

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 conclude the following

AGREEMENT ON ADOPTION OF THE GLOBAL FRAMEWORK OF FISCAL BALANCE AND POLICIES IN BOSNIA AND HERZEGOVINA 2021-2023 BETWEEN THE COUNCIL OF MINISTERS OF BOSNIA AND HERZEGOVINA, THE GOVERNMENT OF REPUBLIKA SRPSKA AND THE GOVERNMENT OF THE FEDERATION OF BOSNIA AND HERZEGOVINA

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

Seeking to maintain the continuity of improving fiscal policy coordination in Bosnia and Herzegovina,

Appreciating the need for timely preparation of the 2021 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 2021-2023* for which the consent was given at the 4th session of the Fiscal Council held on 18 November 2019.

II

The Global Framework of Fiscal Balance and Policies in Bosnia and Herzegovina 2021-2023 determines 2021, 2022 and 2023 budgets in the amount of 1.027.100.000 BAM, including allocation of revenues from indirect taxes in the amount of 780.000.000 BAM.

III

The Global Framework of Fiscal Balance and Policies in Bosnia and Herzegovina 2021-2023 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

Number: _____



BOSNIA AND HERZEGOVINA
THE FISCAL COUNCIL

**GLOBALNI OKVIR FISKALNOG BILANSA I POLITIKA
U BOSNI I HERCEGOVINI
2021 – 2023. GODINA**

August, 2020

List of abbreviations

BiH-Bosnia i 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

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

CBBiH-Central Bank of Bosnia and Herzegovina

CA-Current Account

UNCTAD-United Nations Conference on Trade and Development

SDU (DSU)-Foreign direct investments

CEFTA-Central European Free Trade Agreement

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Summary

On the basis of the analysis of macroeconomic developments in BiH in the previous period, as well as on the basis of consideration of key domestic and foreign development factors, it is envisaged that the real BDP growth rate in the period 2021-2023 will be 3.1, 3.3 and 3.5 %, respectively.

Projections of indirect tax revenues in BiH between 2021 and 2023 demonstrate that in 2021, the net amount for distribution will amount to 6.088.8 million BAM, i.e. it will increase by 3,7 % in comparison with 2020. In 2020, it is envisaged that funds for distribution from indirect taxes will increase by 3,7 %, while further growth by 3,9 % is envisaged in 2023.

Of course, the consequences of the global corona virus pandemic may not be overlooked, suffered primarily by the real sector and consequently by the budgets of all levels of governance in BiH, except the BiH Institutions budget. In this regard, all stated estimates and projections should be taken cautiously since these might imply revising the 2021-2023 Global Framework of Fiscal Balance and Policies of BiH, in particular its key determinants.

Bearing in mind the above said, and 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 tax revenues for 2021, 2022 and 2023 is at the level of 780.0 million BAM. The remaining amount of indirect tax revenues will be distributed in accordance with the applicable regulations.

The BiH fiscal goal for 2021 is the primary surplus continuous increase, i.e. decrease of the primary deficit in 2021, 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 833.7 million BAM or 2.34 % of the projected GDP for 2021.

The level of public spending as a part of GDP in 2021-2023 should be decreased with the aim for the consolidated public spending at the level of BiH to remain below 40 % of GDP, while it will be in the range between 47.4 and 38.9 % of the estimated GDP, respectively, in the observed period.

The upper limits of budget indebtedness in 2021, expressed as the amount needed for total debt servicing or GDP percentage, depending on the legal solution, are estimated within frameworks prescribed by the laws regulating borrowing for each level of governance.

Introduction

The Global Framework of Fiscal Balance and Policies in Bosnia and Herzegovina 2021- 2023 is prepared pursuant to the Law on the Fiscal Council of BiH (*Official Gazette of BiH*, 63/08), prescribing the contents of the document. In this regard, the document contains all necessary elements required by the fiscal policy leads in Bosnia and Herzegovina for preparation of their framework budget documents for the 2021-2023 period, as well as the 2021 annual budget. These elements are the following: fiscal goals defined as the primary fiscal balance (primary surplus or primary deficit), projections of total indirect revenues based on macroeconomic projections and their distribution for the following fiscal year, as well as the ceilings of indebtedness.

Agreement on the stated elements represents the basis for budget planning by fiscal policy leads in BiH and represent the essence of fiscal coordination in BiH. Without agreeing upon these, the coordination of fiscal policies and preservation of fiscal stability are not possible for both individual fiscal sovereignties and Bosnia and Herzegovina as a whole.

The first chapter of the document includes analysis and macroeconomic development trends in BiH prepared by the Directorate for Economic Planning of BiH (DEP BIH). This part includes projections of basic macroeconomic indicators with a special focus on macroeconomic elements which directly influence the elements of the fiscal policy, primarily the level of public revenues.

The second part provides analysis of the levels and structure of indirect tax revenues and provides these projections for the following three years prepared by the Department for Macroeconomic Analysis of the Management Board of the Indirect Taxation Authority of BiH (MEAD). Since these revenues are distributed to more fiscal entities in BiH, this part also includes elements of the distribution of indirect tax revenues starting from the applicable regulations of BiH in this field.

The third part of the document relates to the fiscal goals of the budgets of the Institutions of BiH, the Federation of BiH, Republika Srpska and Brčko Distrik of BiH. The basic elements of fiscal policies such as the level of public spending and the policy of public borrowing are treated in this part, as well.

2018-2022 macroeconomic indicators and projections

The following table presents the estimate and projections of macroeconomic indicators in BiH for the 208-2023 period, representing the starting point for projections of total indirect taxes.

Table 1.1 2018-2023 macroeconomic indicators

Indicator	Official data	Projections				
	2018	2019	2020	2021	2022	2023
Nominal GDP in mill. BAM	34,023	35,365	34,283	35,709	37,460	39,226
Nominal growth in %	5.2	3.9	-3.1	4.2	4.9	4.7
GDP deflator (previous year=100)	101.9	100.7	99.8	101.1	101.5	101.2
Real GDP in mill. BAM (previous year=100)	33,399	35,116	34,342	35,330	36,898	38,778
Real growth in %	3.3	3.2	-2.9	3.1	3.3	3.5
Inflation measured by retail prices index in %	1.4	0.6	-0.5	1.2	1.3	1.4
Spending in mill. BAM	32,048	32,931	32,350	33,236	34,429	35,695
Real growth in %	2.0	1.8	-1.7	1.5	1.8	1.9
Government spending in mill. BAM	6,611	6,776	6,972	7,007	7,231	7,448
Real growth in %	0.9	1.0	2.5	-0.2	0.7	0.5
Private spending in mill. BAM	25,437	26,155	25,377	26,229	27,197	28,247
Real growth in %	2.3	2.0	-2.8	2.0	2.1	2.3
Fixed assets investments (gross) in mill. BAM	6,310	6,857	6,153	6,664	7,318	7,989
Real growth in %	9.2	8.3	-8.4	7.1	8.7	7.7
Government investments in mill. BAM	859	954	858	972	1,096	1,219
Real growth in %	15.4	9.4	-8.3	11.6	10.8	9.0
Private investments in mill. BAM	5,451	5,903	5,295	5,692	6,222	6,769
Real growth in %	8.3	8.1	-8.5	6.3	8.3	7.5
Import in mill. BAM	19,097	19,955	18,435	19,497	20,848	22,542
Nominal growth in %	6.7	4.5	-7.6	5.8	6.9	8.1
Real growth in %	3.7	2.5	-5.8	4.0	4.5	5.1
Export in mill. BAM	14,087	14,850	13,515	14,571	15,810	17,289
Nominal growth in %	10.0	5.4	-9.0	7.8	8.5	9.4
Real growth in %	6.1	3.4	-7.1	6.1	5.9	7.1
National gross savings in % of GDP	16.9	18.4	16.0	16.9	17.7	18.3
Current account balance in mill. BAM	-1,236	-1,022	-1,361	-1,366	-1,452	-1,620
Growth in %	-9.1	-17.4	33.3	0.3	6.3	11.6
Current account balance in mill. BAM	-3.6	-2.9	-4.0	-3.8	-3.9	-4.1

Source: The Directorate for Economic Planning of Bosnia and Herzegovina (DEP BiH)

The baseline scenario

Projections in the baseline scenario were prepared when no statistical data were available for March 2020 due to unperceived shocks on the side of supply and demand. The projections are based on the assumption that the consequences of the crisis will impact the first quarter of 2020 the most, with continuation of this effect until the end of the year, although reduced. In addition, the projections did not include the stabilisation measures of Entity Governments and the Council of Ministers of BiH in their entirety since the final scope of these measures was not known at the moment of preparation of the document.

The real sector

BiH GDP developments in 2019 and projections for 2020

In accordance with the current preliminary data of the Agency for Statistics of BiH (hereinafter referred to as: "BHAS"), the statistics of national accounts, on the expenditures side for 4 quarters, it is estimated that in comparison with the previous year, in 2019 BiH achieved the economic growth of approximately 2.6 %.¹ This growth rate represents significant slowing down of economic growth in Bosnia and Herzegovina by more than 0.5 percentage points (p.p.) in comparison with the previous year. The basis of the achieved economic growth in this period is represented by domestic demand through increase in final spending and investments, to a lesser extent. Increase in private spending is clearly due to the increase in the number of employees and retired persons, as well as their income in real terms, and money transfers from abroad, which resulted in the increased available income of citizens. On the other hand, in interpreting the contribution of foreign investments, one should be careful since this component includes reserves, as well. The foreign sector, i.e. net import due to export decrease and import increase had a negative effect on economic growth developments in BiH over the observed period. The BiH economic growth downturn in 2019 is largely due to the downturn of economic activities in the international economic environment, i.e. economic growth downturn in certain EU countries such as Germany and Italy.

The beginning of 2020 was characterised by additional complication of international economic circumstances and Covid-19 outbreak. This will have negative implications on economic developments in the world, in the region and finally in Bosnia and Herzegovina. The intensity and duration of these new circumstances will essentially determine economic growth developments, in both the short and medium terms. Prior to the very analysis of macroeconomic developments in BiH, it should be noted that, at the time of preparation of this report, all international relevant institutions (the International Monetary Fund (IMF), the World Bank (WB), the European Commission (EC)) carried out weekly projections of macroeconomic developments for 2020, representing an additional obstacle in preparation of this report. The newest reference document of the IMF, *World Economic Outlook, April 2020, The Great Lockdown* envisages a drastic downturn of world economy by 3 % in 2020 depending on the duration and intensity of Covid-19 pandemics. In accordance with these projections, the expected GDP downturn in developed countries amounts to 6,1 %, while the expected level in the developing countries is 1 %.² On the other hand, in their *Spring 2020 Economic Forecast: A deep and uneven recession, and uncertain recovery* from May 2020, the EC envisages the downturn of GDP in EU countries at the level of 7.54 %, whereby the expected decrease of GDP per country amounts to: Germany

¹ BHAS, announcement entitled "Gross domestic product, expenditure method, data for a three-months period", 02/04/2020.

² IMF, „World Economic Outlook, April 2020, The Great Lockdown”, April 2020.

6.5 %, Italy 9.5 %, Austria 5.5 %, Croatia 9.1 % and Slovenia 7.0 %³. If we remember that economic developments in the EU and stated countries represented the main structural parameter of economic developments in BiH (production, spending, foreign trading), we can conclude that the consequences of these development, in view of economic developments in the country, will be very unfavourable. It should be noted that this global economic crisis is very different in nature from the 2009 global financial crisis. It is characterised by simultaneous downturn by the aggregate supply (supply-side shock) and aggregate demand (demand-side shock). Therefore, the projected rates of economic developments in the country are significantly more negative in comparison to 2009.

Despite the uncertainty of the duration of the Covid-19 pandemic and its effect on the global trade, it is already evident that this outbreak will primarily result in downturn of the global economy, and consequently of private spending, investments and finally economic growth. Currently available short term economic indicators for the first quarter of 2020 support this statement. Namely, in accordance with the data of EUROSTAT for Q1 of 2020, the EU countries (EU) recorded decrease in the physical volume of industrial production of over 5 %, of import and export of over 3 %, i.e. 5 % in comparison with the same quarter of the previous year, which resulted in the GDP increase by 2.6 %.⁴ It has to be noted that these indicators encompass Q1 2020, including 31 March 2020. In other words, the true consequences of the global pandemic in view of economic development in EU should be expected in the following quarters, if not in the following years. Bearing in mind all of the above and certain short term indicators of economic development in the country and abroad, DEP BiH drastically revised its projection of export growth in 2020 to -7.1 % in comparison with the previous year, conditioned by stabilisation of the economic environment in main trading partners in the second half of the current year. The currently available data on foreign trading in goods for the period between January and April 2020 already show drastic downturn in comparison with the previous year. Namely, in accordance with BHAS data for the first four months of 2020, export of goods from Bosnia and Herzegovina decreased by 12.7 % in comparison with the same period of the previous year. On the other hand, the decrease of import into Bosnia and Herzegovina by 14.8 %.⁵ On the other hand, although precise data on import of services during the observed period were not available at the time of preparation of this report, it can be assumed that the same will be very unfavourable. In accordance with the new circumstances, it is realistic to expect downturn in the first half of the year that other aggregates of economic growth such as private spending and investments (domestic demand). Therefore, the projection of the import developments in 2020 amount to -5.8 % in comparison with the previous year⁶. If we keep in mind that, in foreign trading terms, Bosnia and Herzegovina is characterised by an imbalance of import (42 % of GDP) and export (56 % GDP), this downturn of the exchange would result in the decrease of the trading balance of approximately 2 % in real terms, and the influence of which would be partially positive. This does not represent any surprises since Bosnia and Herzegovina is a country with high import dependency, while a similar scenario is recorded during the 2009 global economic crisis.

On the other hand, if we bear in mind the structural composition and economic growth developments in BiH, it should be noted that the domestic demand, or more precisely, private demand, represented the key determinant of economic developments in the previous years. However, in accordance with the downturn of total economic activity in the country due to the outbreak of the pandemic, private spending is expected to decrease by 2.8 % in 2020 in real terms in comparison with the previous year. The key determinant of this decrease of private spending is represented by the already certain decrease in the number of employed

³ DG ECFIN, „Spring 2020 Economic Forecast: A deep and uneven recession, and uncertain recovery”, May 2020

⁴ Eurostat, „Euroindicators” 81/2020. 15 May 2020.

