ In the period between Q1 2019 / Q1 2018, the number of employed persons in the processing industry decreased by 0.4 per cent.

projections of the number of employees. In addition, the level of investments affects the intensity of employment growth. In accordance with DEP projections, it is expected that the volume of investments and trade, but also of industrial production, will increase. All of the above stated could affect the growth in the number of employed persons in BiH at the rate of 2.4 per cent annually, in addition to continuation of a gradual decrease of the unemployment rate. The average net salary in 2020 could increase by 3.3 per cent annually¹².

Preparation of a medium term scenario 2021-2020 in the area of labour market is based on the expected economic growth in the observed period, i.e. the level of spending, trade and investments. In their projections for 2021, the ECB predicts that the unemployment rate in the euro zone will decrease to 7.3 per cent, in addition to increase in the number of employed persons by 0.6 per cent. The predicted investment and trade growth in BiH should positively affects the number of employed persons, especially in the sectors that employed the biggest number of persons in the previous years. In addition to positive developments in industry, trade, as well as in certain service industries would create realistic preconditions for the growth of the number of employed persons in the observed activities. It is expected that the contribution to the increase in the number of employed persons could be more modest in the public sector¹³ in comparison with all the other areas of activities. In general, it is expected that the positive business environment in both BiH and the region and the EU countries will contribute to increase in the number of employed persons by approximately 2.5 per cent annually, in addition to continuation of the gradual net salary increase trend at the level of 3.4 - 3.5 per cent annually.

Developments in the labour market are determined by the economic growth, i.e. Business environment and labour demand in BiH, the region and in the EU. Therefore, in case of negative divergences in projections in the area of industrial production, trade and investments, this would affect the dynamics of growth in the number of employed persons and salaries. In addition, implementation of planned structural reforms in BiH could affect creation of new jobs and increase in salaries, i.e. improvement/worsening of purchase power and living standards. At the same time, all stated changes represent basic risks to projections in the labour market in the basic scenario.

1.4. Prices in the medium term

Prices growth in BiH continued in 2019, although at a rate slower than the rate in the previous year. Between January and July 2019 and January and July 2018, inflation was registered at the rate of 0.8 per cent. If observed in terms of sections related to purpose of spending, the most significant growth rates were recorded in the section of alcoholic beverages and tobacco (4.4 per cent), housing, water, electric energy, natural gas and other energy generating products (2.9 per cent), transport (2.5 per cent) and food and non-alcoholic beverages (1.2 per cent). Since 1 January 2019, the excise duties on tobacco and cigarettes continued to increase¹⁴ due to alignment of the policy with the EU regulations. This resulted in the growth of prices in the section of alcoholic beverages and tobacco.

¹² The level of average net salary 2020-2022 could increase depending on labour demand (retaining quality and deficient labour).

¹³ The analysis relates to public administration, health and education activities.

¹⁴ Increase of excise duties on cigarettes and tobacco since 1 January 2019. Minimal excise duty on a pack of 20 cigarettes is 2.86 BAM, while the specific excise duty for the same package is 1.65 BAM. Excise duty on smoking tobacco is established at the rate of 80 per cent of a minimal excise duty on cigarettes determined in Article 3, paragraph (3) of this Decision, stated for 1000 cigarettes, and amounts to 114.40 BAM per kilogram. Source: Decision on determining the specific and the minimal excise duty on cigarettes and the amount of excise duty on smoking tobacco for 2019.

Growth of prices in the section of transport was slower in comparison with the same period of the previous year and was largely determined by oil and gas prices. Growth of prices in the section of housing, water, electric energy, natural gas and other energy generating products contributed to growth of liquid and solid fuel, natural gas and housing rents. Although the section of food and non-alcoholic beverages recorded a somewhat slower growth (in comparison with the previously stated sections), their contribution to the total inflation growth was not negligible due to large share in CPI. Therefore, it might be assumed that in 2019, inflation in BiH will be somewhat lower than in the previous year, at the rate of approximately 1 per cent.

Observing the historical growth of prices in Bosnia and Herzegovina, it can be concluded that it is predominantly determined by changes in the crude oil prices on the global market, prices of food, excise duties in certain products, prices of utilities, etc. This is why the projections of inflation in 2020 are based on the assumption on developments in prices of the said products. Projections of WB¹⁵, IMF¹⁶, as well as EC summer projections show decrease in the crude oil prices in 2020. In accordance with EC projections, crude oil price in 2020 should decrease in comparison to 2019 by approximately 4.9 per cent and amount to 61.5\$/barrel, while inflation in the EU is projected at the level of 1.6 per cent. In addition, prices of food, in accordance with IMF projections, could be by 2.1 per cent annually higher in the observed year. For projections of inflation in BiH in 2020, the possible continuation of excise policy in view of cigarettes and tobacco is possible. Assuming the prices of utilities and food remain stable in BiH, it can be expected that the inflation will be recorded at the rate of 1.2 per cent.

On the basis of available data on world prices, it might be expected that the inflation in BiH will grow moderately in the period between 2020 and 2021. In accordance with the ECB projections, it can be expected that the inflation in euro zone will be at the rate of 1.6 per cent, where the price of crude oil (brent) could be 62.7\$/barrel, i.e. by 4.7 per cent lower than in 2020. At the same time, in accordance with the WB summer projections, the food prices index could grow at the rate of approximately 1.7 to 1.8 per cent annually in 2021 and 2022. Bearing in mind stable utility prices, it can be expected that the inflation in BiH in the observed years will be recorded at the rate of 1.4 to 1.5 per cent.

As in previous years, inflation projections in the basic scenario are based on crude oil prices developments as an external factor which significantly determines prices developments in BiH. In addition, domestic factors determining inflation, such as excise duties on certain products, utility prices, etc. should likewise be taken into account. Therefore, in case crude oil prices diverge in the period between 2020 and 2022 more than assumed in the basic scenario, this would be reflected in the level of inflation. At the same time, unannounced increase in prices of certain product and utilities might affect the inflation growth. Continuation of implementation of excise duties on cigarettes and tobacco will also determine the growth of prices in BiH.

1.5. Bank loans and deposit growth prognosis

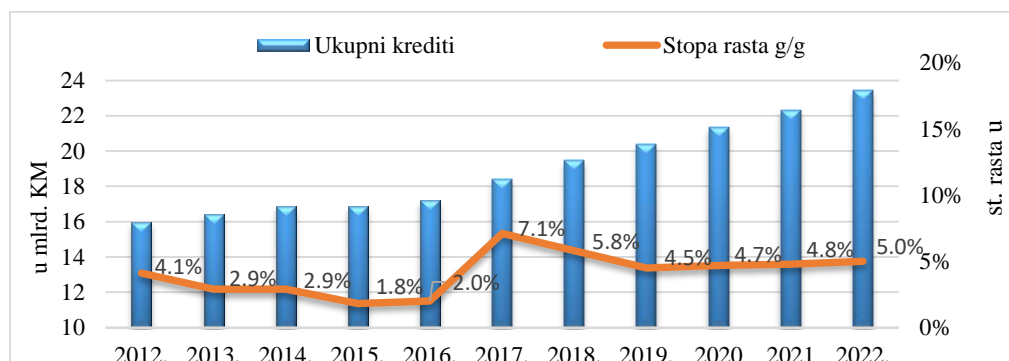
By the end of 2018, loan activity grew at the rate of 5.8 per cent annually and achieved the amount of 19.5 billion BAM. At the end of July 2019, the growth rate was 5.3 per cent annually, while the total loan sum amounted to 20.2 billion BAM. All sectors contributed to growth, while the biggest in value at the end of July were loans to citizens which amounted to 9.7 billion BAM and the growth rate of 7.6 per cent annually, followed by loans to non-financial enterprises amounting to 9.4 billion BAM and the growth rate of 4.3 per cent annually. Expected global economic growth deceleration accompanied by deceleration of economic growth in BiH results in the assumption of further deceleration of loan

¹⁵ April 2019 projections

¹⁶ WEO, July 2019

growth. Therefore, it is estimated that by the end of 2019, total loans would grow at the rate of less than 4.5 per cent annually (in comparison with the end of the previous year). It is expected that 2020 will bring stabilisation with a somewhat higher growth projection rate of 4.7 per cent annually. Likewise, 2021 is expected to bring faster growth, at the rate of 4.8 per cent annually, while the rate of 5.0 per cent annually is expected in 2022.

Figure 1: Total loans (in billion BAM, end of period) and annual change rate in billion BAM



Source: DEP

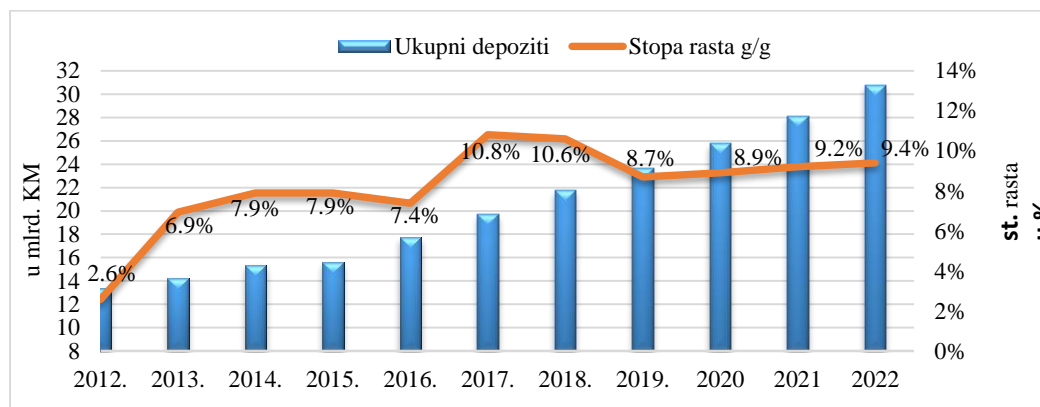
At the end of 2018, the total deposit growth rate was 10.6 per cent annually. Growth rate was gradually decelerating from the beginning of 2018 and reached 8.9 per cent annually, amounting to 22.8 billion BAM at the end of July 2019. The largest portion of the said amount were deposits to citizens amounting to 12.7 billion BAM and the growth rate of 8.9 per cent annually, while deposits to non-financial enterprises amounted to 5.3 billion BAM with the growth rate of 5.3 per cent annually.

Somewhat smaller rates of economic growth, both globally and in BiH, create a precondition for a projection of a decelerated deposit growth in 2019, with the expected rate of 8.7 per cent annually. The following years might bring accelerated economic growth which would bring better results in the banking sector (improvement of financial indicators CAR¹⁷, NPL¹⁸). This would create realistic preconditions for higher growth rate of total deposits. It is expected that growth rates will be 8.9, 9.2 and 9.4 per cent annually in 2020, 2021 and 2022, respectively.

¹⁷ CAR- Capital Adequacy ratio

¹⁸ NPL-Non-performing loans

Figure 1.2.: Total deposits (in billion BAM, end of period) and annual change rate In billion BAM



Source: DEP

Further worsening of geopolitical conditions and consequently of crisis on the energy market, trade war between USA and China and deceleration and drop in economic activity in the EU, caused by the extended *BREXIT* crises would certainly affect the banking market as well. Instability and more difficult operations in the banking system would manifest in decrease of the total loan activity and thus in decreases in the volume and deposit growth rates.

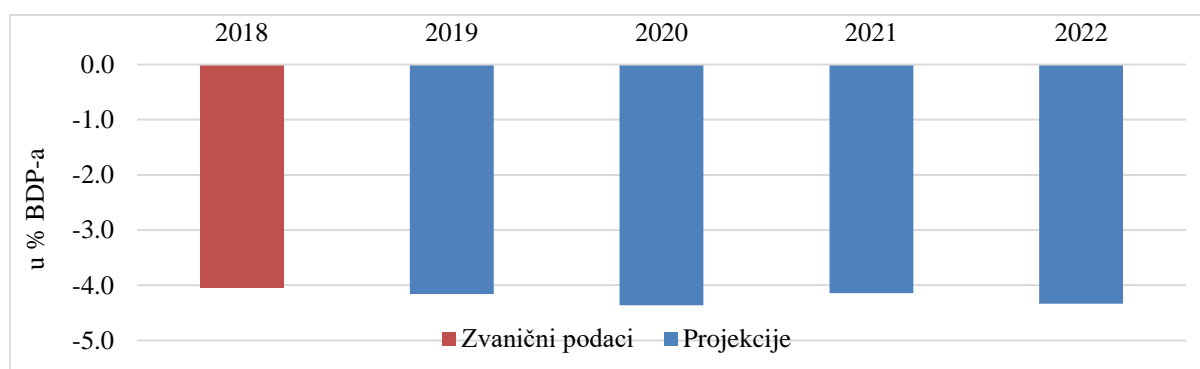
1.6. Foreign sector

1.6.1. BiH 2019-2022 payment balance

In accordance with the official BiH payment balance data for Q1 2019 and DEP projections for Q2, Q3 and Q4 of 2019, the current account deficit under BiH payment balance would amount to 1.5 billion BAM, thus representing increase by 7 per cent (annually). This increase in the current account deficit would predominantly be the result of deceleration of economic activities in the EU, and thus a diverse impact on the foreign trade exchange of goods and services of BiH.

In Q1 2019, the current account deficit amounted to 477 million BAM, i.e. Increase by 13.2 per cent in comparison with the previous year. This current account deficit increase is predominantly determined by the deficit in foreign trade of goods and services, that is increase in import and export by 4.6 and 2 per cent annually, respectively. Current net foreign inflows in Q1 2019 grew by 9.7 per cent as the result of increase in current inflows by 6.4 per cent (growth on the basis of transfers of citizens from abroad and compensation to BiH residents employed abroad) and decreased outflow of money to abroad by 1.6 per cent (predominantly due to drop in dividends from direct and portfolio investments).

Figure 1.3.: BiH current account deficit projections



Source: DEP

On the basis of DEP projections, the volume of foreign trade exchange in the period between 2020 and 2022 will increase. Therefore, in this period, the foreign trade exchange deficit would record a nominal growth rate of 0.1 to 3.1 per cent as the result of import rate growth (6.8 to 8.6 per cent) and export rate growth (8.2 to 10.5 per cent).

As a share in GDP, the current account deficit for 2019, in accordance with DEP projections, would amount to approximately -4.0 per cent, while it could be expected for it to remain at the approximately same level between 2020 and 2022 (the deficit could range from -4.1 to -4.4 per cent of GDP). It is expected that the current foreign net inflows will range between 9.2 to 10.1 per cent of GDP between 2020 and 2022. As in the previous years, current account deficit financing would be enabled through inflow of financial funds from abroad (through social benefits and transfers from citizens from abroad, direct foreign investments and trade loans and through possible new borrowings on international financial market).

Main risks to changes in BiH payment balance developments for increase or decrease in the current account deficit are posed by foreign trade deficit, more exactly by changes in the rates of import and export of services and changes in the prices on the global market.

The most important risks to the current account deficit financing are posed by decrease in BiH foreign assets abroad, insufficient inflow of direct foreign investments, difficult access to trade loans and inability to borrow in the international financial market.

1.6.2. 2019-2022 foreign trade exchange overview

Increase in economic activity in Bosnia and Herzegovina and more favourable economic developments in main trade partners in 2018 resulted in intensified foreign trade exchange of goods with the rest of the world. The key factors determining the foreign trade exchange of goods in BiH in 2018 were: strengthening of export demand due to improvement of economic opportunities in main trade partners and increase in world prices of certain products such as metals 5.5 per cent and energy-generating products (27.7 per cent). In 2018, BiH therefore recorded increase in the total volume of exchange, import increase by 6.0 per cent and somewhat smaller growth of import by 3.2 per cent which led to decrease in the foreign trade deficit of 3.6 per cent and positive contribution to economic growth of more than 0.5 percentage points.

However, as it was the case with the physical volume of industrial production, foreign trade indicators growth rates in 2018 were twice lower than in comparison with the previous year¹⁹. This is most likely a consequence of weakened export demand caused by deceleration of economic activity in the EU countries in the second half of the previous year. This trend of weakening economic activity, i.e. export demand from the previous year continued in 2019, as it can be clearly seen through the value of foreign trade indicators. Namely, in accordance with BHAS preliminary data for the first six months of 2019, BiH recorded stagnation in import of goods at the rate of -0.1 per cent and increase in the import of goods at the rate of 4.5 per cent, resulting in significant increase in the deficit in goods of more than 10 per cent, while coverage of import by export decreased by 3 percentage points. If we bear in mind that in foreign trade exchange terms BiH is significantly concentrated on markets of the countries in terms of 3/4 of export being placed to the markets of EU countries, while approximately 60 per cent of import originates from the EU, it is not difficult to conclude that economic developments in these countries will determine developments of foreign trade exchange in BiH by the end of 2019. On the basis of currently available projections for the EU, BiH is facing a somewhat slower growth of foreign trade exchange of goods in comparison with the previous year. In accordance with DEP projections, import of goods is expected to grow by 2.5 per cent, while the expected growth of import of goods is almost identical and amounts to 2.6 per cent. Bearing in mind the higher import basis, this balancing of import of goods and import will result in mild increase of the foreign trade exchange deficit, while its contribution to the economic growth should be neutral.

Despite very frequent debates on currency and trade wars and strengthening of protectionism in the world, international institutions such as MMF, SB and EC is that the world economy growth trend should be continued in the 2020-2022 period. Announcements of favourable external developments, in addition to contribution of internal dynamics reflected in improvements in the business environment in BiH, represent the basis of projections of global foreign trade exchange developments. Therefore, it is expected that during this period, real average economic growth will be at a rate higher than 36 per cent, while investments are expected to grow by almost 9 per cent on an annual level. This should result in increased global foreign trade exchange. Increase of production on the side of BiH supply will result in increased export potential within the framework of most branches of export-oriented BiH processing industry, electric energy production sector as well as increase in export of services.

Bearing in mind the stated circumstances, DEP projects that in the 2020-2022 period, BiH might expect real increase in total export of goods at annual rates ranging from 6.1, 7.8 and 7.4 per cent, respectively. On the other hand, the higher level of economic activity will result in increase in domestic demand within the framework of domestic demand in population and corporate sectors, which will result in BiH import increase. It is expected that the rates of import of goods will be somewhat lower than export and should range from 3.9 per cent in 2020, 5.5 per cent in 2021 and 5.0 per cent in 2022. In terms of export and import developments (higher export growth rate), it is expected that foreign trade exchange balance will gradually stabilise at the rate of 14 per cent of GDP. If we observe the longer period, faster import growth rate and increase in its share in GDP in comparison to import will lead to improvement of total export-import coverage ratio, in addition to stabilising the foreign trade exchange balance. Therefore, up to and including 2020, the share of import in GDP should be approximately 46 per cent, while import would stay at the level of approximately 59 per cent. This will result in improvement of total export-import coverage ratio at approximately 78 per cent.

¹⁹ The referent growth rates of foreign trade indicators for 2017 were 11.8 and 7.7 per cent for export and import growth, respectively.

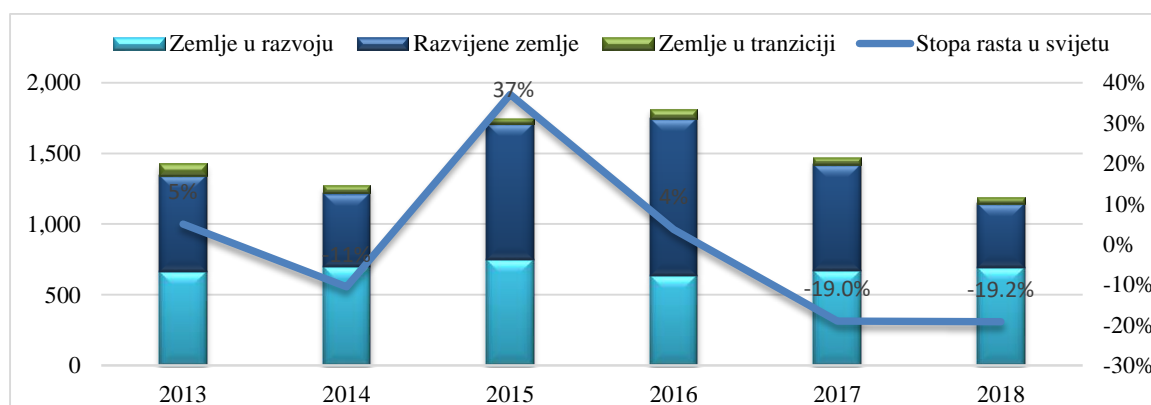
Previously discussed developments might be expected unless one of the following events take place: turbulence in functioning of main BiH trade partners economy, sharp increase in export and import prices of main import and export categories of goods, decrease in industrial production, investments, spending, as well as new natural disasters or any other event that could have a diverse impact on foreign trade exchange.

Other important risks to BiH global foreign trade exchange of goods are currency and trade wars between leading world economies, as well as strengthening of protectionism, especially in the EU market.

1.7. Foreign direct investments

If we observe 2019 current global economic developments, it is evident that the economic growth is decelerating in comparison with the previous year²⁰. Mutual increase in tariffs in the USA and China (further escalation of which was stopped after the G20 summit), in addition to uncertainty of BREXIT and growing geopolitical tensions (in addition to the possibility of sanctions being introduced in the oil market), resulted in insecurities and negative influence on the growth of economic flows²¹. In accordance with the latest UNCTAD data, 2018 global investments decreased by 19.2 per cent annually and the trend is expected to continue in 2019. In accordance with payment balance²² data published by CB BiH, Q1 2019 foreign direct investments (FDIs) amounted to 231.2 BAM (net financial liabilities) and are by 12.4 per cent annually lower.

Figure 1.4.: Total global FDIs in billion USD



Source: DEP

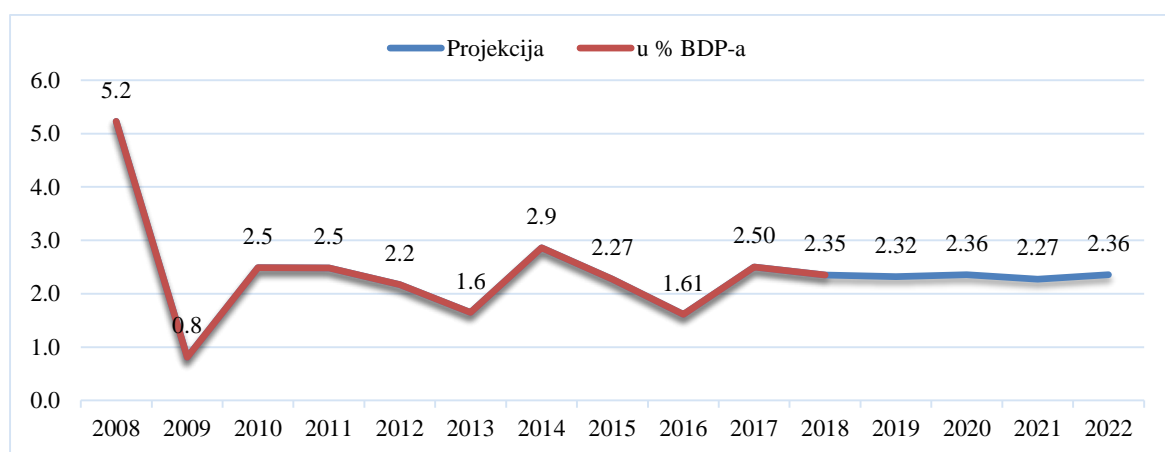
In accordance with these data, it can be expected that FDIs will be somewhat smaller or at the level of the previous year, i.e. Approximately 2.3 per cent of GDP. As a consequence of worsened economic developments in the previous year, both globally and in Europe, FDIs in BiH in 2020 should not be significantly different and should be at the rate of approximately 2.4 per cent. Bearing in mind numerous announcements in energy, infrastructure, services and tourism sectors, there is a realistic basis for FDIs to gradually increase in the following period. This would bring FDIs to the level of 2.3 and 2.4 per cent of GDP in 2021 and 2022, respectively.

²⁰ <https://www.worldbank.org/en/publication/global-economic-prospects>

²¹ <https://www.ecb.europa.projections>

²² CB BiH, BOP6_z_a_korisnike_Q3_2018.