⁵ Agency for Statistics of Bosnia and Herzegovina, Information “The Statistics of Trade Exchange of BiH with Foreign Countries, January-April 2020”, May 2020.

⁶ DEP projections, May 2020

persons, reduction of salaries and remittances from abroad, which will additionally weaken the available income of citizens. Decrease in the remittances from abroad will likely impact the foreign sustainability of the country. This might manifest in an increase of the current account deficit within GDP to 4 %, which would represent an increase of more than 1 p.p. In comparison with the previous year. On the other hand, it is expected that the institutions will additionally engage in view of protection of public health and mitigation of economic consequences of Covid-19. In this view, it is expected that public spending in 2020 will be higher than the multi-annual average and amount to 2.5 % in comparison with the previous year. Therefore, this category might have a positive impact on the economic growth. Investments participate with about 18 % in the GDP structure, whereby private investments make for more than 4/5, while the remaining part pertains to public investments in Bosnia and Herzegovina. Uncertainty and turbulences on the international, as well as on the domestic market could have a rather negative effect on the development of investments in 2020. This is predominantly related to private investments where a decrease of 8.5 % is expected. On the other hand, increased public spending through increased allocations to public health sector and support to the economy will likely affect public investments where a decrease by approximately 8 % is expected. Bearing in mind the stated international circumstances and the current state of the economy in BiH, assuming that the Covid-19 pandemics will spread in a limited manner in the first half of the year, it might be expected that the real GDP will decrease by about 3 % by the end of the year in comparison with the previous year.

2021-2023 assumptions of GDP developments

The key basis for development of macroeconomic parameters in BiH in the 2021-2023 period is the improvement of the external environment. However, as stated before, the World Health Organisation (WHO) as the only relevant international institutions, still did not produce an official position on the duration of the global pandemic. On the other hand, certain international financial institutions such as IMF, expect strong recovery of the global economy in 2021, with the expected economic growth rate of 5.8 %, while the EC envisages growth by 6.1 % for EU, which appears rather optimistic. In this regard, DEP projections for the medium term are mainly based on the projections of the stated international institutions and are based on the assumption that the virus pandemic is a short term occurrence which will be overcome in the second half of 2020. Therefore, the precondition for achievement of the stated projections is overcoming the newly created circumstances in the short term, improvement of the international economic surrounding, as well as implementation of both intervention and structural reforms in the country in order to increase the contribution of internal dynamics to the economic growth in BiH. Under the assumption of achievement of the stated circumstances, in accordance with DEP BiH projections for the 2021-2023 period, Bosnia and Herzegovina expects continuation of the approximately 3 % economic growth annually (2021: 3.1%, 2022: 3.3%, and 2023: 3.5%). It is assumed that domestic demand through increased private spending and investments will play the key role in support to the economic growth during this period. Namely, the increased total economic activity in the country, in addition to the expected increase in industrial production and civil works, accompanied by increased employment and export revenues (goods and services) should result in the increase in available income of citizens and thus in private consumption that will provide key support to economic growth as was the case in previous years. Therefore, it is expected that the 2021-2023 private spending will grow at the rate of 2% (2021: 2.0 %, 2022: 2.1%, 2023: 2.3%). On the other hand, bearing in mind the high level of public spending under GDP in BiH and activities invested through the 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 2021-2023 private spending will grow only mildly, at the

annual rate of 0.3 % (2021: -0,2%⁷, 2022: 0.7%, and 2023: 0.5%). If we keep in mind that the projected rate of the economic growth would be higher than public spending increase, the share of the same in GDP would be partially smaller at the end of 2023. It is expected that measures of fiscal policy would enable for the part of savings under current spending to be directed towards strengthening investment spending in Bosnia and Herzegovina. As the result of this and improvement of the business environment, investments could grow more significantly during this period in comparison with previous years, therefore contributing more to the GDP growth. It is expected that total investments will increase at an average annual growth rate of 8 per cent between 2021 and 2023 (2021: 7.1%, 2022: 8.7%, 2023: 7.7%). Within this period, it is expected that private investments, representing a major portion of total investments (approximately 85 per cent of total investments) will increase during this period, in addition to a more significant increase in public investments. It is considered that the progress in terms of European integrations, 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 have a more important role in encouraging the economic growth in the medium term. Road infrastructure construction projects and projects in the energy sector, as well as availability of funds of international financial institutions, with adequate and timely implementation, could result in increased public investments at the rate of more than 10 per cent at an annual level. Therefore, public investments level under GDP in BiH should increase in the medium term by more than 3.5 per cent of GDP.

More favourable external environment and improved industrial base and increased competency in BiH represent key preconditions for improvement of external trade exchange with the world. If the stated external assumptions for the 2021-2023 period are achieved, it might be expected that the external trade exchange with the world will increase. In this case, an average annual growth rate of approximately 7 per cent of import might be expected, whereby the projected increase in goods and services would be mostly balanced. Therefore, as the result of the export growth, the share of export in GDP would increase from 40 per cent in 2021 to approximately 44 per cent in the end of 2023. At the same time, it is expected for the export to develop at a somewhat slower rate of 4.5 per cent in the same period. A rather balanced growth of import of goods and export of services is expected during this period. As the result of such import growth, the share of import in GDP should increase from 54 per cent of GDP in 2021 to approximately 57 per cent in the end of 2023. A slightly stronger growth of export in comparison with the growth of export in the medium term would result in the gradual stabilisation of foreign trading balance as a share in GDP at approximately 13 per cent, i.e. In neutral economic growth, while the export-import ration should amount to approximately 77 per cent in the end of 2023.

Risks

The risks in achieving the stated projections might be classified into two groups, into foreign and domestic, whereby foreign risks are more certain and affect the economic growth in Bosnia and Herzegovina more. In addition to the fact that the available reports of international institutions already announced the downturn in the economic activity in the external environment, the global Covid-19 outbreak represents the ultimate primary risk to achievement of this basic scenario projections. Overcoming these new challenges as soon as possible represents the precondition for achievement of the stated macroeconomic indicators projections. On the other hand, domestic challenges, i.e. BiH domestic risks pose a threat, as well. The domestic risks is represented by the complex system of decision making and slow rate at which economic reforms are implemented in the country. Possible delays in implementation of intervention measures due to the Covid-

⁷ It should be noted that the decrease of public spending in 2021 is the result of the basis effect (high basis) from the previous year.

19 pandemic, as well as in implementation of general structural reforms might affect negatively the total economic growth.

When it comes to medium term risks for the 2021-2023 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.

Industrial production

BiH industrial production developments in 2019 and projections for 2020

The 2019 statistics of BHAS imply that BiH recorded, after a long time, a very negative results when it comes to the developments of the physical volume of industrial production. Namely, in accordance with the available BHAS 2019 data, BiH saw a decrease of the physical volume of industrial production of 5.5 per cent in comparison with the same period of the previous year.⁸ This decrease represents the most significant downturn of industrial production since the time of the global economic crisis. The key reason behind these developments of the industrial production in BiH is represented by the downturn of economic activity in main trading partners, as well as the challenges faced by domestic companies in certain economic sectors. Namely, in accordance with the 2019 EUROSTAT data, the physical volume of industrial production in EU28 countries was at the level of 0.8 per cent, If observed by countries, the most important decrease of the physical volume of industrial production was recorded in Germany, 4.7 per cent, Italy 1.2 per cent, as well as in the countries of the region, in Montenegro, 7.6 per cent, Turkey 1.5 per cent and Serbia 0.2 per cent.⁹ Overview of the 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 largest decrease rate was recorded in the electricity production sector and amounted to 8.2 per cent in comparison with the previous year. This decrease is the result of an equal downturn in production in both hydro power and thermal power plants. In addition to the decrease in production of electric energy, 2019 recorded 3.7 per cent decrease in the mining sector, predominantly as the result of the decrease in the production in coal and lignite mines in comparison with the previous year. At the same time, 2019 saw a 5 per cent decrease in comparison with the previous year in the export-oriented processing industry. This decrease is caused by the downturn of economic activity in main trading partners, i.e. by weakening of export demand for BiH products. The detailed insight into the structure of the processing industry shows that in 2019 the most significant downturns were recorded in the export-oriented sectors such as oil derivatives and coke, textile production and tobacco production, where double-digit decrease of productions rate was recorded. In addition to these production branches, decreased production was recorded in production of chemicals and chemical products, wood processing (except furniture), leather and in production of base metals-approximately 10 per cent, respectively, in comparison with the previous period of the previous year. At the same time, increase in the production in the food processing industry and building materials by approximately 4.7 per cent, as well as other industry sectors were not enough to prevent decrease in the processing industry production, i.e. In the total industrial production in comparison with the previous year.

⁸ BHAS, announcement entitled "Bosnia and Herzegovina industrial production volume index for December 2019-previous data", 28 January 2020.

⁹ EUROSTAT, Production in industry January –December 2019 /January-December 2018 (seasonally & calendar adjusted data)

Projections of industrial production developments in Bosnia and Herzegovina in 2020 is very hard to predict now, since the same showed signs of weakness already last year, with these manifested in the decrease of the physical volume of production. In addition, the uncertainty created by the new circumstances-Covid 2019 outbreak further complicates composition of projections of the developments of the physical volume of industrial production in Bosnia and Herzegovina. The technological structure of the production base, as well as its dependence on market developments in main trade partners in the previous period has shown all vulnerabilities of industry, in particular the processing industry in Bosnia and Herzegovina. Therefore, the economic developments in main trade partners in 2020 will play the crucial role in determining the developments of the physical volume of production, number of employees and the level of investments in the industry sector in Bosnia and Herzegovina. Currently available statistical data on the developments of physical volume of industrial production in Q1 2020 imply intensification of the negative trend recorded in the previous year, due to spreading of the global Covid-19 pandemics. Namely, in accordance with the preliminary data of the BiH Agency for Statistics for Q1 2020, Bosnia and Herzegovina recorded a 3.8 per cent decrease in the industrial production volume in comparison to the same period of the previous year, while the decrease in March, in comparison to the same month of the previous year amounts to almost 10 per cent¹⁰. If the development of industrial production volume is observed by sectors, it is evident that the decrease in production is a consequence of the decrease in the processing industry by 8.1 per cent in comparison to Q1 of 2019, while the decrease in March even amounted to 16.1 per cent. This decrease in production is quite understandable if we keep in mind the structure of processing industry in Bosnia and Herzegovina which is rather export-oriented and directly impacted by the Covid-19 breakout. Therefore, the most important decreases were registered in the export-oriented branches where two-digits decrease rate were recorded. In accordance with the data of the BiH Agency for Statistics, the production development rates recorded in Q1 2020 amounted to: bare metals -33.4 per cent, furniture -22.2 per cent, motor vehicles parts approximately -20 per cent, coke and oil derivatives -15.3 per cent, machines and appliances -10 per cent, chemical products -9.3 per cent and footwear approximately -10 per cent. On the other hand, the mining and electricity production sectors, where the developments are determined by the domestic demand, recorded increase at the rate of 6.1 and 3.1 per cent, respectively. This production increase somewhat amortised the decrease in the total industrial production physical volume in Bosnia and Herzegovina in Q1 2020. Bearing in mind the previously stated international developments and the structural composition of industrial production in Bosnia and Herzegovina at the end of 2020, it might be expected for the physical volume of industrial production to decrease.

2021-2023 BiH industrial production developments projections

The medium-term developments of the industrial production physical volume will mostly depend on the economic market developments in the main trading partners, as this was the case in the previous period. In case the consequences of the new developments (Covid-19 pandemics) are to be recovered in the short-term period, it may be expected for Bosnia and Herzegovina to record a more evident economic progress in which the developments in the industrial production sector should play the crucial role. In addition to more favourable circumstances in this medium-term period, it is expected that the internal dynamics will have a more significant impact on strengthening industrial production in Bosnia and Herzegovina. Namely, it is expected that the reform measures being implemented by the competent institutions in Bosnia and Herzegovina with the aim of improving the business environment will have measurable outcomes. This improvement in the business environment should result in increased investments (domestic and foreign),

¹⁰BHAS, announcement entitled "Bosnia and Herzegovina industrial production volume index for December 2019-previous data", 20 April 2020.

higher utilisation of the existing and mobilisation of new capacities, increased employment and strengthening of the competitive position of producers in Bosnia and Herzegovina, in both domestic and foreign markets. Bearing in mind all of the above mentioned circumstances, Bosnia and Herzegovina is expected to achieve somewhat higher industrial production physical volume growth rates in the 2021-2023 period.

Risks

When it comes to industrial production, the risks are identical to general risks, whereby the risks in terms of weather conditions may be added as the electricity production sector does depend on the same. In the medium term, the risk for the projected strengthening of industrial production might be represented by a possible slowing down of reform processes with the aim of improving the business environment in the country.

Labour market

Labour market in 2019

The average number of employees in the period between January and December 2019 increased by 2.6 per cent in comparison to the 2018 and amounts to 823.1 thousands.¹¹ The most important increase in the number of employed persons was recorded in the area of trade, hospitality and processing industries. However, the growth in the processing industry was slower in comparison to 2018, which may be the result of the decreased production volume. In the services sector, the significant increase was recorded in the accommodation and food preparation and serving sectors, in addition to increased number of visits and night accommodation in Bosnia and Herzegovina. The average number of employed registered persons was 411.2 thousands, i.e. by 9 per cent less than in 2018. The intensity of the decrease in the number of unemployed persons was higher in comparison to 2018.¹² The survey unemployment rate in Bosnia and Herzegovina in 2019 decreased and amounts to 15.7 per cent. The average net salary in Bosnia and Herzegovina in 2019 amounted to 921, with the nominal growth rate of 4.8 per cent in comparison with 2018.