Figure 1.5.: Annual FDIs in million BAM and FDIs in percentages of GDP



Source: DEP

In 2019, FDIs would be at the rate of 2.3 per cent of GDP. Despite delays in implementation of comprehensive infrastructure and energy projects, investments in telecommunications were recorded in the meantime, thus investments in this year could still be at the level of the previous year. Significant funds (approximately 150 million EUR, as announced) should be derived from Serbian M-Tel purchase of Elta Kabel²³. Likewise, a protocol was signed related to Doboj-Vukosavlje-Brčko motorway construction on the basis of a contract on concession with Chinese enterprise Sinochem Capital²⁴, and commencement of implementation of a 700 million BAM²⁵ Banja Luka-Prijedor motorway is expected. In accordance with the available data, project of construction of a solar power plant SPP Bančić Ljubinje²⁶ did not yet start. Likewise, there was a delay in construction of Wind Power Plant Trusina²⁷, while investments are announced in view of Wind Power Plants Debelo Brdo, Gradina and Kupres²⁸. Construction of residential complex Buroj Ozone in the Municipality of Trnovo²⁹ and Green Valley City³⁰ in the vicinity of Sarajevo also imply increase in FDIs.

In the following period, gradual stabilisation of conditions in Europe and in the world can be expected, and 2020 FDIs might be at the rate of approximately 2.4 per cent of GDP. Construction of 350 MWh Thermal Power Plant Gacko in the amount of 500 million EUR is announced. A contract was signed with China Machinery Engineering Corporation and Emerging Market Power Fund³¹ under which majority share would be owned by Chinese partners. Commencement of implementation of announced infrastructure projects should contribute to the growth of FDIs, resulting in their share in GDP at the level of approximately 2.3 and 2.4 per cent in 2021 and 2022, respectively.

²³ <https://mtel.ba/Press-centar/a14258-Mtel-postao-stopostotni-vlasnik-Elta-kabela.html>

²⁴ <http://privrednastampa.ba/tag/autoputevi-republike-srpske/>

²⁵ <http://www.autoputevirs.com/aprs/Doc.aspx?cat=5&subcat=24&id=24&lang=cir&txt=295>, a contract on concession has been signed with Chinese enterprise China Shadong Int. Economic & Technical Cooperation Group Ltd.

²⁶ <http://fipa.gov.ba/novosti/aktivnosti/default.aspx?id=8180&langTag=en-US>

²⁷ <https://crp.org.ba/project/raskinut-koncesioni-ugovor-za-vjetropark-trusina/>

²⁸ Gradina d.o.o., approximately 150 million EUR and Kamen dent d.o.o., estimate of approximately 70 million EUR.

²⁹ Buroj Property Development from the United Arab Emirates.

³⁰ <http://greenvalleyuae.com/projects.php?id=13&stat=gallery&lang=en>

³¹ <http://www.vladars.net/sr-SP-Cyrl/Vlada/Ministarstva/mper/media/vijesti/Pages/Potpisan-sporazum-o-izgradnji-TE-Gacko-2.aspx>

Recommencement of trade war accompanied by global political tensions (aggravated sanctions against Russia and Iran) would undeniably influence FDIs toward BiH, as well. The resulting deceleration of economic growth in China and Great Britain leaving the European Community without arrangements would additionally worsen economic environment in the EU. Worsened economic conditions, in particular in BiH trade partners would most certainly reflect in weak economic results, worsened payment balance and, finally, additional borrowing, which would, of course, be tied to further deterioration of BiH credit rating.

II 2019-2022 INDIRECT TAXES REVENUES PROJECTIONS

2.1. Indirect taxes revenues projections basics and assumptions

Indirect taxes projections are based on projections of September 2019 DEP macroeconomic indicators, with indirect taxes revenues collection trends and current government policies in the area of indirect taxation (baseline scenario).

Current policies in the area of indirect taxation include:

- a) VAT obligations and payment system is regulated by the Law on Value Added Tax³².
- b) Excise duties policy is regulated by the Law on Excise Duties in Bosnia and Herzegovina³³. Indirect taxes revenues projections are based on the assumption of continued alignment of excise duties on cigarettes with EU standards and cut tobacco taxation policy in accordance with 2014 amendments to the Law³⁴. 2019 policy of excise duties on tobacco is determined in accordance with the Law on Excise Duties and the Decision³⁵ of ITA Governing Board. It is expected that the legal ceiling of the excise duty on cigarettes of 176 BAM/1000 cigarettes, for all categories, will be achieved in 2019, whereby alignment with the EU standards related to cigarettes taxation would be completed³⁶.
- c) The Law on Customs Policy in BiH³⁷ regulates basic elements of customs policy and general rules and procedures applied to goods imported and exported from the customs territory of BiH.

³² *Official Gazette of BiH*, 9/05, 35/05, 100/08 and 33/17

³³ *Official Gazette of BiH*, 49/09, 49/14, 60/14 and 91/17

³⁴ The new policy is applicable as of 1 August 2014. (Amendments to the Law on Excise Duties in BiH, *Official Gazette of BiH*, 49/14).

³⁵ The Decision on determining the specific and the minimal excise duty on cigarettes and the amount of excise duty on smoking tobacco for 2019 (*Official Gazette of BiH*, 75/18).

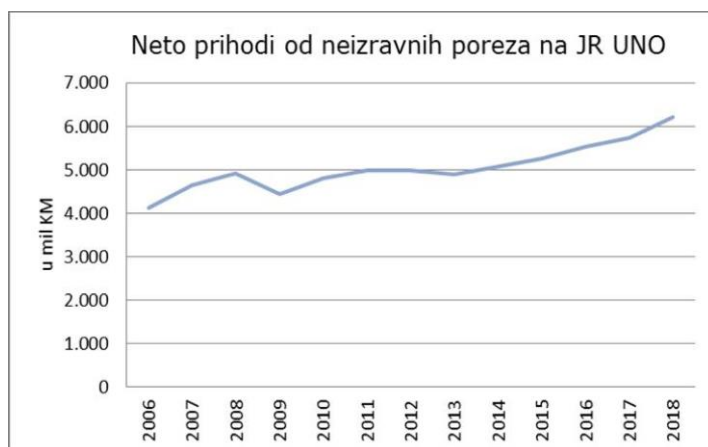
³⁶ Amendments to the Law on Excise Duties are being considered in the Parliamentary procedure. These were adopted by ITA Governing Board in 2018 and include introduction of a three-year moratorium on increase of specific excise duties on cigarettes as of 2019. Decision on determining the specific and the minimal excise duty on cigarettes and the amount of excise duty on smoking tobacco for 2019 was adopted pursuant to the applicable Law. In view of expectations related to achievement of EU standards in cigarettes taxation in 2019, possible adoption of the amendments to the Law on Excise Duties would not have real impact on collection of revenues in the 2020-2022 period.

³⁷ The new Law on Customs Policy (*Official Gazette of BiH*, 58/15) will be applicable only as of August 2019, while the old Law on Customs Policy is applicable prior to that date (*Official Gazette of BiH*, 57/04, 51/06, 93/08, 54/10 and 76/11). Article 207 of the Law will be applicable as of 25 April 2018.

2.2. Indirect taxes collection trends

Collected indirect taxes revenues reflect the long-term growth trend. Exceptions were the 2009 crisis that resulted in strong decrease in revenues, at the rate of 9.9 per cent and stagnation and milder decrease of revenues in 2012 and 2013, respectively. In all other years, revenues collected in the ITA Single Account grew (Figure 2.1.).

Figure 2.1. Net indirect taxes revenues (2006-2018)



Source: MEAD, Bulletin 166/167, May/June 2019

Net indirect taxes revenues collected in 2006 in the ITA Single Account amounted to 4.1 billion KM, while net collected taxes in 2018 increased by more than 50.0 per cent (6.2 billion BAM) in comparison with 2006. It should be noted that these amounts do not include remaining delayed payments of indirect taxes to the accounts of the Entities which were more significant in the first years after introduction of VAT.

Share of indirect taxes in the ITA Single Account varied over the years. After this share dropped from 18.8 per cent in 2008 to 17.1 per cent in 2009, the crisis year, it ranged between 17.3 and 18.6 per cent since 2010. In 2018 it was estimated at the level of 18.3 per cent (DEP GDP projections). Share of indirect taxes in the ITA Single Account in total spending also varied, while it showed a continuous growth trend since 2014. In 2018, it was estimated at the level of 19.4 per cent (DEP spending projections).

2.2.1. Collection in 2018

The amount of indirect taxes revenues collected in 2018, i.e. 6.220.8 billion BAM is the record amount ever collected since establishment of ITA in 2018, while the Growth rate reached 8.6 per cent. This high growth rate was expected bearing in mind the effects of the amendments to the Law on Excise Duties. In order to ensure, for the purpose of analysis, comparison of collection of indirect taxes revenues in 2018 and 2017, it is necessary to completely exclude collection of toll due to the fact that almost all effects of amendments to the Law on Excise Duties (applicable as of 1 February 2018) relate to designated toll. The amount of revenues after exclusion of dedicated toll represents transfers of revenues to the budget of BiH Institutions, Entities and BD (funds for distribution). Upon exclusion of collection of designated toll from the amount of total collected indirect taxes revenues in 2017 and 2018, increase in funds for distribution is 4.7 per cent. Since the effects of amendments to the Law on Excise Duties include the amount of VAT charged to additional designated toll, exclusion of that effect

leaves 4.0 per cent of funds for distribution. Therefore, it can be concluded that amendments to the Law on Excise Duties resulted in 4.6 percentage point growth of revenues from indirect taxes.

2.2.2. January - September 2019 Collection

Total revenues

In accordance with the ITA preliminary report on cash flow on the ITA Single Account, net collection of indirect taxes was by 2.7 million BAM or 0.5 per cent higher in September 2019 than in September 2018. Lower collection of indirect taxes in September significantly decelerated the growth of cumulative collection. At the level of nine months 2019, gross collection of indirect taxes revenues was by 309.1 million BAM or 5.5 per cent higher than in the same period of 2018. At the same time, refunds were by 65.8 million BAM or 6.4 per cent higher. Finally, the amount of net collected revenues in the nine-month period was by 243.4 million BAM higher than the amount collected in the same period of 2018. This represents a 5.3 per cent growth. Comparison of collection in 2019 and 2018 per quarters shows a stable growth in collection of indirect taxes in the past five years. Growth of revenues at the rate of 7.4 per cent in Q1 2019 is partly the result of toll increase due to amendments to the Law on Excise Duties which were displayed in January. Due to extremely poor collection in Q2, in June, the growth was 2.8 per cent. However, Q3 already recorded a high growth at the rate of 6.5 per cent, mainly due to strong growth in revenues from excise duties on tobacco products and oil derivatives. (Figure 2.2.)

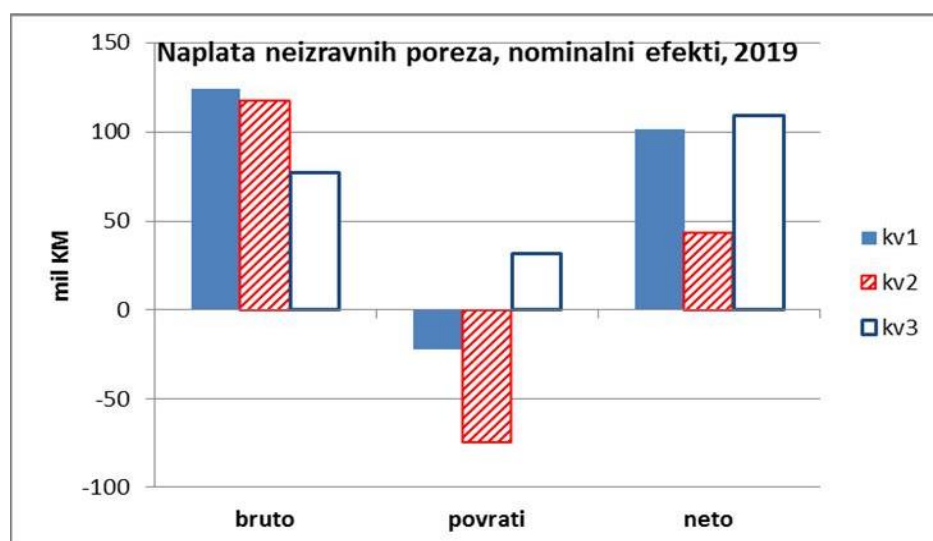
Figure 2.2. Changes in collection of indirect taxes (Q/Q)



Source: MEAD, Bulletin 172/173, May/June 2019

Comparison of quarterly nominal effects of collection point to a conclusion that the most important effects were recorded in Q1, as expected due to collection of increased tolls in January 2019. In addition to corresponding VAT, it amounted to approximately 20 million BAM (Figure 2.3.).