Labour market - projections 2020-2023

In accordance with the preliminary BHAS data, in March 2020 there were 830.4 thousands¹³ employed persons in Bosnia and Herzegovina, i.e. 2.2 per cent more than in March 2019, while the same number is by 0.2 per cent smaller in comparison to February 2020. On the other hand, the average number of employees in March 2020 decreased by 5.9 per cent in comparison to March 2019 and amounts to 398.5 thousands. The average net salary in the first quarter of 2020 was 945 BAM and is nominally higher by 4.5 per cent in comparison with the first quarter of 2019. However, from April 2020 onwards, the first indications of the COVID-19 pandemic on the labour market may be expected as shown by currently available data of entity Tax Administrations. In accordance with the official records from the Single system of registration, control

¹¹ Preliminary data.

¹² In 2018, the average number of registered unemployed persons decreased by 7.7 per cent y/y.

¹³ Source: BHAS, temporary data.

and collection of contributions of the Tax Administration of the Federation of Bosnia and Herzegovina, the number of employed persons in the Federation of Bosnia and Herzegovina in April 2020 was 510.009, i.e. 4 per cent less in comparison to April 2019 (or 21.483 employed persons). At the same time, in accordance with the data of the Tax Administration of Republika Srpska, there were 289.225 registered payers of insurance contributions treated as employment, which is by 2.4 per cent less in comparison to April 2019 (or 7.180 employed persons). All of the above indicates that the average number of employed persons in Bosnia and Herzegovina in 2020 due to previously mentioned circumstances might be smaller in comparison to data for 2019. The first signs of the crisis will definitely be felt by the persons employed in the hospitality industry. Due to the expected decrease in the volume of business activities arising from the COVID-19 crisis in the tourism sector (decrease in the number of visits and night accommodation), as well as hospitality, hotel, entertainment, recreation and culture industries, it might be expected that the number of employed persons in the stated industries will be lower than in the previous years. In addition to the stated industries, the developments in the volume of investments, trade and general economic growth will have a significant influence for preparation of the labour market (see the chapter on economic growth). This is why the previously described developments in the processing industry and trade in 2020 were taken into account in preparation of projections, as these sectors employ the majority of persons in Bosnia and Herzegovina (39 per cent). All of the above stated changes would negatively reflect on the number of employed persons in Bosnia and Herzegovina that might be by 1.5 per cent y/y, which would affect the unemployment rate growth.¹⁴ At the same time, the stated economic developments and more unfavourable business climate might have a negative effect on the wages of the employed persons in Bosnia and Herzegovina, i.e. decrease the net salaries growth rate in comparison to the previous year by 1.2 per cent y/y.¹⁵ However, the labour market projections will depend on the stated risks (in the end of the text), as well as the measures planned/implemented by entity governments and the Council of Ministers of Bosnia and Herzegovina with the aim of mitigating the consequences of the COVID-19 pandemics on both the economy and the labour market.

Preparation of the medium term scenario 2021-2023 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 (further described in the chapter on economic growth). In its projections (May 2020), the EC envisages increase in the number of employees in 2021 in the EU at the rate of 3.3 per cent y/y. Therefore, it is expected that the unemployment rate in the EU in 2021 will be lower in comparison to the previous year, at the rate of 7.9 per cent. In accordance with the DEP projections, a positive economic growth at the rate of 3 per cent y/y is expected in Bosnia and Herzegovina in 2021. In addition, the predicted investment and trade growth in BiH should positively affect 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 realistic preconditions would be created for the growth of the number of employed persons in the observed activities. As it was the case in previous years, it is expected that the contribution to the increase in the number of employed persons could be more modest in the public¹⁶ sector in comparison with all other areas of activities. In addition, the number of employed persons in the hospitality industry which was affected by the crisis, might start increasing again. In general, it is expected that the positive business environment in both BiH and the region and the EU countries will contribute to the increase

¹⁴ For the sake of comparison, as the consequence of the economic crisis in 2009, the number of employed persons in Bosnia and Herzegovina first decreased in 2010 (-0.8 per cent y/y), i.e. In the average period between 2010 and 2012 it decreased by approximately 0.7 per cent.

¹⁵ Likewise, as a consequence of the 2009 economic crisis, the net salary real growth rate in Bosnia and Herzegovina decreased for the first time in 2010 (-1.1 per cent), due to somewhat higher inflation rate. The nominal growth of the average net salary was positive in the observed year.

¹⁶ The analysis relates to public administration, health and education activities.

in the number of employed persons in the period between 2021 and 2023 by approximately 1.7-2.5 per cent annually, in addition to continuation of the gradual net salary increase trend at the level of 2.2-3 per cent annually. However, the assumed risks will be significantly determined by the increase in the number of employed persons, but also of net salary in the period to which the projections pertain.

Risks

Developments in the market labour in the period between 2020 and 2023 will be significantly determined by the developments in the surroundings, i.e. in the business environment in both Bosnia and Herzegovina and in the EU and the region. Therefore, the extension of the current developments caused by COVID-19 could reflect negatively on the economy and subsequently on the labour market in the second part of the year, as well. With the economic growth which is slower than the assumed, the number of employed persons could be significantly lower, as well. In addition, the reduction in the work force (migrations) and the degree of implementation of planned structural reforms in Bosnia and Herzegovina might influence the observed labour market indicators, i.e. the level of purchase power and living standards. All stated changes represent basic risks to the labour market projections.

Price

Prices in 2019

The average increase of the level of prices in Bosnia and Herzegovina was much slower in 2019 in comparison to the previous year.¹⁷ In the period between January and December 2019/January and December 2018, the average inflation rate measured by the consumer prices index amounted to 0.6 per cent. The decrease and a modest growth of prices in certain sections of the consumer prices index contributed to the low inflation growth rate. In the period between January and December 2019/January and December 2018, the fastest prices growth was recorded in the section of alcohol beverages and tobacco (5.1 per cent). The growth in the prices of tobacco and cigarettes in 2019 was the result of increased excise duties on tobacco and cigarettes, i.e. due to alignment with the EU legislation.¹⁸ In the section of housing, water, electricity, gas and other energy-generating products, the prices increased by 2.4 per cent y/y in the observed period due to the increase in the prices of liquid and solid fuel, water supply, gas and housing rents. In the section of food and non-alcoholic beverages, the prices increased by 1.1 per cent in the observed period as the consequence of the growth of food prices, as the prices of non-alcoholic beverages were reduced. Prices in the section of transport increased by 1 per cent in comparison to 2018.

Prices - projections 2020-2023

In the period between January and March 2020, Bosnia and Herzegovina registered a 0.4 per cent inflation in comparison to the same period of 2019. The decrease in the sections of clothing and footwear, furniture, house appliances and regular house maintenance, and other goods and services is the result of the low inflation rate in Bosnia and Herzegovina. In addition, the modest growth of prices in certain sections also

¹⁷ Inflation in Bosnia and Herzegovina amounted to 1.4 per cent y/y in the period between January and December 2018.

¹⁸ The minimum excise duty for a pack of 20 cigarettes amounts to 2.86 BAM, while the specific excise duty for the same pack is 1.65 BAM. The excise duty on cigarettes determined at the level of 80 per cent of the minimum excise duty 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. In addition to implementation of the policy of excise duties on cigarettes and tobacco in 2019, the price of cigarettes of certain producers also increased, which additionally affected the growth of prices of this product.

contributed to the low inflation rate. Therefore, the prices in the transport section decreased by 0.4 per cent y/y in the period between January and March 2020/January and March 2019. Crude oil prices developments affected the lowest prices in this section. In the section of food and non-alcohol beverages, the prices increased by 1.1 per cent in the period between January and March 2020/January and March 2019. At the same time, in the section of housing, water, electricity, gas and other energy-generating products, the prices increased by 0.8 per cent y/y, mainly due to the increase in the prices of liquid and solid fuel, water supply, gas and housing rents. The fastest growth of prices in the observed period was in the section of alcoholic beverages and tobacco (5.5 per cent y/y). Since 1 January 2020, the alignment of excise duties on cigarettes in Bosnia and Herzegovina with the EU continued.¹⁹

In accordance with the available data, it may be assumed that inflation developments in Bosnia and Herzegovina are significant for determining prices of energy-generating products, i.e. oil, food, excise duties, utilities prices and alike. The future prices developments in 2020 are likewise susceptible to significant insecurities as the result of COVID-19 pandemics. In accordance with the analysis²⁰ of the Bank of Slovenia, global prices of oil are decreasing due to smaller demand due to COVID-19 and increased oil demand (as the result of a price war between the Saudi Arabia and Russia). The analysis also states that import interruptions together with a drop in economic activity might shortly result in increases in the prices of specific products, while the prices of food might increase in case of import barriers. In addition, in accordance with the latest available projections²¹ of the EC (May 2020, table below), it is expected that the prices of crude oil might be significantly lower in 2020 in comparison to 2019 (-40.1 per cent y/y). Total inflation in the EU might be significantly lower and amount to 0.6 per cent (it amounted to 1.4 per cent in 2019). In their latest projections, the IMF foresees a similar scenario²² (WEO, April 2020), where they state that the price of crude oil might be by 42 per cent lower in 2020 in comparison to the previous year. Bearing in mind all the stated developments in the world and the domestic factors in Bosnia and Herzegovina, a deflation might be expected in 2020 at the rate of 0.5 per cent²³ in comparison to the previous year. However, inflation projections will depend on the stated risks (at the end of the text) and measures taken by all levels of governance that might affect price levels in Bosnia and Herzegovina.

In this view, the projections of inflation in Bosnia and Herzegovina in the period between 2021.-2023. are based on the changes in the prices of crude oil in the world market, food prices, excise duties on certain products, utilities prices and alike. In their projections, the EC expects the EU inflation to grow at the rate of 1.3 per cent, with increase in the crude oil prices at the rate of 4.8 per cent. Similar projections related to inflation and crude oil prices developments were presented by the IMF as well (table below). Assuming that the prices of oil and food²⁴ are growing moderately and the prices of utilities in the period between 2021 and 2023, Bosnia and Herzegovina might expect the prices to increase by 1.2 to 1.4 per cent. In addition, the inflation in Bosnia and Herzegovina will also be determined by the period of implementation of the policy of excise duties on cigarettes and tobacco (alignment with the EU legislation).

¹⁹ The Management Board of the Indirect Taxation Authority adopted a decision on determining the specific and the minimal excise duty on cigarettes and the amount of excise duty on smoking tobacco for 2020. The minimum excise duty for a pack of 20 cigarettes amounts to 3.04 BAM, while the specific excise duty for the same pack is 1.65 BAM. The excise duty on cigarettes determined at the level of 80 per cent of the minimum excise duty determined in Article 3, paragraph (3) of this Decision amounts to 121.6 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 2020.

²⁰ Source: <http://bankaslovenije.blob.core.windows.net/publication-files/prikazi-in-analize-marec-2020.pdf>

²¹ Source: https://ec.europa.eu/info/business-economy-euro/economic-performance-and-forecasts/economic-forecasts/spring-2020-economic-forecast-deep-and-uneven-recession-uncertain-recovery_en

²² Source: <https://www.imf.org/en/Publications/WEO/Issues/2020/04/14/weo-april-2020>

²³ In an extreme case, the level of deflation might be even higher depending on the extent in which the prices of energy-generating products in the global market will reflect upon the total CPI index in Bosnia and Herzegovina. In addition, food prices developments in Bosnia and Herzegovina will have a significant impact on the total level of prices.

²⁴ In accordance with the World Bank projections (April 2020), the food prices index could grow at the nominal rate of 1.9 per cent y/y.

Table 1 2: Crude oil price and inflation, 2020-2023 projections

	2019	2020	2021	2022	2023
Inflation-Bosnia i Herzegovina	0.6%	-0.5%	1.2%	1.3%	1.4%
European Commission projection (May 2020) below:					
Inflation-Eurozone	1.2%	0.2%	1.1%	n/a	n/a
Inflation-eurozone	1.4%	0.6%	1.3%	n/a	n/a
Crude oil price, brent \$/barrel	64.1	38.4	40.2	n/a	n/a
Crude oil, growth rate y/y	-10.4%	-40.1%	4.8%	n/a	n/a
International Monetary Fund projections (April 2020) below:					
Inflation-Eurozone	1.2%	0.2%	1.0%	n/a	n/a
Inflation-eurozone	1.4%	0.6%	1.2%	n/a	n/a
Crude oil price, brent \$/barrel	61.4	35.6	37.9	n/a	n/a
Crude oil, growth rate y/y	-10.2%	-42.0%	6.3%	n/a	n/a

Source: Historical data for Bosnia and Herzegovina taken from BHAS, DEP 2020-2023 projections

Risks

Inflation projections in the basic scenario are based on crude oil and food prices as a 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 2023 more than assumed in the basic scenario, this would be reflected in the prices level in Bosnia and Herzegovina. The continuation of implementation of excise duties on cigarettes and tobacco will also determine the growth of prices in BiH.

Bank credits and deposits

2020-2023 bank credits and deposits growth development estimates

In accordance with the latest available data of the Central Bank of Bosnia and Herzegovina (CBBiH), the credit activity growth has decreased in comparison to the end of the last year and the growth rate was 3.7 per cent y/y at the end of March 2020. (by 2.9 p.p. lower than in the end of 2019), while the total credit sum reached 20.49 billion BAM.