Figure 2.3. Collection of indirect taxes revenues-nominal effects



Source: MEAD, Bulletin 172/173, May/June 2019

However, a decreasing trend in quarterly effects of gross collection is evident. On the other hand, collection of revenues in 2019 was highly marked by oscillations in refunds which escalated in Q2 and thus significantly lowered the positive growth of gross collection. However, refunds first decelerated in Q3 resulting in positive effects in September and positive influence over net collection of indirect taxes in Q3. Collection of indirect taxes revenues at the rate of 5.3 per cent for the first nine months of 2019 is by 1.6 percentage points higher than MEAD projections from April 2019³⁸. It has to be noted that the effect of amendments to the Law on Excise Duties brought a 0.4 percentage points increase in indirect taxes revenues.

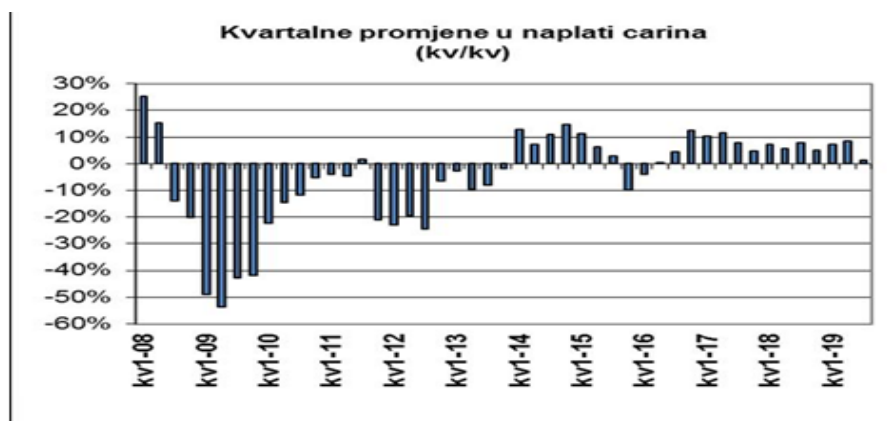
Analysis per type of revenues³⁹

Custom duties. After a longer period of positive monthly growth in August and September 2019, customs revenues dropped and thus decelerated the cumulative growth rate at the level of 5.5 per cent. Decrease in customs revenues in August was a consequence of deceleration of EU import and import from Russia, China and other Asian countries. Overview of quarterly trends shows stable and continuous collection of customs revenues over the past twelve quarters, with quarterly rates ranging between 5 and 10 per cent which were not endangered by the application of the adapted SSP. In Q1 2019 and Q2 2019, collection of customs revenues increased by 7.1 and 8.5 per cent, respectively. This trend was unexpectedly interrupted in Q3 which saw a modest growth of revenues at the rate of 1.3 per cent. It can be assumed that deceleration of import from the EU signals deceleration of BiH economy, while deceleration of import from Asian countries signals deceleration of private spending in BiH. (Figure 2.4.).

³⁸ Projections were published in MEAD Bulletin No. 166/167, May/June 2019, www.oma.uino.gov.ba

³⁹ Note: The amount of 20.0 million BAM was collected, as well, but these could not have been taken into account for analysis of collection per revenues since they are not aligned in the IT system.

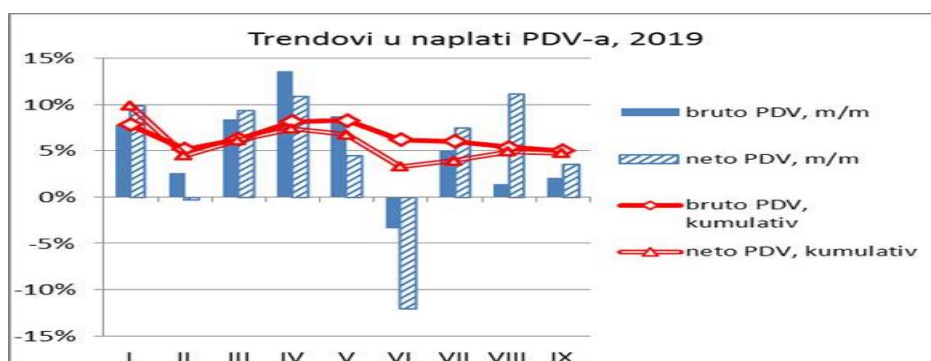
Figure 2.3. Quarterly changes in customs collection



Source: MEAD, Bulletin 172/173, May/June 2019

Value Added Tax. Collection of net VAT revenues in 2019 is characterised by high growth rates, except a serious decrease in June which was the consequence of cumulative negative effect of decrease in gross collection and increase in refunds. Positive trends in gross collection and refunds were recorded in the last three months, resulting in stabilisation of net collection. Between January and September 2019, gross and net VAT collection increased by 5.0 and 4.7 per cent, respectively. Moderate increase in the cumulative rate is expected after alignment, since the preliminary report states that the amount of 21.0 million BAM remained unaligned.

Figure 2.4. VAT collection trends

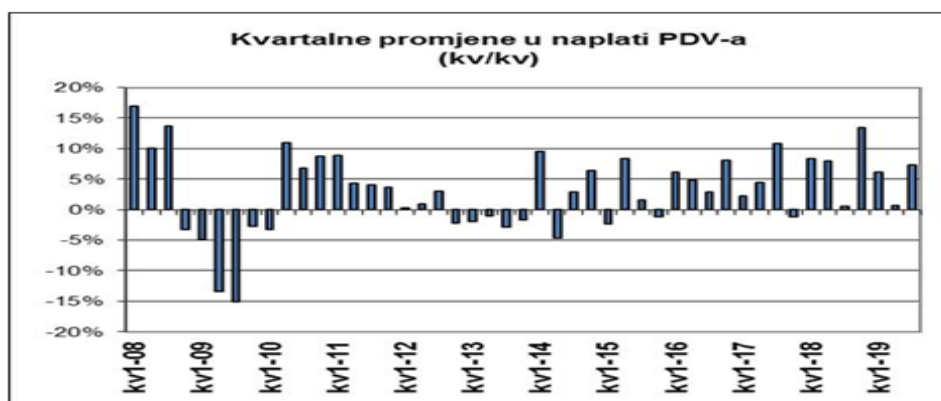


Source: MEAD, Bulletin 172/173, May/June 2019

It is necessary to emphasize that the concept of net cash reporting in 2018 resulted in increased VAT collection in 2018 by the amount of VAT credits used for payments of excise duties obligations related to oil derivatives. After correction of the basis in 2018, the cumulative net VAT growth rate between January and September 2019 amounted to 5.8 per cent, i.e. it is 1.1 percentage point higher than in the cash report per types of revenues.

Quarterly trends (Figure 2.5.) point to strong quarterly oscillations in the last two years, which are partially a consequence of changes in the scheme of VAT refunds, i.e. temporary suspensions of refunds during comprehensive control activities. Q1 2019 recorded a net growth rate of 6.1 per cent, while the same was 0.7 and 7.3 per cent in Q2 and Q3, respectively.

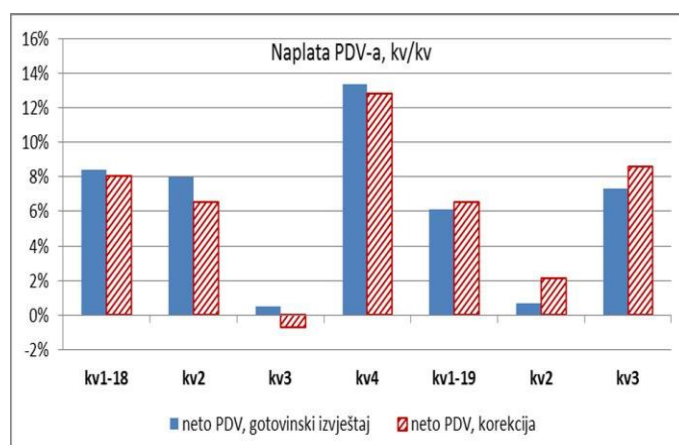
Figure 2.5. Quarterly changes in customs collection



Source: MEAD, Bulletin 172/173, May/June 2019

After corrections of the basis for comparison in 2018, quarterly comparisons of VAT collection in Figure 2.6 show higher growth rates at the level of 2019 quarters in comparison with calculation on the basis of ITA cash report in Figure 2.5.

Figure 2.6. Quarterly changes in customs collection



Source: MEAD, Bulletin 172/173, May/June 2019

Gross VAT components analysis indicates a positive collection trend in both VAT on import and domestic VAT, but with sharper monthly oscillations and deceleration in Q3. Quarterly analysis shows oscillatory positive VAT on import growth rates of 4.0 per cent in Q1, and 9.0 and 2.9 per cent in Q2 and Q3, respectively. On the other hand, when it comes to domestic VAT, Q1 recorded growth in collection at the rate of 9.8 per cent in Q1 and 1.4 and 2.7 in Q2 and Q3, respectively. Alignment of unaligned revenues for September, in the structure of which VAT has a large share, will surely increase domestic VAT growth rates. Correction of the basis for comparison in 2018, due to cash reporting per types of revenues, results in increase in quarterly rates, i.e. increase in the cumulative domestic VAT growth rate to 6.6 per cent in the first nine months of 2019.

Figure 2.7. Quarterly changes in VAT refunds



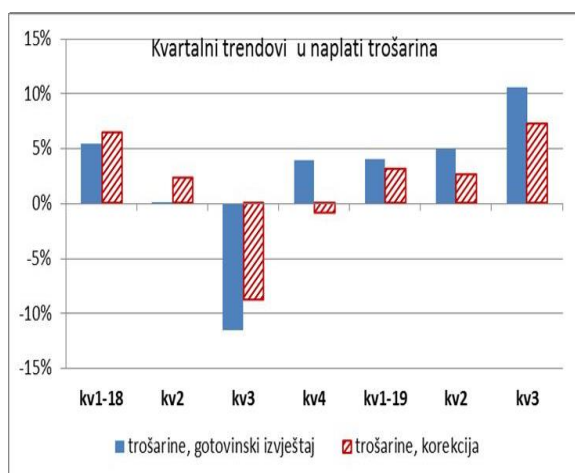
Source: MEAD, Bulletin 172/173, May/June 2019

VAT refunds in September 2019 were by 3.2 per cent lower in comparison with September 2018, which additionally decelerated the cumulative growth rate to 5.7 per cent. At the level of the first nine months of 2019, tax payers received refunds in the amount which is by 61.3 million BAM higher than the amount in the same period of 2019, while international organisations and projects received 3.0 million BAM less VAT than in the first nine months of 2018.

Due to deceleration of refunds in comparison with the previous year, the share of VAT in gross collected VAT was by only 0.5 percentage points higher than the annual share of VAT refunds in gross collection 2018. Quarterly analysis of VAT refunds in 2019 shows strong turbulences-moderate growth of 6.7 per cent in Q1, enormous growth at the rate of 21.9 per cent in Q2 and significant decrease at the rate of 9.3 per cent in Q3 2019.

Excise duties and toll. Collection of toll revenues in 2019 shows stable positive growth with the exception in June. Collection peaked in the summer season, which leads us to a conclusion that toll collection growth is seasonally determined by spending of non-residents, tourists and diaspora. Last two months show gradual decrease of the growth rate which in turn decelerated the cumulative growth rate at the level of 6.7 per cent. Quarterly trends of total toll collection show stable positive growth in the last four quarters (Figure 2.8.).

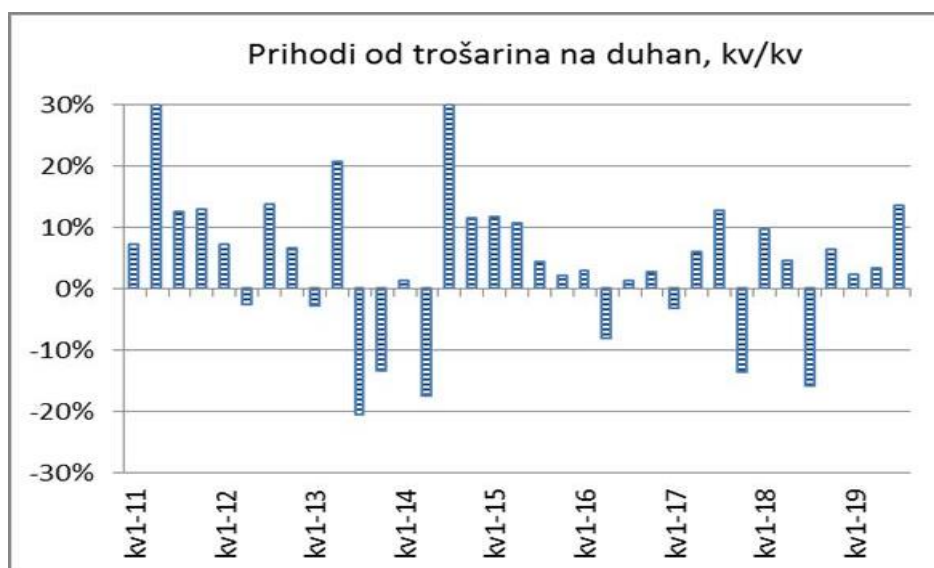
Figure 2.8. Excise duties-quarter trends



Source: MEAD, Bulletin 172/173, May/June 2019

Q1 and Q2 recorded a 4.0 and a 4.9 per cent growth, respectively. Strong growth in excise duties collection at the rate of 10.6 per cent recorded in Q3 is the result of increase in collection of excise duties on tobacco products and oil derivatives. However, it is necessary to bear in mind the fact that a significant portion of growth of revenues from excise duties is the consequence of the accounting factor, i.e. cash reporting per types of revenues. Correction relates to increase in the basis for comparison and decrease in the growth rate in the period from January to September 2019 to 4.4 per cent. Corrections lead to decrease in quarterly growth rates to 3.1, 2.6 and 7.2 per cent. Collection of total revenues from excise duties is determined by collection of excise duties on tobacco products which participate in the surplus of revenues from excise duties in the period between January and September 2019 with 80.0 per cent. In Q1 2019, excise duties grew by 2.3 per cent in comparison Q1 2018. This growth was the result of increase in sale of cigarettes due to postponement of increase in retail sale prices which was usual in the early years following the increase in specific excise duties on cigarettes in the beginning of the year. Tobacco companies carried the major part of additional tax burden in 2019 at the cost of their profit for six months, which had a positive influence on collection of revenues. Q2 recorded a 3.3 per cent growth. Somewhat higher growth of revenues in Q2 can be tied to announcements of corrections of prices to a higher value from June for the amount of additional tax burden, which resulted in increase in reserves prior to increase in retail sale of cigarettes. A share of effects of increased reserves on collection of revenues spilt to Q3. In addition, spending of tobacco products in Q3 is increased due to seasonal spending, which cumulatively affected the growth of collection in Q3 at the rate of 13.5 per cent.

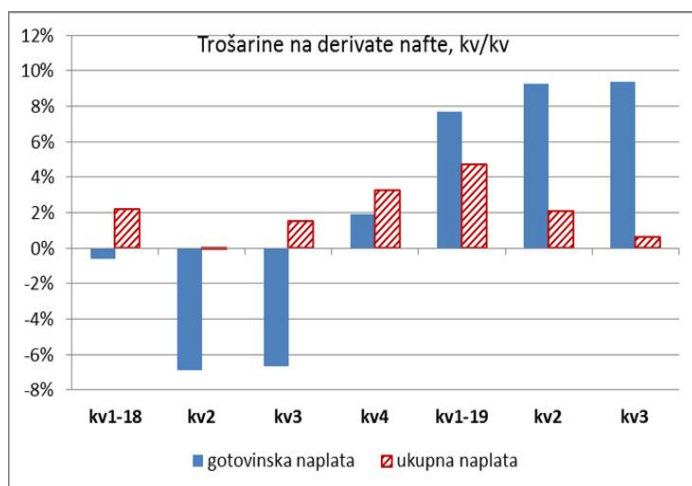
Figure 2.9. Excise duties on tobacco (Q/Q)



Source: MEAD, Bulletin 172/173, May/June 2019

In accordance with net cash report of the ITA in all three quarters of 2019, stable positive trends in collection of excise duties on oil derivatives were recorded. Q1 recorded a 7.7 per cent growth, while Q2 and Q3 recorded a 9.2 and 9.4 per cent growth in Q2 and Q3 (Figure 2.10.). At the level of nine months, the growth is 8.9 per cent.

Figure 2.10. Revenues from excise duties on oil derivatives

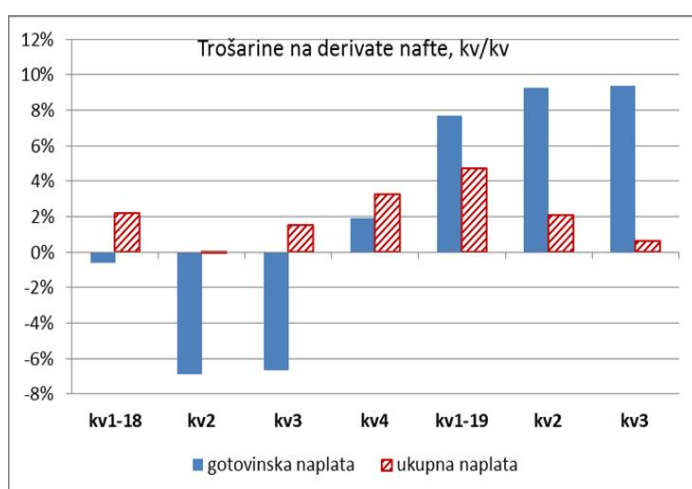


Source: MEAD, Bulletin 172/173, May/June 2019

However, as much as 3/4 net effects of collection of excise duties on oil derivatives are a consequence of ITA cash reporting in 2018, because of which the basis for comparison from 2018 was lowered. The amount of correction is significant, as high as 6.6 percentage points, which decreased the cumulative growth for nine months of 2019 to only 2.3 per cent. Quarterly analysis after corrections shows that collection of excise duties on oil derivatives in Q1 is by 4.7 per cent higher, in Q2 2.1 per cent, while Q3 recorded a growth at the rate of 0.6 per cent. Trends reflect the impact of growth of prices of oil derivatives in the global market which is generated by the political and military crisis in the Middle East, to domestic spending of derivatives. Upon exhaustion of effects of increased toll from 1 February 2018 to February 2019, a period of stabilisation of growth in toll revenues ensued. Negative growth

rates were also recorded in the last two months, resulting decrease of the cumulative growth rate for nine months to 6.1 per cent. Overview of quarterly trends shows the scale of effects of amendments to the Law on Excise Duties on Collection of Toll Revenues (Figure 2.11.). In order to consider real trends in collection of toll, it is necessary to analyse the toll growth rate to factors which generated it. Lower statistical basis for comparison from 2018 For the amount of toll collected from compensation from VAT credits brought approximately 1.3 percentage points growth in toll revenues, while the effects of amendments to the Law on Excise Duties which were displayed in January 2019, brought a 3.7 percentage point growth. The negative corrective factor implies a one-time collection of toll on reserves existing prior to 31 January 2018, before the increase in the toll rate, which increased the basis for comparison and thus lowered the growth rate in 2019 by 1.9 percentage point. Comparison of negative and positive growth rates, in turn in comparison with net cash reporting, puts the revenues growth rate between January and September 2019 at the level of 2.9 per cent.

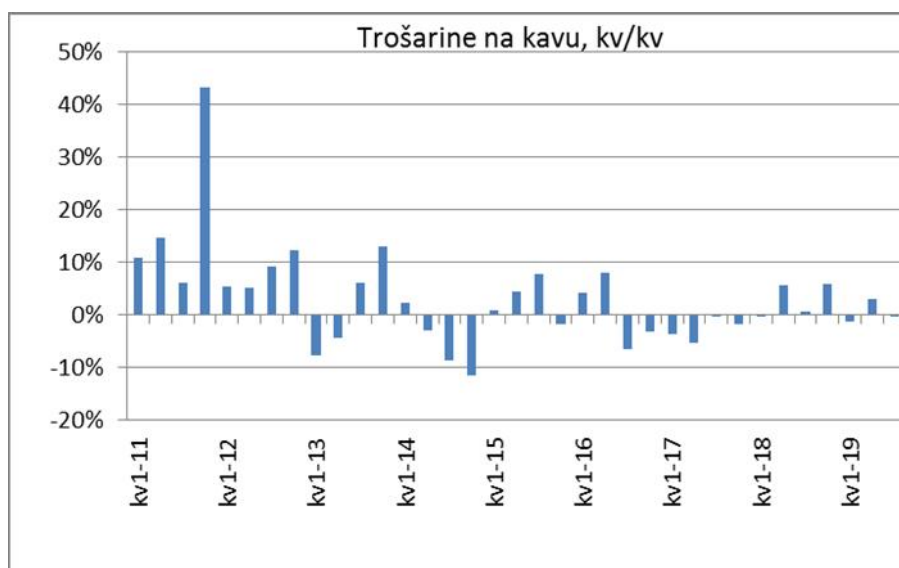
Figure 2.10. Toll revenues (Q/Q)



Source: MEAD, Bulletin 172/173, May/June 2019

Collection of excise duties on coffee between January and September 2019 was by 0.7 per cent higher than in the same period of 2018. Quarterly analysis shows a 1.2 per cent decrease in revenues in Q1 and a 3.0 per cent growth in Q2. Despite strong growth in collection in September, total collected excise duties in Q3 are recorded at the level of the same quarter of 2018 (Figure 2.11.).

Figure 2.11. Excise duties on coffee (Q/Q)

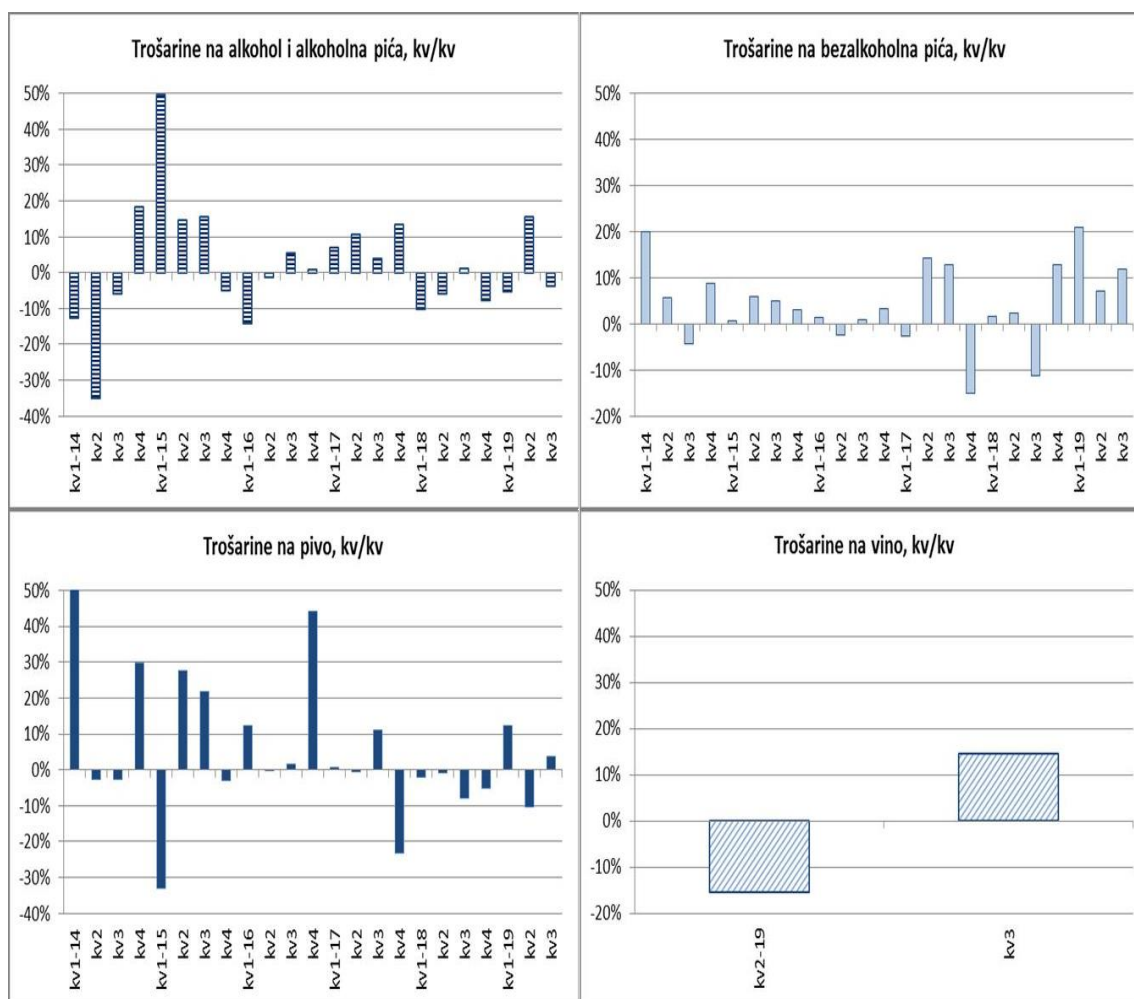


Source: MEAD, Bulletin 172/173, May/June 2019

Negative trend in collection of revenues from excise duties on alcohol and alcoholic beverages recorded in August continued in September, as well, thus decreasing positive effects from the previous part of the year. Negative growth rates recorded in Q1 and Q3 were neutralised by a strong growth in collection in Q2 2019, thus resulting in a 2.2 per cent cumulative growth rate in the first nine months.