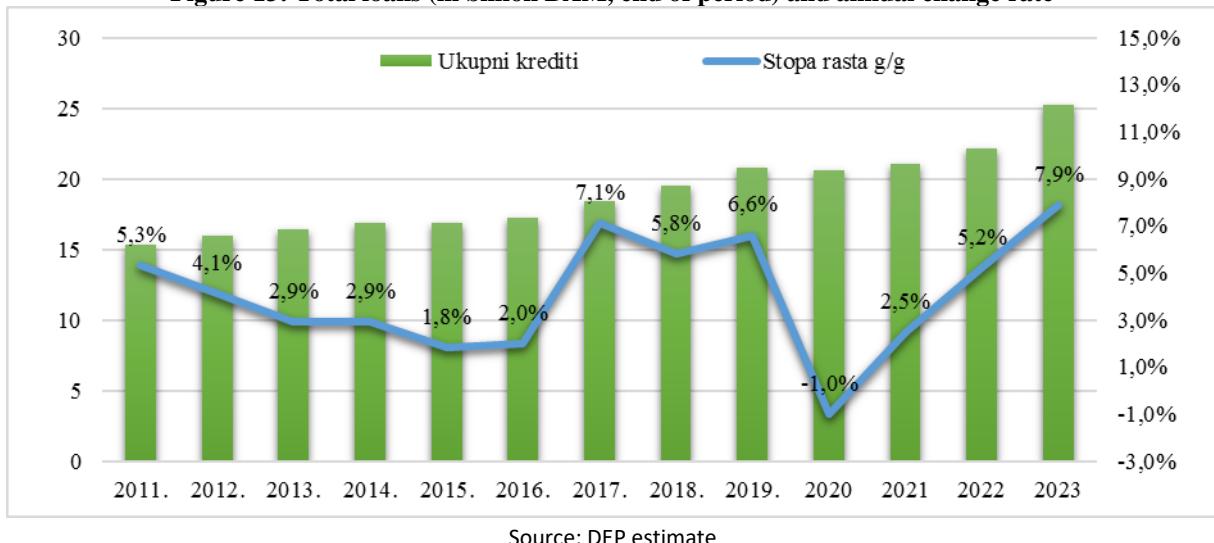
Credit growth rate decrease in March in comparison to 2019 is recorded in the population sector (lower by 2.7 p.p.) and non-financial companies (lower by 3.8 p.p.), while credits granted to the government sector recorded an increase in the growth rate (higher by 1.1 p.p.).

The evident sharp decrease in economic growth in the world, with its still inconceivable consequences, is already affecting BiH, including the decrease in the credit placement, primarily in the sectors of population and non-financial companies, while a slightly moderate growth may be expected in the sector of general government. In accordance with estimates of leading reference economic institutions, a new global recession and GDP decrease is expected in almost all major world economies (most likely similar to the 2008/2009 financial crisis). In estimating further operations of the banking sector (both developments and return of credit placements), the estimate of the duration of the epidemics, i.e. of the consequential duration of close downs and restrictions in economic activities. The effects of the government measures package for assistance to the economy have not been taken into account in estimates as these were not yet implemented at the time of development of projections. One of the proposed measures, introduction of a moratorium on repayment of credits (currently for the period of three months) will definitely result in decreased liquidity and efficiency of banks' operations.

It is necessary to note that the possibility of the duration of the pandemics by the end of the second quarter of 2020 was taken into account in estimates of credit placements and deposit developments, including continuation of a more moderate negative impact in the third and the fourth quarters.

It is estimated that the total credits may record a 1.0 per cent y/y drop by the end of 2020. It is expected that 2021 will bring stabilisation which will enable a somewhat higher growth projection rate of 2.5 per cent y/y. Likewise, 2022 is expected to bring moderate growth of credit activity at the rate of 5.2 per cent y/y and 7.9 per cent y/y in 2023.

Figure 13: Total loans (in billion BAM, end of period) and annual change rate



In accordance with the latest available data from the end of March 2020, a downturn in the deposit growth was recorded. In addition to the 7.2 per cent y/y growth rate (by 2.3 p.p. lower than in the end of 2019), these amounted to 23.97 billion BAM.

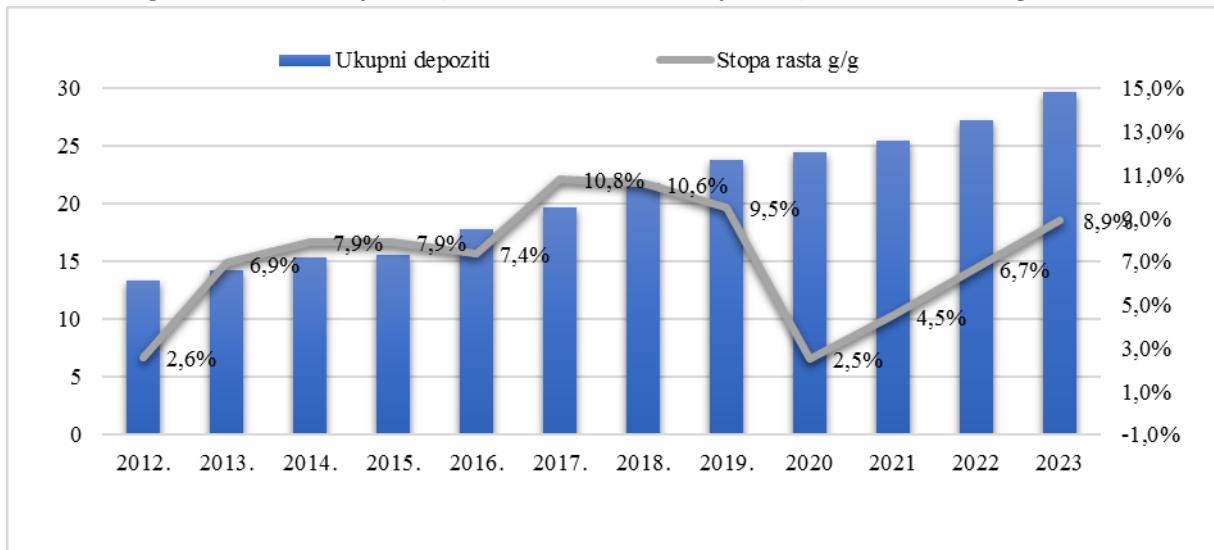
It is interesting that, in comparison to the end of 2019, a downturn in the deposit growth rate was recorded in all sectors except in the non-financial companies sector, which recorded a 5.5 p.p. growth rate increase. In the same period, the sector of population recorded the growth rate lower by 4.4 p.p., while the deposits in the general government sector recorded the rate lower by 7.8 p.p.

Decrease of economic activity in the world and in the neighbouring countries, as well as closing and restrictions in business operations will result, through decreased employment, in increased deposit withdrawal, primarily in the population sector. It is estimated that the rate will be approximately 2.5 per cent y/y until the downturn in the growth rate of total deposit sum in 2020. The following years might bring stabilisation of economic circumstances which would bring better results in the banking sector (improvement of financial indicators CAR²⁵, NPL²⁶). The total deposit would increase at a more moderate rate in the following years, so that the growth rate would be 4.5 per cent y/y in 2021, 6.7 per cent in 2022 and 8.9 per cent y/y in 2023, after commencement of a more significant recovery.

²⁵ CAR- Capital Adequacy ratio

²⁶ NPL-Non-performing loans

Figure 1.4: Total deposits (in billion BAM, end of period) and annual change rate



Source: DEP estimate

Risks

Continuation of the impact of the pandemics and the possibility of a new wave will definitely reflect on Bosnia and Herzegovina, in addition to global economic and political impact which cannot yet be foreseen. A continued downturn, in addition to slow recovery of economic activity in the leading countries of the world in the following years (primarily EU countries, China and the United States) would, without doubt, affect economic growth and banking sector of Bosnia and Herzegovina.

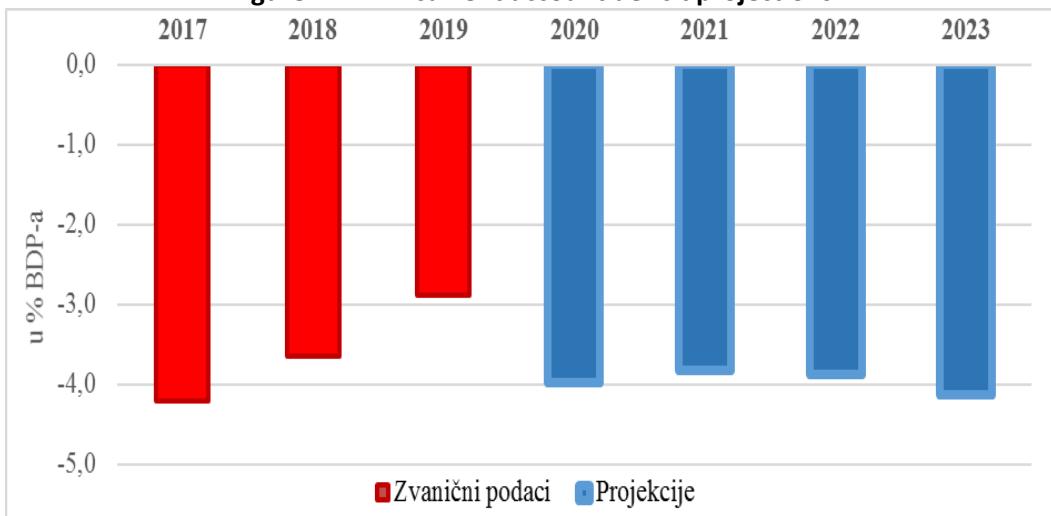
Foreign sector

Bosnia and Herzegovina payment balance

Data in the payment balance of Bosnia and Herzegovina show that unfavourable foreign trade exchange and payment balance developments were recorded in 2019, which is predominantly caused by the downturn in the economic activity in main foreign trade partners.

In accordance with the official data of CBBiH for 2019, the current account deficit under the payment balance of Bosnia and Herzegovina amounted to 1.2 billion BAM (i.e. 2.9 per cent of GDP). Nominal import of goods and services increased by 1.8 per cent in the observed period, while nominal export of goods and services grew by 0.2 per cent. Current net inflow of money from abroad increased by 8.2 per cent in 2019.

Figure 1.2: BiH current account deficit projections



Source: CBBiH and DEP projections

2020-2023 payment balance assumptions

On the basis of DEP projections, a nominal downturn of foreign trade deficit by 3.6 per cent might be expected in 2020 (in addition to a 7.6 per cent decrease in import and 9 per cent decrease in export). The expected nominal growth of foreign trade deficit in the period between 2021 and 2023 would range between 0.1 and 4.3 per cent, as the result of the import rate growth (5.8-8.1 per cent) and export rate growth (7.8-9.4 per cent). As a share in GDP, in accordance with DEP projections, the current account deficit in 2020 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 9.3 and 10.4 per cent of GDP in the period between 2020 and 2023.

As it is very hard to predict the current account deficit financing sources, it may be expected that the current account deficit will continue to be financed from foreign financial funds inflow (social benefits and foreign remittances, direct investments, trade credits and possible new borrowing in the international financial market).

Risks

The main risks to changes in BiH payment balance developments, i.e. increase or decrease of the current account deficit lay in the foreign trade deficit, i.e. in changes in goods and services import and export rates, as well as in global market prices changes. Favourable business environment and increased employment rate among BiH diaspora might result in growth of current foreign transfers rate, thus increasing the available income. On the other hand, in case of less favourable business environment and lower BiH diaspora employment rate, current foreign transfers would also decrease, thus resulting in lower available income.

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.

Overview of foreign trade in 2019 and projections for 2020

Unlike 2018, when BiH recorded a very good foreign trade result because of more favourable business environment in main foreign trade partners, this was not the case in 2019. Namely, in accordance with currently available BHAS data for 2019, BiH recorded a significant downturn in foreign trade exchange with the world, and this was further intensified at the very end of the year. It is very well known that, in foreign trade view, BiH largely depends on economic developments in EU countries, as almost 75 per cent of export is places on the EU market, while approximately 60 per cent of import comes from the EU. Therefore, economic developments in these countries, in addition to production level of the domestic production sector, almost completely determine foreign trade exchange developments. Namely, the downturn of economic activity in EU countries resulted in decreased export demand and thus in decreased production in the processing industry and export of goods. Therefore, in accordance with BHAS preliminary data for 2019, BiH recorded a decrease in the import of goods at the rate of 3.4 per cent and reduced import of goods at the rate of 1.2 per cent, resulting in significant increase in the deficit in goods of 8.6 per cent, while coverage of import by export decreased by more than 2 p.p.²⁷ On the other hand, the currently available BHAS data for the period between January and April 2020 show continuation and additional intensification of the decreasing trend in foreign trade exchange in 2020. Namely, in accordance with this data, BiH recorded, in the first four months of 2020, a decrease in export of goods by 12.7 per cent, while export decreased only in April by 32.7 per cent in comparison to 32.7 per cent.²⁸ This downturn in export of goods at the very beginning of 2020 is an obvious example of negative consequences of the global COVID-19 pandemics on economic developments in BiH. On the other hand, downturn of economic activities in the country and decrease in domestic demand resulted in a decrease in import of goods by 14.8 per cent in the period between January and April 2020, in comparison to the same period of the last year. Observed on a monthly level, the decrease of import of goods in April 2020 in comparison to the same month of the previous year amounted to 35.2 per cent. Such developments in export and import and the generally lower level of economic activity in the country resulted in certain decrease in the foreign trade goods deficit. If the current trend of decreasing foreign trade exchange in the world is taken into account, as well as the circumstances related to COVID-19 outbreak, it is not difficult to conclude that 2020 will be an exceptionally challenging year when it comes to BiH foreign trade exchange. Even if these problems prove to be short-term (half-year), BiH may expect significant downturn in export and import of goods. In the baseline scenario under which these problems would be resolved in the second half of 2020, BiH expects a decrease in the total import by 7.1 per cent in comparison to the previous year. On the other hand, it is highly likely that the downturn in the total economic activity (decreases in spending, production and investments) will result in the downturn of import by the expected rate of 5.8 per cent in real terms.

2021-2023 BiH foreign trade exchange developments projections

Developments of economic activities in external environment in the medium term will definitely represent the main determinant of developments of foreign trade exchange in BiH in this period. Improvements in the foreign trade exchange in BiH may be expected only in case of improvement of economic activities and new economic challenges caused by the COVID-19 pandemics the global economy is currently facing. Therefore, if the stated circumstances could be resolved, DEP projects that in the 2021-2023 period, BiH might expect real increase in total export of goods at annual rates ranging from 6.1, 5.9 and 7.1 per cent, respectively. This

²⁷Agency for Statistics of Bosnia and Herzegovina, Information "The Statistics of Trade Exchange of BiH with Foreign Countries, January-December 2019", 20 January 2020.