Collection of excise duties on non-alcoholic beverages has been continuously growing over the last four quarters at positive growth rates, resulting in 12.3 per cent growth in the first nine months 2019 (Figure 2.12.). Collection of excise duties on beer was positive in Q1 and Q3 2019, while decrease was recorded in Q2. However, it has to be noted that old debt related to domestic excise duty on beer were collected in January 2019. This resulted in increase in collection of domestic excise duties and total revenues, above realistic values. If the effects of the old debt are excluded, total collection of excise duties on beer is negative, at the rate of -2.5 per cent, while the collection of excise duties on domestic beer is very low, at the rate of -8.8 per cent. The excise duty on wine was introduced through the last amendments to the Law on Excise Duties. Since collection of excise duties on wine started in February 2018, comparison of collection in Q1 2019 is not relevant for analysis. Revenues decreased by 15.6 and increased by 14.4 per cent in Q2 and Q3, respectively.

Figure 2.12. Excise duties on tobacco (Q/Q)



Source: MEAD, Bulletin 172/173, November/December 2019

2.3. 2019-2022 Indirect Taxes Revenues Projections

2019-2022 revenues projections are shown in Table 2.1. In order to ensure comparability of projected and collected indirect taxes revenues, revenues projections are shown on a cash basis in accordance with ITA reports on collection per types of revenues.

Table 2.1 2019-2022 Indirect Taxes Revenues Projections (in million BAM)

Vrsta prihoda (neto)	u mil KM						projektirana stopa rasta			
	Izvršenje	Projekcija					2019	2020	2021	2022
		2018	2019	2020	2021					
PDV	3.839,0	4.002,7	4.132,2	4.270,7	4.427,6		4,3%	3,2%	3,4%	3,7%
Trošarine	1.444,7	1.521,2	1.554,4	1.594,5	1.639,8		5,3%	2,2%	2,6%	2,8%
Carine	286,6	301,5	322,0	347,2	377,0		5,2%	6,8%	7,8%	8,6%
Putarina	620,7	657,2	669,7	683,1	697,5		5,9%	1,9%	2,0%	2,1%
Ostalo	29,7	29,9	30,3	30,7	31,1		0,7%	1,3%	1,3%	1,3%
UKUPNO	6.220,8	6.512,6	6.708,7	6.926,2	7.173,0		4,7%	3,0%	3,2%	3,6%
Namjenska putarina *)	-385,9	-410,8	-418,6	-427,0	-435,9		6,4%	1,9%	2,0%	2,1%
SREDSTVA ZA RASPODJELU	5.834,9	6.101,8	6.290,1	6.499,2	6.737,1		4,6%	3,1%	3,3%	3,7%

Source: MEAD, Bulletin 172/173, November/December 2019

Note:

*) Designated toll amounted to 0.10 BAM/litre of oil derivative until 1 February 2018, and was raised to 0.25 BAM/litre of oil derivative.

**) The amount of distributed designated toll in 2018, in accordance with the provisions of the Law on Amendments to the Law on Payments to the Single Account and Distribution of Revenues⁴⁰ does not completely correspond to the amount of collected designated toll shown in Table 3 (385.9 million BAM) due to new model of distribution used since 1.2.2018. In accordance with this new model, distribution is not performed on a daily basis but subsequently, after expiration of a month for the previous month on the basis of preliminary/final ITA report on collected revenues per types. Distribution of a 0.10 BAM/litre of oil derivative toll under the old model of daily distribution ended on 31.1.2018. Distribution of a 0.25 BAM/litre of oil derivative to Entities and Brčko District in accordance with the new model started only in March 2018.

Table 2.2 shows revenues estimates as percentages of GDP. The decreasing indirect taxes trend in GDP is explained by projected decrease in the share of spending in GDP (DEP). The projected share of indirect taxes in total spending in the following period is stable at the rate of 19.7 per cent in 2019 and 2020 (0.4 percentage point growth in comparison with 2018), and 19.8 per cent in 2021 and 2022.

⁴⁰ Official Gazette of BiH, 91/17

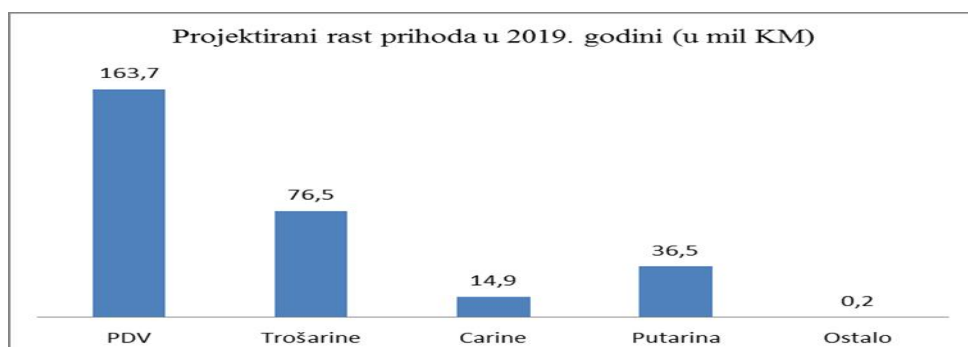
Table 2.2 2019-2022 Indirect Taxes Revenues Projections (in % GDP)

Vrsta prihoda (neto)	u % BDP-a				
	Izvršenje	Projekcija			
		2018	2019	2020	2021
PDV	11,3%	11,3%	11,2%	11,0%	10,9%
Trošarine	4,2%	4,3%	4,2%	4,1%	4,0%
Carine	0,8%	0,9%	0,9%	0,9%	0,9%
Putarina	1,8%	1,9%	1,8%	1,8%	1,7%
Ostalo	0,1%	0,1%	0,1%	0,1%	0,1%
UKUPNO	18,3%	18,4%	18,2%	17,9%	17,6%
Namjenska putarina	-1,1%	-1,2%	-1,1%	-1,1%	-1,1%
SREDSTVA ZA RASPODJELU	17,2%	17,3%	17,0%	16,8%	16,6%

Source: MEAD, Bulletin 172/173, November/December 2019

2.3.1. 2019 Projections

The projected net collection of indirect taxes revenues for 2019 amounts to 6.512.6 million BAM, i.e. by 4.7 per cent higher than in 2018. The projected growth of revenues in the absolute amount is 291.8 million BAM. Figure 2.12 shows participation of certain types of revenues in the projected absolute growth of total revenues.

Figure 2.12. 2019 Revenues Growth Projections (million BAM)

Source: MEAD, Bulletin 172/173, November/December 2019

The largest contribution to the projected absolute growth of revenues in 2019 is represented by VAT revenues (163.7 million BAM). The basic factors for decrease in the annual collection growth rate (4.3 per cent) below the achieved net VAT growth rate achieved between January and September 2019 are:

- ✓ Projections of the annual-level macroeconomic indicators (DEP), primarily private spending growth, which is below the net VAT growth rate in the period between January and September 2019.
- ✓ The basis for comparison is relatively increased at a higher rate in the period between January and September 2018 than in the rest of the year due to the practice of payment of excise duties on oil derivatives and toll from VAT credits. Collection of domestic VAT increased by 2.0 and 1.1 per cent on the same basis between January and September 2018 and October and December 2018, respectively.

The projected amount of total revenues from excise duties in 2019 amounts to 1.521.2 million BAM, i.e. by 76.5 million BAM or 5.3 per cent more than the achieved level in 2018. The largest portion of

excise duties growth in 2019 is derived from the projected excise duties on oil derivatives which is significant due to frequent practice of compensation of liabilities for excise duties and toll with receivables under VAT credits in 2018. Favourable collection trends of these revenues between January and September 2019 are in support of the projected high growth of excise duties on oil derivatives. Projections of revenues from excise duties on tobacco products are in line with current and historical trends, bearing in mind that their development depends on business policies of 3 or 4 companies in tobacco industry. It is expected that the trends will worsen in Q4 since the tobacco industry, unlike in previous years, corrected retail sale prices only six months after the last increase in the specific excise duty on tobacco (1 January 2019). In case total additional tax burden spills over to prices, maintenance of the retail sale prices below the expected level brings growth in sales and revenues above expectations. Since the peak of cigarettes and other tobacco products trade is in the summer period in Q4, it is expected that spending will stabilise and that growth of rates of revenues from excise duties will decelerate. On the other hand, since the harmonisation of excise duties on cigarettes with legal taxation ceiling is completed, there will be no more pressure on tobacco companies and consumers to adjust. This will significantly relax the tobacco industry business policy and consumption of tobacco products and it might therefore have an adverse impact on revenues in the last quarter of 2019. Starting from these assumptions, it is expected that the revenues from excise duties on tobacco products will grow by 4.5 per cent. The projected amount of toll in 2019 amounts to 657.2 million BAM, which is by 5.9 per cent higher than the results achieved in 2018. The projected growth of toll in the amount of 36.5 million BAM in 2019 is based on:

- ✓ Effects of the designated toll rate growth in January 2019 in comparison with January 2018 (amendments to the Law on Excise Duties are effective as of 1 February 2018),
- ✓ Estimates of macroeconomic indicators (DEP),
- ✓ Lower basis for comparison (2018) on the basis of compensation of obligations for tolls from receivables under VAT credits.

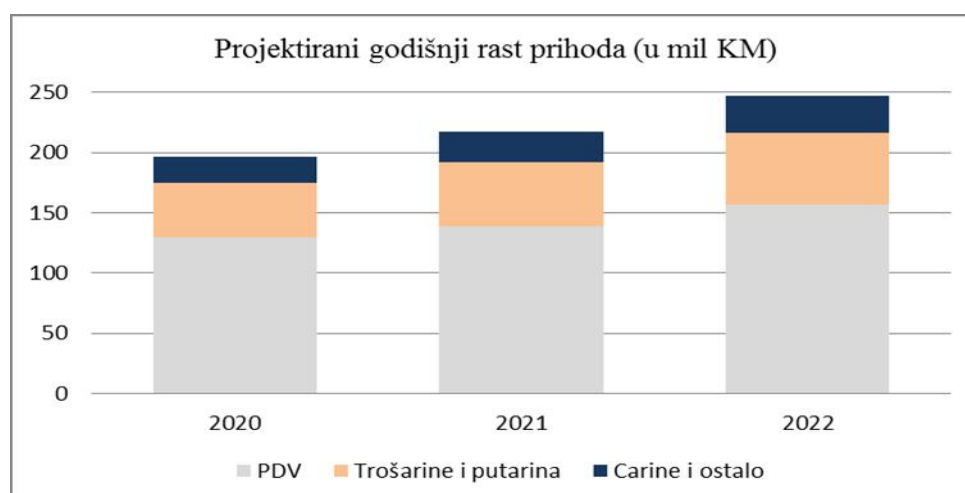
Projection of revenues from customs for 2019 amounts to 301.5 million BAM and is based on current collection trends and import growth projections.

2.3.2. 2020-2022 Projections

Projected growth rates for 2020, 2021 and 2022 are 3.0, 3.2 and 3.6 per cent, respectively. Projection of revenues in the stated period is based on projected relevant macroeconomic indicators, historical collection scheme and projections for certain categories of revenues in 2019.

As in 2019, projections are prepared on cash basis. It is assumed that there will be no compensations of obligations for excise duties and toll and receivables under VAT. In case of possible compensations, this might affect divergences in collection in comparison with projections for types of revenues, but not on total collection if indirect taxes. Annual indirect taxes growth rate is shown in the Figure below.