²⁸Agency for Statistics of Bosnia and Herzegovina, Information "The Statistics of Trade Exchange of BiH with Foreign Countries, January-April 2020", 20 May 2020.

increase in export depends on stable export demand, extension of production base and increased competitiveness in the country. On the other hand, increase in the economic activity in the country, i.e. growth of domestic demand in the population and corporative sector through somewhat faster growth of spending should result in increased import in BiH. It is expected that the rates of import of goods will be somewhat lower than export and should range from 4.0 per cent in 2021, 4.5 per cent in 2022 and 5.1 per cent in 2023. Export growth rates which are higher than import growth rates should, in the medium term, result in increased export participation in GDP at the rate of approximately 45 per cent up to and including 2023. On the other hand, due to a somewhat slower export growth, it is expected that, up to and including 2023, the participation of import in GDP will still be at about 58 per cent of GDP. The result of such export and import development trends would be gradual decrease of foreign trade deficit to approximately 13 per cent of GDP, higher contribution to economic growth and improved export-import ratio at almost 78 per cent up to and including 2023.

Risks

The basic risk to achievement of projections of foreign trade exchange of goods is represented by the weakening growth in main trade partners, i.e. COVID-19 outbreak which, if continued, would completely jeopardise the achievement of the stated baseline scenario. In addition to the stated risk, there is also the potential risk of rapid changes in prices of stock exchange goods such as metals, energy generating products (oil and gas) and food, as well as problems in business operations of main export companies.

Foreign direct investments

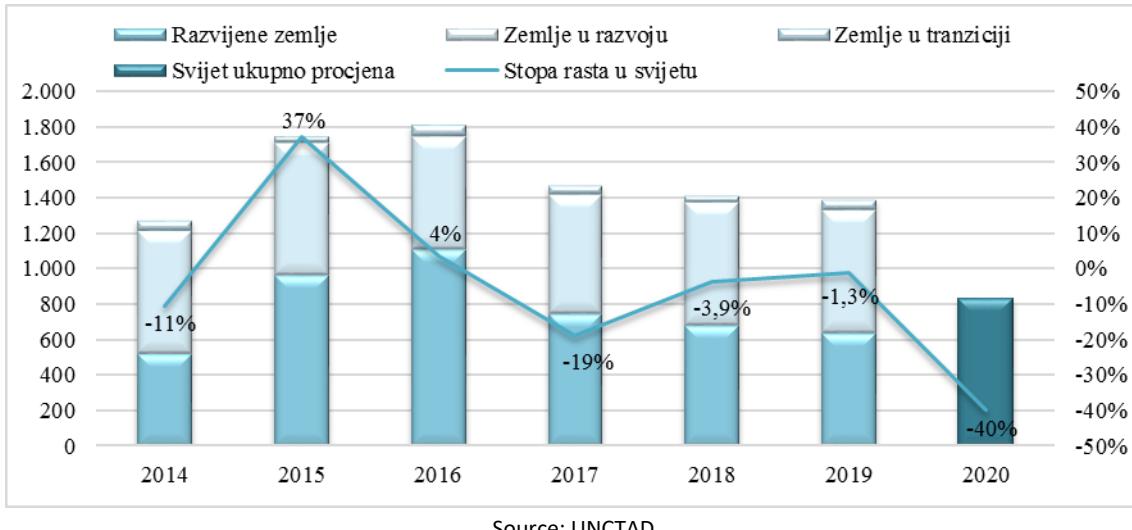
2020-2023 foreign direct investments

The evident global economic crisis caused by the pandemics in the first half of 2020, including its somewhat milder form in the second half will definitely have negative consequences on foreign direct investments. The highest ever recorded downturn (which has not been subdued at the time of preparation of the report) of all important global indices on stock exchanges is the definite indicator of the current unstable state of global economy. In addition, the global economic developments will, without a doubt, be affected by a tariff war (currently only delayed) between China and the United States of America, Brexit consequences and significant decrease of economic growth rates in almost all leading EU and world countries.

In accordance with the newest March special UNCTAD report²⁹ The United Nations Conference on Trade and Development) foreign direct investments (FDI) are expected to globally decrease by 30 to 40 per cent. Decrease in reinvestment of earnings as a consequence of decreased profit of companies worldwide is especially noted, sometimes even globally amounting to 50 per cent FDI.

²⁹ Global Investment Trend Monitor, No. 35 [Special Coronavirus Edition] (UNCTAD/DIAE/IA/INF/2020/3)

Figure 1.6: Total global FDIs in billion USD



Source: UNCTAD

In accordance with data published by CBBiH, total foreign direct investment in 2019 amounted to 898.6 million BAM (net financial liabilities) and are by 11.6 per cent y/y higher. Reinvested earnings in 2019 amounted to 479.7 million BAM and are by 25.3 per cent y/y higher. Their participation in net financial liabilities is more than 50 per cent, i.e. 53.4 per cent. Therefore, participation of FDI in 2019 reached 2.5 per cent of GDP.

As a consequence of the previously mentioned downturn in global as well as EU economic developments, whereby the EU members are the main investors in BiH, there will definitely be a significant decrease in FDI in 2020. It is necessary to note that the duration of the closing down of the economy is still uncertain (restrictions of movement and business operations), both in BiH and globally, and in preparation of the scenario, the impact of the pandemics was taken into account in the first two quarters, with continued, yet milder impact in the second half of 2020. In order to avoid the impact of fluctuation and the pro-cycle effect in estimations, the basis is represented by average investments by quarters in the last five years, and the impact of decrease by quarters.

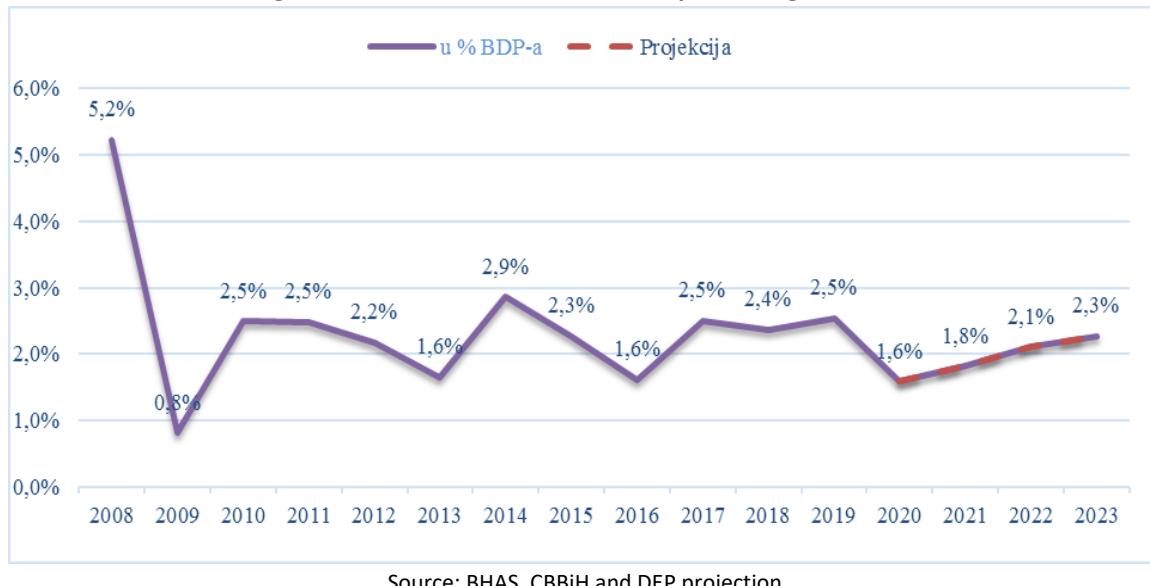
Thus, in accordance with this estimate, FDI would be at the rate of 1.6 per cent of GDP. The previously stated worsening of global economic developments and the already certain significant downturn in the economic growth, primarily in China as the one of major investors in infrastructure will unavoidably lead to delays in implementation, or even delays until the following year, in implementation of planned projects (Thermal Power Plant Gacko³⁰, Doboj-Vukosavlje-Brčko Motorway³¹ and Banja Luka-Prijedor Motorway)³². Gradual recovery and continuation of activities in the following years are expected after decrease in investments in 2020. Bearing in mind numerous announcements of investments in energy, mining and infrastructure sectors and especially in the sector of tourism and services (the sectors which are currently most affected by the crisis), it is realistic to expect gradual FDI increase in the following period. Thereby, the FDI would reach 1.8 per cent of GDP in 2021, 2.1 per cent in 2022 and 2.3 per cent of GDP by the end of 2023.

³⁰ <http://www.vladars.net/sr-SP-Cyril/Vlada/Ministarstva/mper/media/vijesti/Potpisan-sporazum-o-izgradnji-TE-Gacko-2.aspx>

³¹ <http://privrednastampa.ba/tag/autoputevi-republike-srpske/>

³² <http://www.autoputevirs.com/aprs/Doc.aspx?cat=5&subcat=24&id=24&lang=cir&txt=295>, the signed concession agreement with Chinese company China Shandong Int Economic & technical cooperation Group Ltd.

Figure 1.7: Annual FDIs and FDIs in percentages of GDP



Source: BHAS, CBBiH and DEP projection

Continuation of the global economic crisis caused primarily by the devastating effect of the COVID-19 pandemics, in addition to further complication of global economic environment (geopolitical and trade tensions between China and USA) will have an additional negative impact on BiH. Still unmeasurable negative consequences of the economic downturn in China and USA and even more significant further downturn in the countries of the EU which were hit hardest (primarily Italy, Spain and France) will definitely reflect on BiH by way of further deterioration of payment and foreign trade balance, and further FDI downturn.

2020-2023 Indirect Taxes Revenues Projections

On 1 June 2020, the Directorate for Economic Planning (DEP) submitted to the Department for Macroeconomic Analysis (OMA) the revised projections of macroeconomic indicators for BiH (Macroeconomic projections 2020-2023, baseline scenario, May 2020). Indirect taxes projections are based on projections of May 2020 DEP macroeconomic indicators, with indirect tax revenues collection trends and current government policies in the area of indirect taxation (baseline scenario).

Indirect taxes revenues projections-assumptions

Projections of indirect tax revenues for the period between 2020 and 2023 imply the basic (baseline) projections. The assumptions for development of projections are as follows:

- May 2020 2020-2023 DEP macroeconomic indicators prognosis
- Current trends in collection of indirect taxes revenues
- Current policies in the area of indirect taxation.

Current policies in the area of indirect taxation

VAT obligations and payment system are regulated by the Law on Value Added Tax (*Official Gazette of BiH*, 9/05, 35/05, 100/08 and 33/17).

Excise duties policy is regulated by the Law on Excise Duties in Bosnia and Herzegovina (*Official Gazette of BiH*, 49/09, 49/14, 60/14 and 91/17). 2020 policy of excise duties on tobacco is determined in accordance with the Law on Excise Duties and the Decision³³ of ITA Governing Board. As the legal ceiling of total excise duty on cigarettes of 176 BAM/1000 cigarettes was achieved for all price categories of cigarettes in 2019, the alignment with the EU standards in the sphere of cigarettes taxation³⁴ was finalised, while cut tobacco is taxed in accordance with policies under the 2014 Amendments to the Law.³⁵

The Law on Customs Policy in BiH³⁶ regulates basic elements of customs policy and general rules and procedures applied to goods imported and exported from the customs territory of BiH. The gradual process of liberalisation of foreign trade of BiH is shown in Figure 2.1.

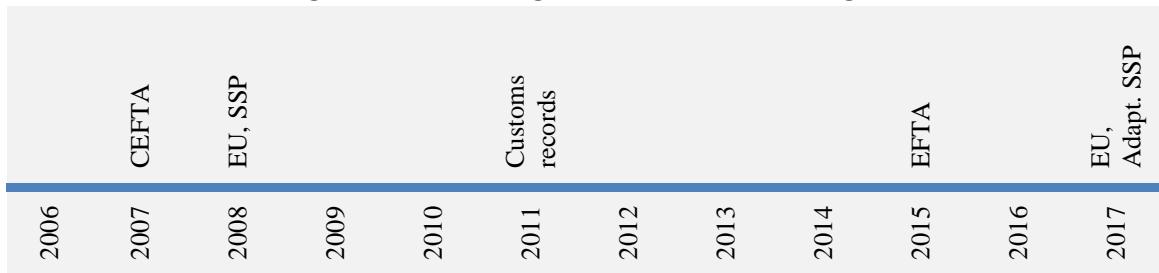
³³ Decision on determining the specific and the minimal excise duty on cigarettes and the amount of excise duty on smoking tobacco for 2020 (*Official Gazette of BiH*, 80/19).

³⁴ It should be stated that 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. In the meantime, the Decisions on determining the specific and the minimal excise duty on cigarettes and the amount of excise duty on smoking tobacco for 2019 and 2020 were adopted pursuant to the applicable Law. As the EU standards of cigarettes taxation were achieved in 2019, the stated amendments to the Law on Excise Duties are not up to date and certain legal steps in this view are expected.

³⁵ 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).

³⁶ The new Law on Customs Policy (*Official Gazette of BiH*, 58/15) will apply as of 1 July 2021 (*Official Gazette of BiH*, 21/20) 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 new Law applicable as of 25 April 2018 represents an exception.

Figure 2.1. BiH Foreign trade liberalisation stages

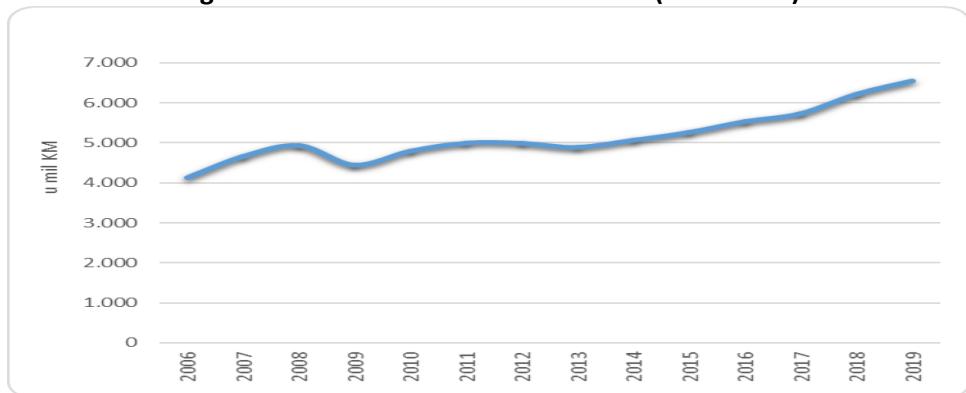


Source: Antić, D. Liberalisation of BiH foreign trade (2007-2017): implications and comparative analysis, OMA bulletin 152/153, March/April 2018, www.oma.uino.gov.ba

Indirect taxes current collection trends

Collected indirect taxes revenues reflect the long-term growth trend. The 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 increased (Figure 2.2.). Net indirect taxes revenues collected in 2006 in the ITA Single Account amounted to 4.12 billion KM, while net collected taxes in 2019 increased by 50.7 per cent (6.54 billion BAM) in comparison to 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. The share of indirect taxes in the ITA Single Account varied over the years (Table 2.1). 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 (2013) and 18.6 per cent (2011) since 2010. In 2018 it amounted to 18.3 per cent. The 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 amounted to 19.4 per cent.

Figure 2.2: Net indirect taxes revenues (2006-2019)



Source: BiH ITA, OMA calculation

Table 2.1: The share of indirect taxes revenues in the ITA Single Account in GDO and total spending

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
% of GDP	19.5	19.8	18.8	17.1	18.5	18.6	18.1	17.3	17.9	17.7	17.9	17.7	18.3
% C	18.4	19.2	17.9	16.5	17.6	17.7	17.4	16.9	17.3	17.8	18.4	18.6	19.4

Source: Calculation on the basis of ITA and BHAS data³⁷

³⁷ GDP in accordance with the expenditures principle, BHAS, Theme bulletin 01, February 2020

Collection in 2019

The overview of indirect taxes revenues collection in 2019, i.e. 6.220.8 billion BAM is the record amount ever collected since establishment of ITA in 2018., while the growth rate was at the level of 5.2 per cent. The overview of quarterly collection³⁸ shows that the highest revenues growth was achieved in the first quarter when it was recorded at the level of 7.2 per cent. It is necessary to state that the collection in January 2019 includes the consequences of the 2018 Amendments to the Law on Excise duties as the increased tolls are applicable as of 1 February 2018. The stated effects contributed 1.4 percentage points to the revenues growth in the first quarter of 2019, and 0.3 percentage points to the achieved net collection growth rate at the level of the entire 2019. In addition to the effects of legal amendments, the rate growth in the first quarter is also the result of increased spending, stabilisation and derivatives spending growth, as well as of the policies of tobacco companies which bore additional tax burden (growth of specific excise duty on cigarettes and cut tobacco as of 1 January 2019) at the expense of their own profit. In the second quarter of 2019, the net collection rate grew by only 2.3 per cent. The low rate is a consequence of a sharp downturn of revenues in June, primarily VAT revenues. Unfavourable VAT collection was partially mitigated by way of the growth of revenues from excise duties on tobacco products, as the result of further delay of overflow of additional tax burden on retail sale prices and announcement of price corrections in July. The third quarter again recorded a strong growth by 6.4 per cent as a result of significant growth of VAZ revenues and excise duties on tobacco. In the beginning of the fourth quarter, a stagnation of revenues was recorded due to reduced collection of almost all types of taxes. However, a strong collection of almost all categories in December resulted in significant impact and a 4.8 per cent quarter-level growth.³⁹

Collection of total revenues in the period between January-April 2020

The indirect taxes revenues growth trend stopped in April 2020 due to the impact of the COVID-19 pandemics in BiH. In accordance with the ITA report, the collection of revenues by types decreased by 155.8 million BAM or 23.4 per cent in April- As the result of decreased refunds, the net collection is by 119.5 or 22.2 per cent lower than in April 2019.

The significant decrease in collected revenues in April annulled the achieved collection surplus achieved in the first quarter of 2020. The cumulative gross collection of revenues for the first four months of 2020 decreased by 96.8 million BAM in comparison to collection in the same period of 2019. At the same time, refund payments decreased by 41.8 million BAM, thus mitigating the total negative impact on cumulative collections. This resulted in the decrease in final net collection of indirect taxes by 55.0 million BAM or 2.7 per cent.

³⁸ Comparison of a certain 2019 quarter to a corresponding 2018 quarter (YoY growth)

³⁹ More details on 2019 collection in Antić, D. Collection of indirect taxes revenues in 2019, OMA bulletin 176/177, March/April 2020, www.oma.uino.gov.ba.

Figure 2.3: Collection of indirect taxes in 2020, nominal effects

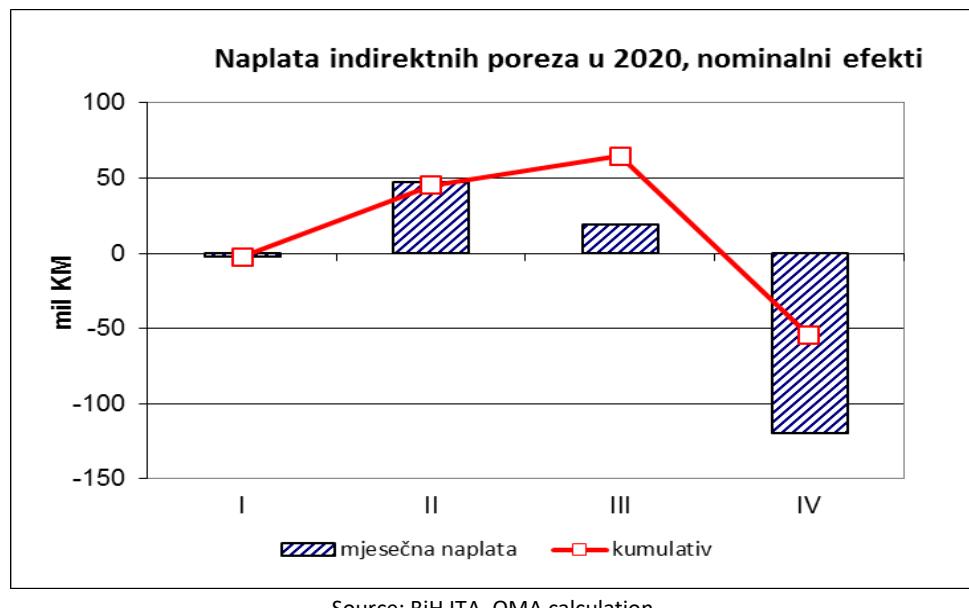
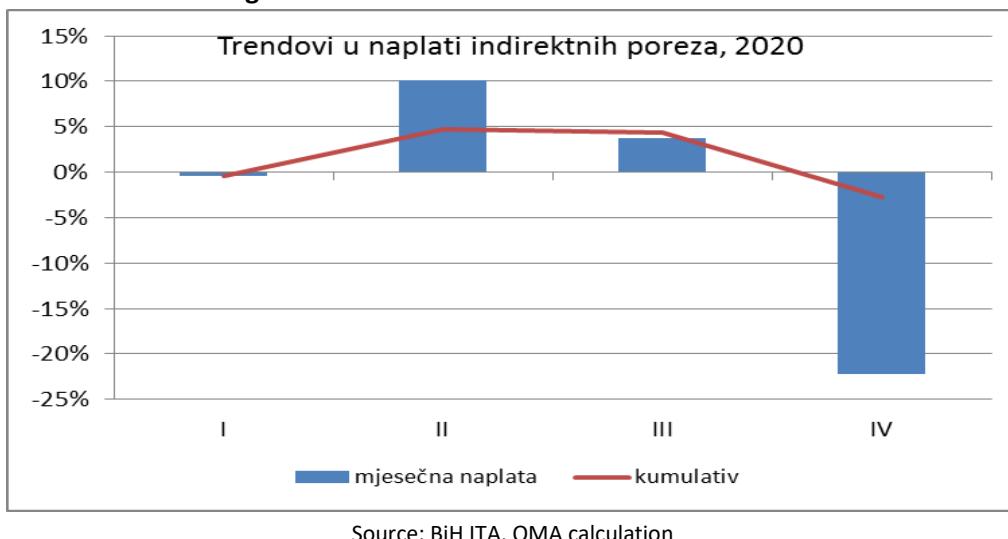


Figure 2.4 show a sharp increase in cumulative net collection in February which was not endangered by a more moderate growth in March when the first negative effects of the corona virus affected the collection of revenues.

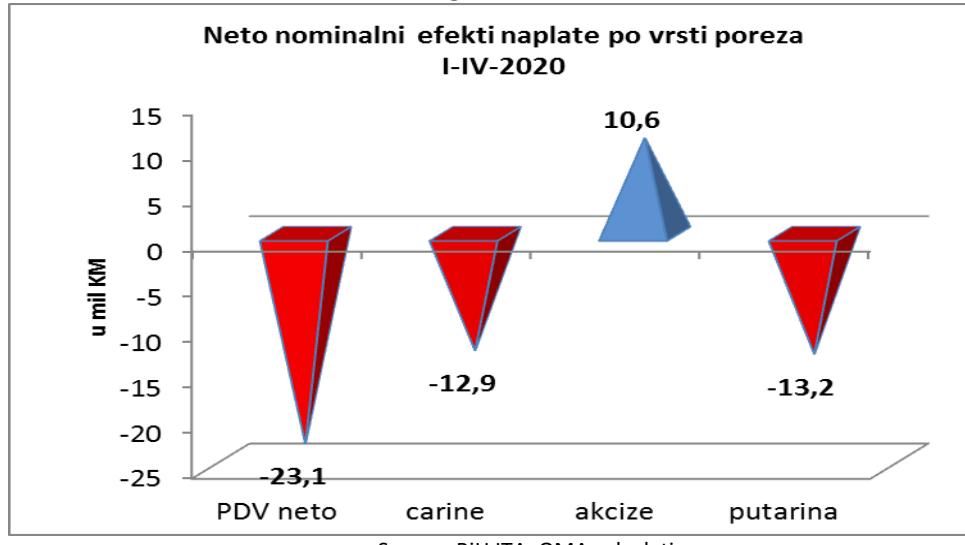
Figure 2.4: 2020 Indirect taxes collection trends



Collection by types of revenues in the period between January-April 2020

A major downturn in April was predominantly due to decreased collection of VAT (23.1 million BAM), tolls (-13.2 million BAM) and customs (-12.9 million BAM), while the only growth was recorded in excise duties revenues (+10.6 million BAM) (Figure 2.5).

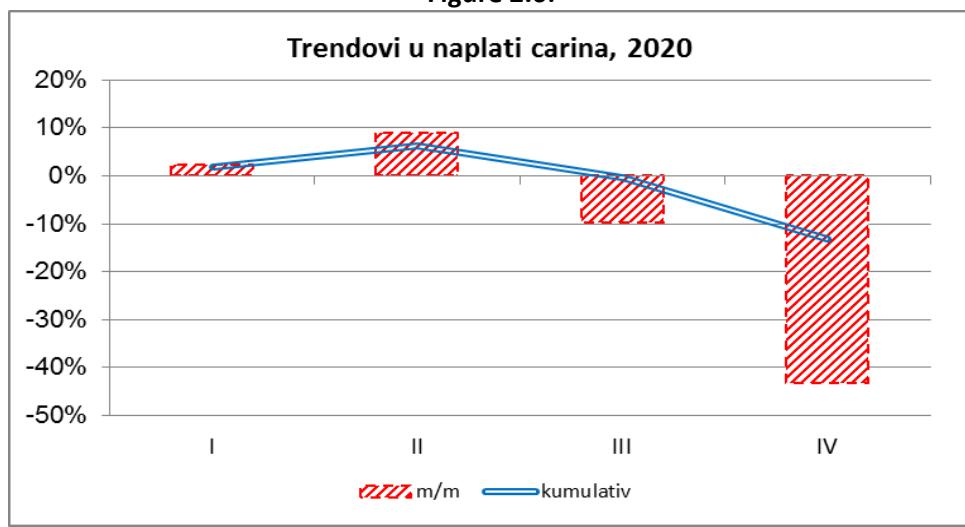
Figure 2.5:



Custom duties

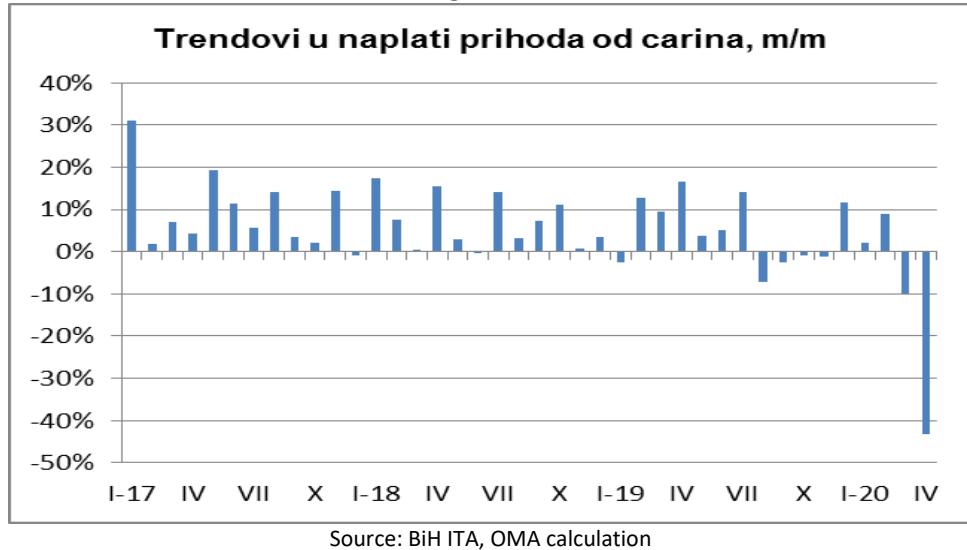
In the first quarter of 2020, collection of customs revenues was at the level of the first quarter of 2019 as the negative effects of the closing of borders due to the corona virus outbreak appeared in March. The collection dramatically worsened in April and the collection decreased by 43.3 per cent (Figure 2.6).

Figure 2.6:



The significant downturn in April forced the customs revenues collection into the negative growth area, at the rate of 13.1 per cent. The customs collection downturn is a consequence of the cumulative negative effects of the decreased import from the EU countries in view of goods subject to customs, and the decrease in the import of goods from China and other Asian countries. Generally, the positive trends in collection of customs revenues collection which were not affected by the last stage of liberalisation of foreign trade exchange under implementation of the SAA adaptation, are now seriously worse (Figure 2.7).