Figure 2.13. Projections of annual revenues growth (in million BAM)



Source: MEAD, Bulletin 172/173, November/December 2019

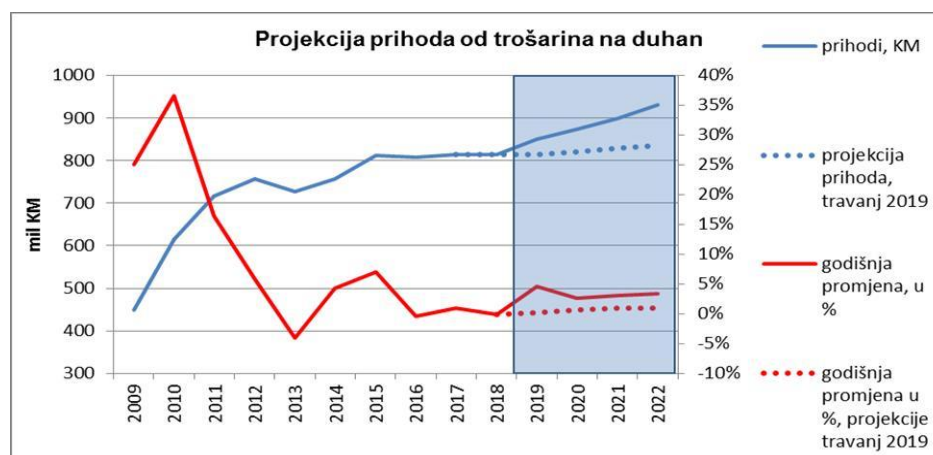
The biggest generator of surplus in revenues from indirect taxes in the stated period is VAT, in view of its significant share in revenues, and planned stable growth rates in accordance with projections of spending developments. In all three stated years, VAT revenues generate more than 63.0 per cent of absolute annual projected revenues growth rate.

Toll revenues do not significantly contribute to the projected absolute growth of revenues in the 2020-2022 period, due to exhaustion of the effects of tax rates growth. Excise duties projections (except for the share of excise duties on tobacco collected ad valorem) and toll are based on projections of real growth rates of corresponding projections of macroeconomic indicators which, in addition to a decrease in the share of spending in GDP, is one of the reasons for the decreasing trend in the projected amount of revenues in GDP.

Finalisation of the process of harmonisation of excise duties on cigarettes with the EU standards in 2019, it can be expected that the tobacco products market will stabilise and subsequently recover in the following three years. Achievement of stated prognosis depends on growth of revenues which might encourage smokers who started smoking cut tobacco earlier because of high prices of cigarettes to return to cigarettes consumption. It is realistic to expect that the cut tobacco market will first stagnate and then decrease, especially since the tax burden on cut tobacco will be higher as of 1 January 2020 because of the alignment with retail prices of cigarettes in 2019.

In view of the urgent need to stabilise the market, it is expected that the prices of cigarettes will stabilise on average. It is possible that positioning in the market will affect changes in prices of certain brands, especially bearing in mind complete uncertainty related to future domestic production of cigarettes. It is expected that the value of cigarettes market will follow the growth of spending, which could, in addition to retaining retail sale prices on the achieved level, result in increase in cigarettes spending after a decade of sharp decreases. Under the stated circumstances in 2020, it can be expected that revenues from excise duties on cigarettes will grow by 2.7, 3.0 and 3.4 per cent in 2020, 2021 and 2022, respectively (Figure 2.14). Except for macroeconomic trends and growth of revenues, efficiency of measures for fight against the black market is still an important factor for achievement of growth prognosis.

Figure 2.14. Projections of revenues from excise duties on tobacco



Source: MEAD, Bulletin 172/173, November/December 20

2.4. Differences in comparison with previous projections

Differences in projections of indirect taxes in the 2019-2022 period in comparison with projections from April 2019 are the result of changes in trends of collection of certain types of revenues and changes in projections of macroeconomic indicators.

Table 2.3 Differences in projections for the 2019-2022 period in comparison with projections from April 2019

	u mil KM				u % BDP-a *)			
	2019	2020	2021	2022	2019	2020	2021	2022
PDV	23,3	25,9	24,2	22,7	0,07%	0,07%	0,06%	0,06%
Trošarine	41,1	58,8	77,4	100,1	0,12%	0,16%	0,20%	0,25%
Carine	-0,8	-2,4	-1,0	0,7	0,00%	-0,01%	0,00%	0,00%
Putarina	0,8	1,5	1,5	1,6	0,00%	0,00%	0,00%	0,00%
Ostalo	-4,6	-4,7	-4,7	-4,7	-0,01%	-0,01%	-0,01%	-0,01%
UKUPNO	59,7	79,1	97,4	120,4	0,17%	0,21%	0,25%	0,30%

*) DEP projections, September 2019

Source: MEAD, Bulletin 172/173, November/December 2019

Table 2.3 clearly implies that the biggest differences in comparison with previous projections are related to revenues from excise duties. The largest share of these differences relate to excise duties on tobacco (87.7 per cent difference in excise duties in 2019 and more than 90.0 per cent difference in excise duties in subsequent years). Differences in projections of excise duties on tobacco are predominantly the result of the policy of prolonged delays in view of retail sale prices of cigarettes and taking on of the additional share of tax burden at the expense of tobacco companies' profit that contributed to the growth in sales of cigarettes and collection of revenues from excise duties above expectations. In addition, increased seasonal spending of non-residents in summer months affected the growth of revenues. In the following years, differences in projections of excise duties on tobacco are the result of a higher 2019 basis, and combining the cigarettes' market value with DEP macroeconomic projections.

Positive differences in projections of VAT revenues in 2019 are the result of higher corrections to the lower value of refunds from corrections of gross revenues in comparison with MEAD April projections.

Although projections of gross VAT revenues were corrected to the lower value due to worsening of collection trends in comparison with Q1 2019, net collection was corrected to the higher value in comparison with April projections due to the decrease in the projected refund amount for 2019 which was based on the latest collection trends.

In the following years, differences in projections of VAT are again the result of a higher 2019 basis and minor differences in projections of private spending growth. Smaller differences in projections of revenues from customs are derived from changes in import projections. Likewise, smaller differences in toll are the result of the envisaged higher growth of the basis for toll revenues in comparison with oil derivatives excise duties due to the changes in structure of basis under the latest data available to ITA.

2.5. Projections risks

Considering the basics of indirect taxes projections and total economic conditions in Bosnia and Herzegovina and globally, achievement of the projected level of revenues from indirect taxes between 2019 and 2019 is susceptible to following risks:

- ✓ Projections of revenues from indirect taxes are closely tied to projections of macroeconomic indicators of DEP. Each divergence of these projected values represents a risk to revenues projections.
- ✓ Weaker economic recovery of main export partners of BiH (EU, CEFTA countries) increases the level of risk for achievement of macroeconomic projections and consequently projections of indirect taxes revenues in total.
- ✓ Weakened fight against black tobacco products market after alignment of tax burden on cigarettes in BiH with EU standards.
- ✓ Mass migrations may result in decreased taxable spending which was financed by unemployed citizens who are leaving BiH from grey economy income or foreign transfers, as well as spending of active population leaving BiH, whose income will be spent outside BiH due to migration of families.
- ✓ External shocks in view of global prices of oil and oil derivatives growing above expected will affect oil derivatives market in BiH and will have an adverse impact on spending of derivatives and thus to achievement of projections from excise duties on oil derivatives and tolls from oil derivatives prices.

III FISCAL GOALS AND FISCAL POLICIES IN BIH

Primary fiscal balance, defined in accordance with Article 1, paragraph 2 of the Law on Fiscal Council in Bosnia and Herzegovina is planned in 2020 in view of a surplus, in the amount of 289.3 million BAM or 0.8 per cent of projected GDP for 2020, of which:

- BiH Institutions plan a deficit in the amount of 67.5 million BAM,
- Republika Srpska plans a surplus in the amount of 76.1 million BAM,
- FBiH plans a surplus in the amount of 271.2 million BAM and
- BD BiH plans a surplus in the amount of 9.5 million BAM.

3.1. Public spending level and structure

Public expenditures level, as a part in GDP in the 2020-2022 period should be decreased with the aim of achieving a consolidated BiH public expenditures level below 40 per cent GDP.

Table 3: 2019-2022 Total Public Expenditures in BiH (in million BAM)

Expenditures	2019	2020	2021	2022
BiH Institutions	962.6	991.4	991.4	991.4
FBiH	9,307.40	8,964.40	9,054.40	9,179.80
RS	4,581.20	4,663.90	4,657.80	4,709.10
BD BiH	270.6	252.4	260.9	269.3
Total expenditures (consolidated)	15,121.80	14,872.10	14,964.50	15,149.60
BDP	35,346	36,893	38,720	40,699
BiH Institutions	2.7%	2.7%	2.6%	2.4%
FBiH	26.3%	24.3%	23.4%	22.6%
RS	13.0%	12.6%	12.0%	11.6%
BD BiH	0.8%	0.7%	0.7%	0.7%
Total in GDP	42.8%	40.3%	38.6%	37.2%

Source: Calculations of the BiH Fiscal Council Counselling Group

3.2. Tabular budget overview

The structure of budget expenditures is illustrative and general, and each level of authority establishes the final expenditures structure in their Framework Budget Documents and annual budgets in accordance with adopted policies. The tabular budget overview below represents a consolidated overview of revenues, expenditures, financing and primary balance for the 2019-2022 period, i.e. Overview for BiH Institutions, RS, FBiH and BD BiH and consolidated overview for BiH.

The report includes:

- Revenues, expenditures and BiH Institutions budget financing (Table 3.1.);
- Revenues, expenditures and RS budget financing (Fund 01) and Funds from 02 to 05; revenues, expenditures and financing of RS budget users operating through their own bank accounts outside the General Account Plan; income, expenditures and financing of budgets of

municipalities and cities; revenues, expenditures and financing of financial plans of non-budget funds; revenues and financing of financial plans of PC Putevi RS and PC Autoputevi RS and foreign projects, escrow account funds and tolls (Table 3.2.);

- Revenues, expenditures and FBiH budget financing; revenues, expenditures and Cantonal budget financing; revenues, expenditures and financing of budgets of municipalities and cities; revenues, expenditures and financing of financial plans of non-budget funds and Cantonal roads directorates, revenues, expenditures and financing of public enterprises and foreign projects (Table 3.3.) and
- Revenues, expenditures and BD BiH budget and funds (Table 3.4);

Note: On the occasion of comparison of level reports, differences in the scope of data should be taken into account

BiH Institutions

Table 3.1a: BiH Institutions Budget Framework (in million BAM)

INSTITUCIJE BiH	2018	2019	2020	2021	2022
Revenues	923,6	880,0	923,9	929,8	926,5
Tax revenues	750,0	750,0	780,0	780,0	780,0
Indirect taxes	750,0	750,0	780,0	780,0	780,0
Direct taxes	0,0	0,0	0,0	0,0	0,0
Other tax revenues	0,0	0,0	0,0	0,0	0,0
Contributions	0,0	0,0	0,0	0,0	0,0
Grants and transfers	18,0	0,6	0,7	0,6	0,5
Other revenues	155,6	129,4	143,2	149,2	146,0
Expenditures	956,6	962,6	991,4	991,4	991,4
Gross salaries and remunerations	652,9	687,4	731,5	735,4	740,3
Expenditures for material and services	173,3	181,6	181,5	182,6	194,9
Interest	0,8	1,1	1,0	1,0	0,9
Subsidies, social contributions and transfers	25,8	20,1	17,2	15,4	15,3
Other expenditures	18,6	17,7	16,5	16,2	16,5
Net expenditures for non-financial assets	85,2	54,6	43,7	40,7	23,5
Balance	-33,0	-82,6	-67,5	-61,5	-64,9
Financing	33,0	82,6	67,5	61,5	64,9
Domestic	34,3	86,0	72,1	7,2	12,3
Internal debt repayment	0,0	0,0	0,0	0,0	0,0
Other (+/-)	34,3	86,0	72,1	7,2	12,3
Foreign	-1,3	-3,4	-4,6	-4,6	-4,6
Foreign credits withdrawals	0,0	0,0	0,0	0,0	0,0
Repayment of foreign credits principal	-1,3	-3,4	-4,6	-4,6	-4,6
Uncovered surplus of expenditures	0,0	0,0	0,0	58,9	57,2

Source: Ministry of Finance and Treasury of Bosnia and Herzegovina

Table 3.2a: RS Budget Framework (in million BAM)