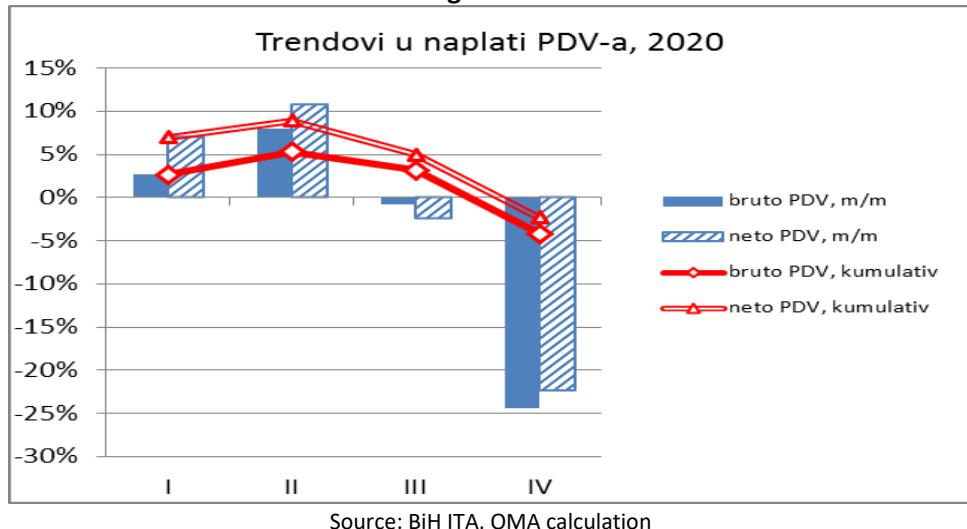
Figure 2.7:



VAT

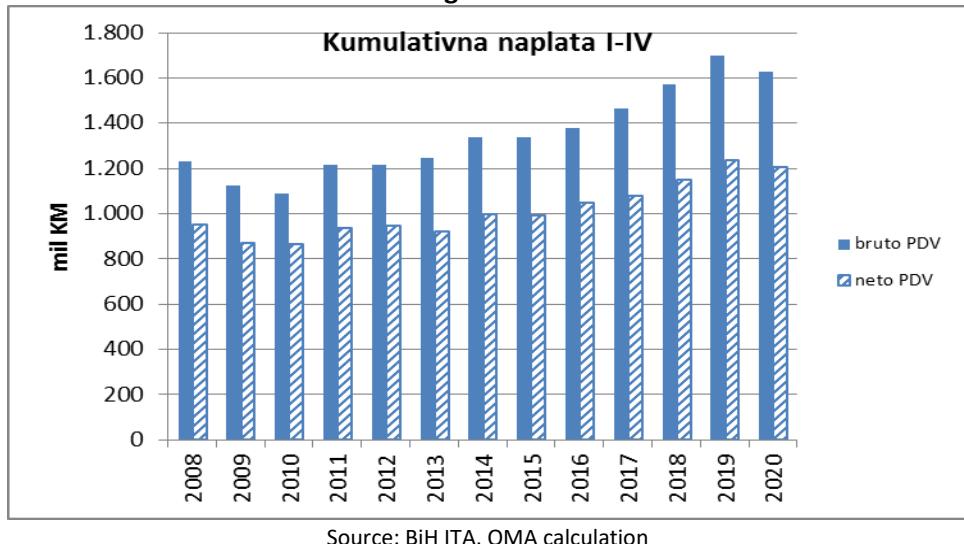
The growing trend in VAT collection recorded in the first quarter of 2020 stopped in April. High negative rates of both gross and net collection were recorded at the level of -23.3 and 20.7 per cent, respectively. The high VAT collection downturn in April lead both gross and net VAT collection into the negative growth zone, at the rate of 3.9 and 1.9 per cent, respectively, in comparison to the same period of 2019 (Figure 2.8).

Figure 2.8:



Comparison of nominal gross and net collection shows decrease in gross and net collection in the first four months of 2020 in comparison to collection to the same period in the previous years. Historically speaking, by observing the VAT collection in the first four months of the fiscal year, it may be concluded that the maximum was achieved in 2019. On the other hand, the collected amount of revenues in 2020, even in addition to negative corona virus effects, is still higher than the amount collected in 2018 which included the effects of the amendments to the Law on Excise Duties (Figure 2.9).

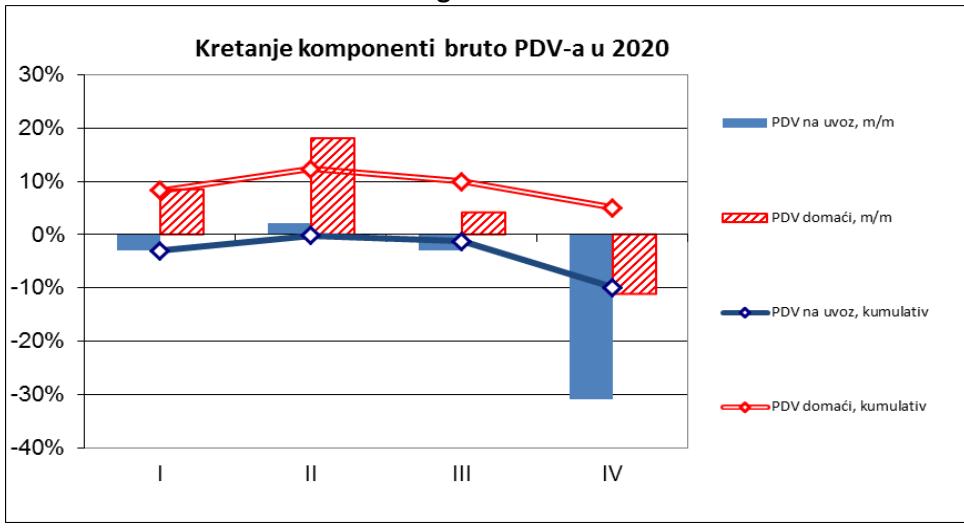
Figure 2.9:



Source: BiH ITA, OMA calculation

The analysis of the structure of gross VAT collection in April 2020 shows a strong downturn in collection of VAT on import at the rate of 30.7 per cent. The first quarter of 2020 was characterised by oscillating growth of VAT on import, ranging from -3 to +3 per cent, which resulted in a cumulative decrease by 1.2 per cent at the level of the first quarter. However, the high rate of collection of VAT on import in April resulted in a cumulative decrease in collection, at the rate of 9.9 per cent at the level of the first four months of 2020. (Figure 2.10, VAT on import-cumulative).

Figure 2.10:

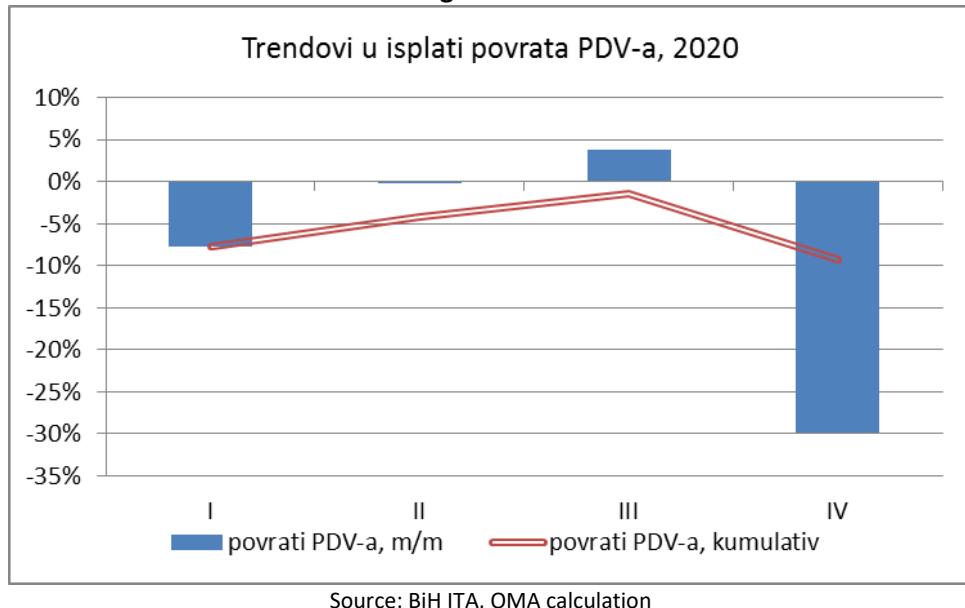


Source: BiH ITA, OMA calculation

On the other hand, following the positive growth of the domestic VAT monthly rate growth in the first quarter in April was recorded in 7.8 per cent as a consequence of down trading of tax payers in March. The downturn in collection of domestic VAT in April decreased the cumulative growth rate, but it remains in the positive growth zone, except that the domestic VAT three-months growth rate was 9.9, while it decreased to 5.9 per cent at the level of four months (Figure 13, Domestic VAT-cumulative). In addition to negative effects of the corona virus pandemics, the growth rates remains above DEP spending projections, and not only from those from May and April, but also from previous projections revisions carried out prior to the corona virus outbreak.

In April 2020, the VAT return rate was 29.9 per cent, which is a consequence of the decrease in export, import and investments. The significant downturn in VAT refunds payments had a positive effect on the cumulative amount of paid returns, which decreased by 9.3 per cent since the beginning of the year (Figure 2.11).

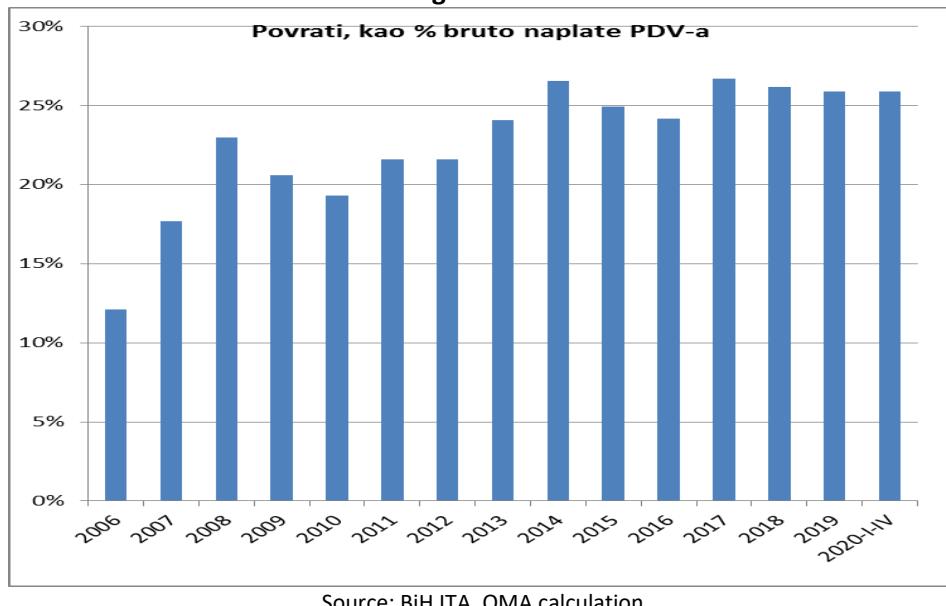
Figure 2.11:



Source: BiH ITA, OMA calculation

The analysis of the return structure showed the downturn in payment of refunds to tax payers at the rate of 12.8 per cent or 55.4 BAM in the previous four months. This is the lowest level of refund payments in the last three years. When it comes to returns to international organisations and projects, the increasing trend recorded in previous months continued, and the growth at the level of 42.3 per cent or 13.2 million BAM was recorded at the level of four months.

Figure 2.12:



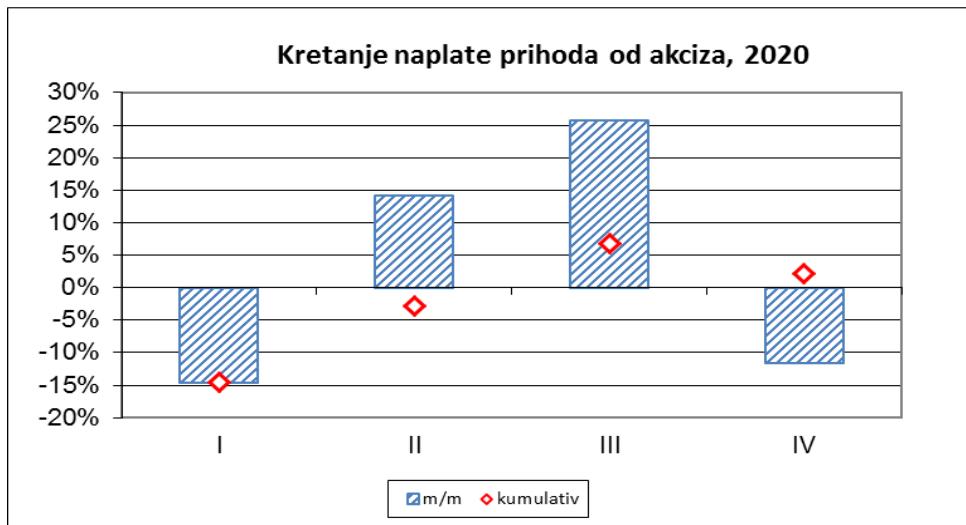
Source: BiH ITA, OMA calculation

In addition to the gross VAT decrease, refunds are decreasing, as well. The indicator of the share of refunds in gross VAT collection amounts to 25.8 per cent, which is almost identical to the average share of paid refunds in gross VAT collection in 2019 and lower in comparison to averages in 2014, 2017 and 2018. (Figure 2.12.).

Excise duties

Collection of excise duties in the first three months recorded an increasing trend, with a great range of monthly growth rates. A high growth rate at the level of 25.8 per cent was recorded in March, thus raising the cumulative growth rate to a high rate of 6.8 per cent, above all real spending projections. However, April brought a decrease at the level of 11.3 per cent, due to which the cumulative growth rate decreased to the level of 2.3 per cent (Figure 2.13).

Figure 2.13:



Source: BiH ITA, OMA calculation

Increase in the excise duties on tobacco and alcohol and alcohol beverages was recorded in April, while revenues from other excise duties products recorded a downturn.