REPUBLIKA SRPSKA	2018	2019	2020	2021	2022
Revenues	4.378,6	4.476,6	4.740,0	4.842,7	4.979,8
Tax revenues	2.435,1	2.520,5	2.647,2	2.724,8	2.821,9
Indirect taxes	1.927,2	1.999,5	2.109,4	2.171,3	2.250,4
Direct taxes	481,5	489,1	497,8	512,8	529,4
Other tax revenues	26,4	31,9	40,0	40,7	42,1
Contributions	1.540,4	1.564,4	1.676,3	1.706,5	1.734,8
Grants and transfers	27,8	11,5	23,9	8,5	6,3
Other revenues	375,3	380,2	392,6	402,9	416,8
Expenditures	4.433,3	4.581,2	4.663,9	4.657,8	4.709,1
Gross salaries and remunerations	947,6	1.006,6	1.089,7	1.097,4	1.103,4
Expenditures for material and services	365,5	386,7	383,0	383,6	386,2
Interest	135,7	140,6	139,0	138,0	133,6
Subsidies, social contributions and transfers	2.225,9	2.290,0	2.369,4	2.417,5	2.418,4
Other expenditures	220,9	161,7	164,7	161,8	169,8
Net expenditures for non-financial assets	537,7	595,6	518,1	459,5	497,7
Balance	-54,7	-104,6	76,1	184,9	270,7
Financing	54,7	104,6	-76,1	-184,9	-270,7
Domestic	-294,3	33,3	-16,4	-71,4	-19,1
Internal debt repayment	-442,9	-375,5	-268,7	-347,7	-325,4
Other (+/-)	148,6	408,8	252,3	276,3	306,3
Foreign	346,0	27,3	-59,8	-113,5	-251,6
Foreign credits withdrawals	654,9	291,2	171,1	138,0	6,1
Repayment of foreign credits principal	-308,9	-263,9	-230,9	-251,5	-257,7
Uncovered surplus of expenditures	3,0	44,0	0,1	0,0	0,0

Source: Ministry of Finance of Republika Srpska

Table 3.3a: FBiH Budget Framework (in million BAM)

FBiH	2018	2019	2020	2021	2022
Revenues	8.719,3	9.322,8	9.235,6	9.424,2	9.625,9
Tax revenues	4.140,9	4.392,0	4.509,3	4.678,7	4.836,4
Indirect taxes	3.261,9	3.526,6	3.626,0	3.779,8	3.923,6
Direct taxes	878,2	864,7	883,2	898,8	912,8
Other tax revenues	0,8	0,7	0,1	0,1	0,0
Contributions	3.456,5	3.533,7	3.607,2	3.655,9	3.708,0
Grants and transfers	16,7	33,7	9,2	8,7	8,9
Other revenues	1.105,2	1.363,4	1.109,9	1.080,9	1.072,6
Expenditures	7.839,8	9.307,4	8.964,4	9.054,4	9.179,8
Gross salaries and remunerations	1.753,4	2.058,0	2.055,4	2.068,2	2.069,6
Expenditures for material and services	1.734,7	2.033,2	1.956,8	1.967,5	2.008,3
Interest	113,3	140,0	137,0	155,0	161,7
Subsidies, social contributions and transfers	3.627,6	3.954,0	4.138,6	4.201,8	4.264,2
Other expenditures	308,4	544,6	316,5	318,6	320,8
Net expenditures for non-financial assets	302,4	577,6	360,1	343,3	355,2
Balance	879,5	15,4	271,2	369,8	446,1
Financing	-879,5	-15,4	-271,2	-369,8	-446,1
Domestic	-774,2	-441,1	-780,8	-615,6	-284,5
Internal debt repayment	-270,8	-224,0	-487,9	-511,8	-572,8
Other (+/-)	-503,4	-217,1	-292,9	-103,8	288,3
Foreign	26,2	95,1	368,0	44,6	-257,8
Foreign credits withdrawals	563,4	587,1	822,9	563,8	241,7
Repayment of foreign credits principal	-537,2	-492,0	-454,9	-519,2	-499,5
Uncovered surplus of expenditures	-131,5	330,6	141,6	201,2	96,2

Source: FBiH Ministry of Finance

BD BiH**Table 3.4a: BD BiH Budget Framework (in million BAM)**

BD BiH	2018	2019	2020	2021	2022
Revenues	253,5	251,5	261,9	269,3	277,7
Tax revenues	203,9	208,0	217,7	224,5	232,1
Indirect taxes	175,7	179,5	187,8	194,6	202,2
Direct taxes	28,2	28,5	29,9	29,9	29,9
Other tax revenues	0,0	0,0	0,0	0,0	0,0
Contributions	31,0	31,6	32,4	33,0	33,8
Grants and transfers	2,4	0,0	0,0	0,0	0,0
Other revenues	16,2	11,9	11,8	11,8	11,8
Expenditures	221,5	270,6	252,4	260,9	269,3
Gross salaries and remunerations	71,1	84,8	92,0	92,4	92,5
Expenditures for material and services	67,6	72,0	72,9	73,7	80,9
Interest	0,4	0,4	0,8	0,7	0,6
Subsidies, social contributions and transfers	77,9	85,9	75,6	83,9	84,9
Other expenditures	0,0	0,0	0,0	0,0	0,0
Net expenditures for non-financial assets	4,5	27,5	11,1	10,2	10,4
Balance	32,0	-19,1	9,5	8,4	8,4
Financing	-32,0	19,1	-9,5	-8,4	-8,4
Domestic	2,9	5,6	6,1	6,0	6,0
Internal debt repayment	-0,6	-0,6	-0,7	-0,7	-0,7
Other (+/-)	3,5	6,2	6,8	6,7	6,7
Foreign	-4,0	-8,1	-9,3	-8,0	-8,2
Foreign credits withdrawals	2,8	0,6	0,0	0,0	0,0
Repayment of foreign credits principal	-6,8	-8,7	-9,3	-8,0	-8,2
Uncovered surplus of expenditures	-30,9	21,6	-6,3	-6,4	-6,2

Source: BD BiH Finance Directorate

BiH: Consolidated**Table 3.5a: BiH Consolidated (in million BAM)**

BiH-CONSOLIDATED	2018	2019	2020	2021	2022
Revenues	14.275,0	14.930,9	15.161,4	15.466,0	15.809,9
Tax revenues	7.529,9	7.870,5	8.154,2	8.408,0	8.670,4
Indirect taxes	6.114,8	6.455,6	6.703,2	6.925,7	7.156,2
Direct taxes	1.387,9	1.382,3	1.410,9	1.441,5	1.472,1
Other tax revenues	27,2	32,6	40,1	40,8	42,1
Contributions	5.027,9	5.129,7	5.315,9	5.395,4	5.476,6
Grants and transfers	64,9	45,8	33,8	17,8	15,7
Other revenues	1.652,3	1.884,9	1.657,5	1.644,8	1.647,2
Expenditures	13.451,2	15.121,8	14.872,1	14.964,5	15.149,6
Gross salaries and remunerations	3.425,0	3.836,8	3.968,6	3.993,4	4.005,8
Expenditures for material and services	2.341,1	2.673,5	2.594,2	2.607,4	2.670,3
Interest	250,2	282,1	277,8	294,7	296,8
Subsidies, social contributions and transfers	5.957,2	6.350,0	6.600,8	6.718,6	6.782,8
Other expenditures	547,9	724,0	497,7	496,6	507,1
Net expenditures for non-financial assets	929,8	1.255,3	933,0	853,7	886,8
Balance	823,8	-190,9	289,3	501,6	660,3
Financing	-823,8	190,9	-289,3	-501,6	-660,3
Domestic	-1.031,3	-316,2	-719,0	-673,8	-285,3
Internal debt repayment	-714,3	-600,1	-757,3	-860,2	-898,9
Other (+/-)	-317,0	283,9	38,3	186,4	613,6
Foreign	366,9	110,9	294,3	-81,5	-522,2
Foreign credits withdrawals	1.221,1	878,9	994,0	701,8	247,8
Repayment of foreign credits principal	-854,2	-768,0	-699,7	-783,3	-770,0
Uncovered surplus of expenditures	-159,4	396,2	135,4	253,7	147,2

Source: Calculations of the BiH Fiscal Council Counselling Group

3.3. Budget indebtedness ceilings

Limits of debt amounts at all levels of governance in BiH are stipulated by Laws, as follows:

- The Law on Borrowing, Debt and Guarantees of Bosnia and Herzegovina, (Official Gazette of BiH, 52/05);
- The Law on Borrowing, Debt and Guarantees of Republika Srpska (Official Gazette of RS, 71/12, 52/14 and 114/17) and
- The Law on Debt, Borrowing and Guarantees in the Federation of Bosnia and Herzegovina (Official Gazette of FBiH, 86/07, 24/09, 44/10 and 30/16).

RS

The Law on Borrowing, Debt and Guarantees of RS stipulates that the public debt of RS (RS debt, local self-government units debt and social security funds debt) at the end of a fiscal year may not exceed 55 per cent of GDP achieved in the same year (in 2020 6.370.7 million BAM), while the total debt of RS (RS public debt, public enterprises debt, debt of the RS Investment-Development Bank and public

sector institutions) at the end of a fiscal year may not exceed 60 per cent of GDP achieved in the same year (in 2020 6.949.8 million BAM)⁴¹.

FBiH

Total revenues of cities and municipalities in FBiH amounted to 890.2 million BAM in 2018.

Pursuant to the Law on Debt, Borrowing and Guarantees, cities and municipalities may borrow in the long-term if, at the time when the borrowing is approved, the amount of debt servicing maturing in each subsequent year, including servicing of the proposed new borrowing and all loans guaranteed by cities and municipalities do not exceed 10 per cent of revenues achieved in the previous fiscal year.

In 2018, 10 per cent of revenues of cities and municipalities amounts to 89.02 million BAM, representing legal limitation of total annual debt servicing of all municipalities. Each municipality/city may borrow individually if, at the time when the long-term borrowing is approved, the amount of debt servicing maturing in each subsequent year, including servicing of the proposed new borrowing and all loans guaranteed by municipalities/cities do not exceed 10 per cent of revenues of the relevant municipality/city achieved in the previous fiscal year.

Total revenues of Cantons in FBiH achieved in 2018 amounts to 2.301.2 million BAM.

Pursuant to the Law on Debt, Borrowing and Guarantees, Cantons may borrow in the long-term if, at the time when the long-term borrowing is approved, the total amount of domestic and foreign debt and guarantees servicing maturing in each subsequent year, including servicing of the proposed new borrowing and all loans guaranteed cantons do not exceed 10 per cent of revenues achieved in the previous fiscal year.

Ten per cent of revenues of Cantons achieved in 2018 amounts to 230.116.973 BAM, representing the amount of total possible annual servicing of all debts (liabilities) of cantons, with each Canton being able to borrow if at the moment of the long-term borrowing, the amount of debt servicing for total domestic and foreign debt and guarantees maturing in each subsequent year, including servicing of a new proposed borrowing and all loans guaranteed by Cantons, do not exceed 10 per cent of revenues of the particular Canton achieved in the previous fiscal year.

The consolidated revenues of FBiH and Cantons in 2018 amounts to 4.460.7 million BAM, of which:

FBiH 2.159.5 million BAM

Cantons 2.301.2 million BAM

FBiH may borrow in the long-term if the amount for servicing total domestic and foreign debt and guarantees maturing in each subsequent year, including servicing of the proposed new borrowing and all loans guaranteed by FBiH, together with limitations to the amount of debt of Cantons do not exceed 18 per cent of consolidated revenues of FBiH and Cantons achieved in the previous fiscal year. The annual debt servicing of FBiH and Cantons may not exceed 18 per cent of consolidated revenues of FBiH and Cantons achieved in 2018, i.e. 802.927.862 BAM. Annual debt servicing in 2018 of all levels of governance in FBiH may amount up to 892.0 million BAM, of which:

- Servicing of debt of municipalities and cities up to 89.02 million BAM (10 per cent of total revenues in 2018)

⁴¹ In accordance with estimates of the Ministry of Finance of RS, the estimated nominal gross domestic product of RS in 2020 will amount to 11.583.0 million BAM.

- Servicing of debt of Cantons up to 230.1 million BAM (10 per cent of total revenues of Cantons in 2018)
- Servicing of debt of FBiH up to 572.9 million BAM, representing a difference between 803.0 million BAM (18 per cent of consolidate revenues of FBiH and Cantons in 2018) and 230.1 million BAM (10 per cent of revenues of Cantons achieved in 2018).