Excise duties revenues related to tobacco products recorded a 8.4 per cent growth in April, thereby continuing the positive growth trend since February (Figure 2.14). The growth in collection of excise duties in April ensured that the cumulative growth rate at the level of the first quarter of 2020 is maintained. In view of the circumstances, the increase in the excise duties on tobacco is surprising, even more so as the excise duties are paid in advance to the ITA Single Account prior to the actual trading and spending. As these payers are several great global tobacco companies, it might be expected that they are anticipating a growth in consumption of cigarettes and tobacco during the pandemic, as well.

In addition to the growth in excise duties revenues in April, the number of excise duties stamps (i.e. packs of cigarettes) was by 1.9 per cent lower. As a whole, at the level of four months, tobacco companies took up 5.8 per cent more excise stamps for cigarettes than in the same period of 2019, although retail sale prices of cigarettes increased at the beginning of the year (Figure 2.15).

In the end, it is indicative that the growth in revenues from the excise duty on cigarettes was the result of collection in view of imported cigarettes. **For the first time since the establishment of the records related to excise duties stamps in accordance with the new Law on Excise Duties in 2009, no stamps were taken up for domestic cigarettes.** This indicates that no domestic production of cigarettes is planned in the future period. It remains to be seen whether this business decision is just an introduction for a total shut down of domestic tobacco industry in Sarajevo or the result of the currently difficult business situation in BiH caused by the corona virus.

Figure 2.14

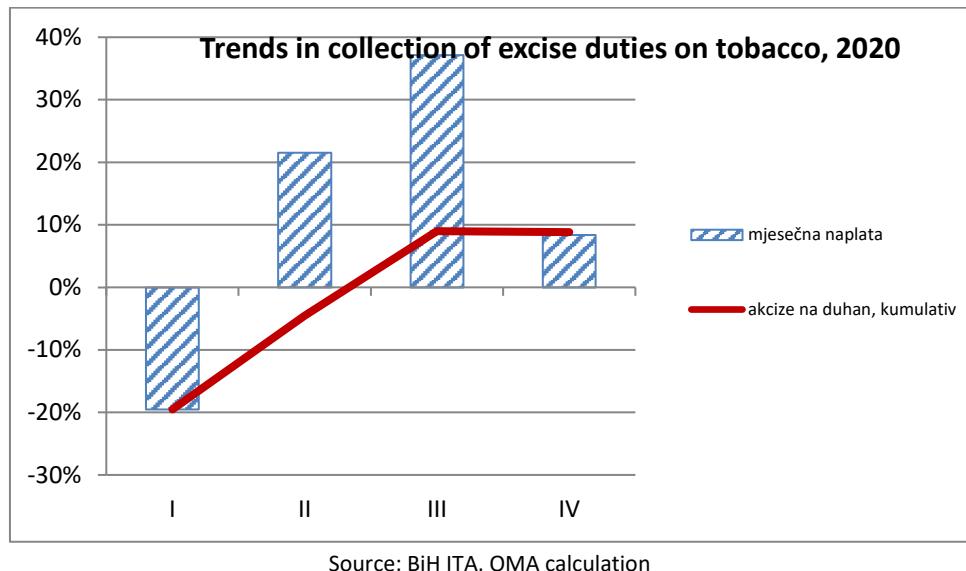
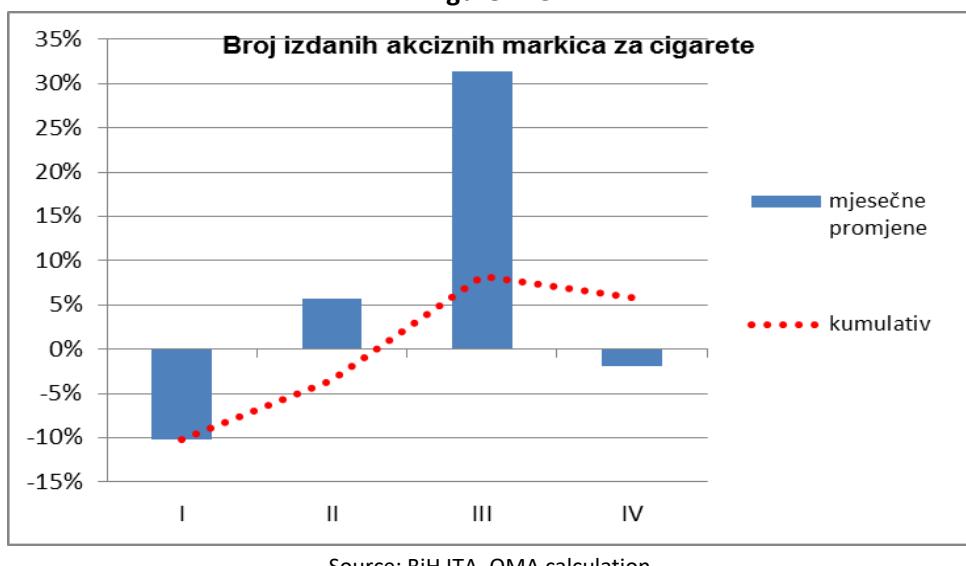
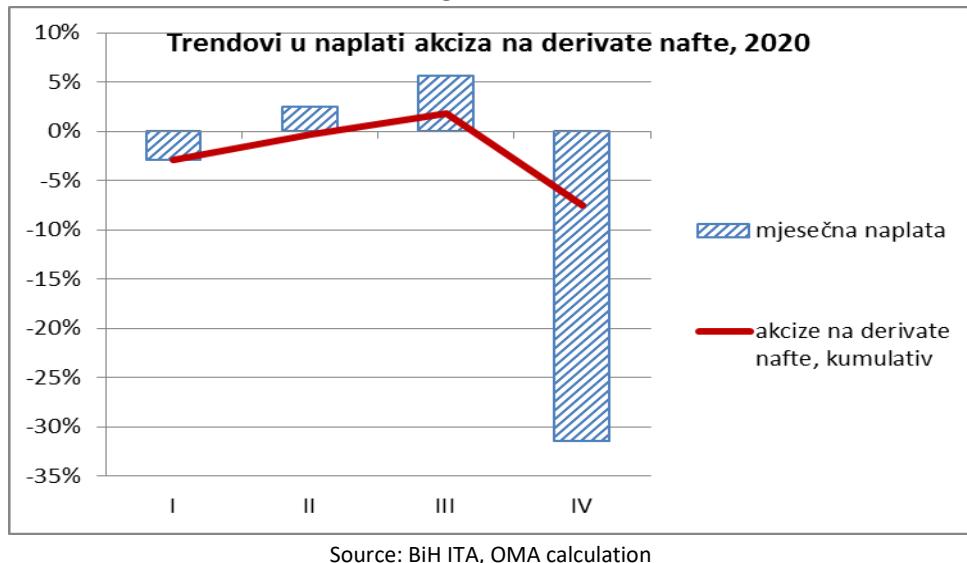


Figure1.15



A significant downturn in collection of excise duties on oil derivatives was recorded in April 2020, at the rate of 31.5 per cent. The downturn is expected in view of all restrictions related to movement of BiH citizens, border crossings and import, export, domestic transport and operations of companies as a whole. A significant decrease in the revenues from excise duties in April annulled the growth achieved at the level of the first quarter and finally resulted, at the level of four months, with a downturn at the rate of 7.5 per cent. (Figure 2.16, cumulative line).

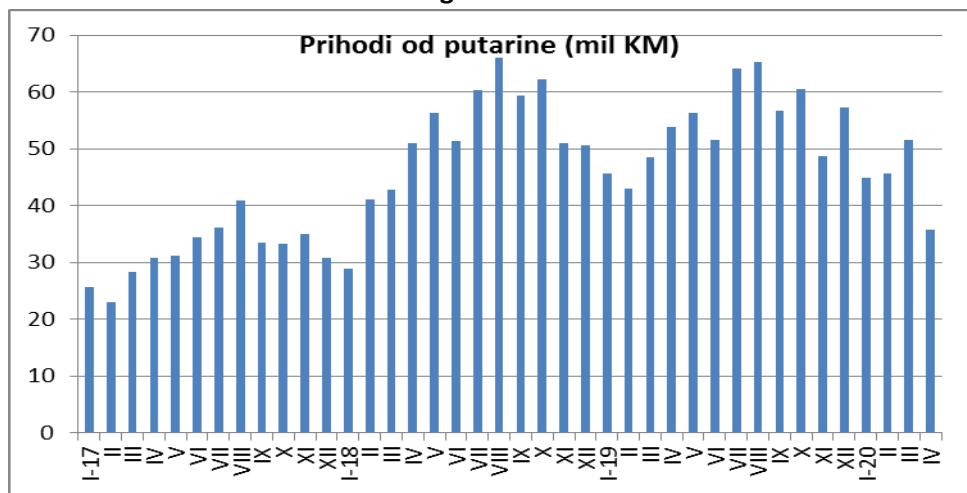
Figure 2.16:



Source: BiH ITA, OMA calculation

Revenues from pay tolls recorded a downturn at the rate of 33.4 per cent in April (Figure 2.17), while the rate cumulatively decreased by 6.9 per cent at the level of four months.

Figure 2.17:

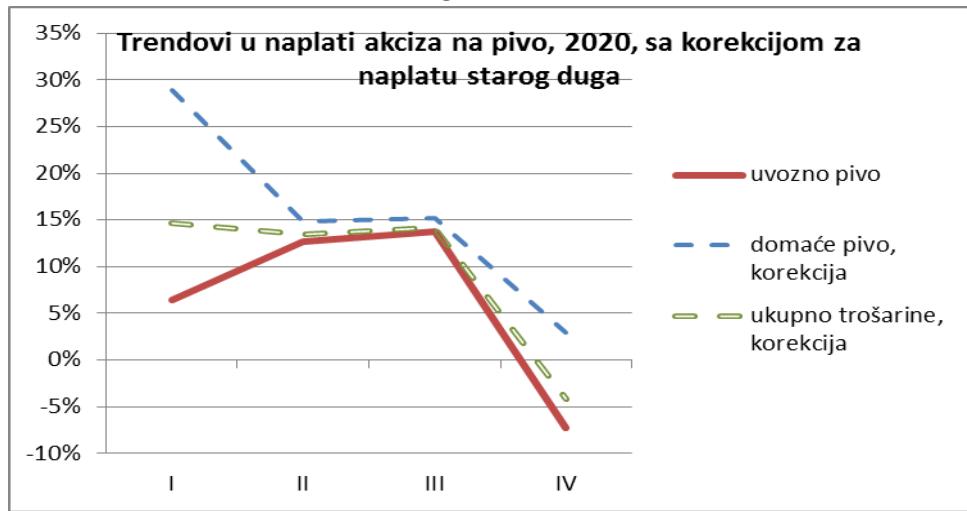


Source: BiH ITA, OMA calculation

The trend of growing revenues from excise duties on alcohol and alcohol beverages, i.e. the trend of decreasing excise duties on non-alcoholic beverages continued in April.

After two months of positive growth, a significant decrease in collection of excise duties on beer at the rate of 41.9 per cent was recorded, which resulted in a negative growth of total collection of excise duties on beer. However, it is necessary to note that the 2019 statistical basis for comparison is higher than the amount of collected old debts for excise duties on beer. After exclusion of the collection of the old debt, the decrease in the excise duties on beer for the first four months of 2020 amounts to 4.2 per cent, whereby leaving the cumulative collection of excise duties on beer in the positive growth zone, at the level of 3 per cent.

Figure 2.18:



Source: BiH ITA, OMA calculation

Indirect taxes revenues projections

2020-2023 revenues projections are available in Table 2.2 in order to ensure comparability of the 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 2.2 2020-2023 Indirect taxes revenues projections in million BAM, June 2020

Type of revenues (net)	in million BAM					Projected growth rate			
	Performance		Projection						
	2019	2020	2021	2022	2023	2020	2021	2022	2023
VAT	4,022.4	3,849.6	3,978.8	4,125.7	4,285.0	-4.3%	3.4%	3.7%	3.9%
Excise duties	1,533.3	1,493.6	1,548.7	1,599.0	1,651.7	-2.6%	3.7%	3.2%	3.3%
Custom duties	300.6	273.7	289.6	309.6	334.6	-9.0%	5.8%	6.9%	8.1%
Toll	650.2	614.4	650.2	670.3	692.3	-5.5%	5.8%	3.1%	3.3%
Other	35.3	26.5	27.8	29.1	30.6	-24.8%	4.7%	4.9%	5.0%
TOTAL	6,541.8	6,257.9	6,495.2	6,733.6	6,994.2	-4.3%	3.8%	3.7%	3.9%
Dedicated toll *)	-406.2	-384.0	-406.4	-418.9	-432.7	-5.5%	5.8%	3.1%	3.3%
FUNDS FOR DISTRIBUTION	6,135.6	5,873.8	6,088.8	6,314.7	6,561.5	-4.3%	3.7%	3.7%	3.9%

Note:

*) Designated toll amounted to 0.10 BAM/litre of oil derivative until 1 February 2018, entirely dedicated to construction of motorways and was raised to 0.25 BAM/litre of oil derivative as of 1 February 2018 (0.20 BAM/litre) and for construction and reconstruction of other roads (0.05 BAM/litre).

**) The amount of distributed designated toll in 2019, 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 (406.2 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 January 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 2.3 2020-2023 Indirect taxes revenues projections in % of GDP

Type of revenues (net)	in % of GDP				
	Performance	Projection			
		2019	2020	2021	2022
VAT	11.4%	11.2%	11.1%	11.0%	10.9%
Excise duties	4.3%	4.4%	4.3%	4.3%	4.2%
Custom duties	0.9%	0.8%	0.8%	0.8%	0.9%
Toll	1.8%	1.8%	1.8%	1.8%	1.8%
Other	0.1%	0.1%	0.1%	0.1%	0.1%
TOTAL	18.5%	18.3%	18.2%	18.0%	17.8%
Dedicated toll	-1.1%	-1.1%	-1.1%	-1.1%	-1.1%
FUNDS FOR DISTRIBUTION	17.3%	17.1%	17.1%	16.9%	16.7%

GDP data source: DEP projections (Macroeconomic projections, 2020-2023, May 2020), GDP by expenditures method

2020 Projections

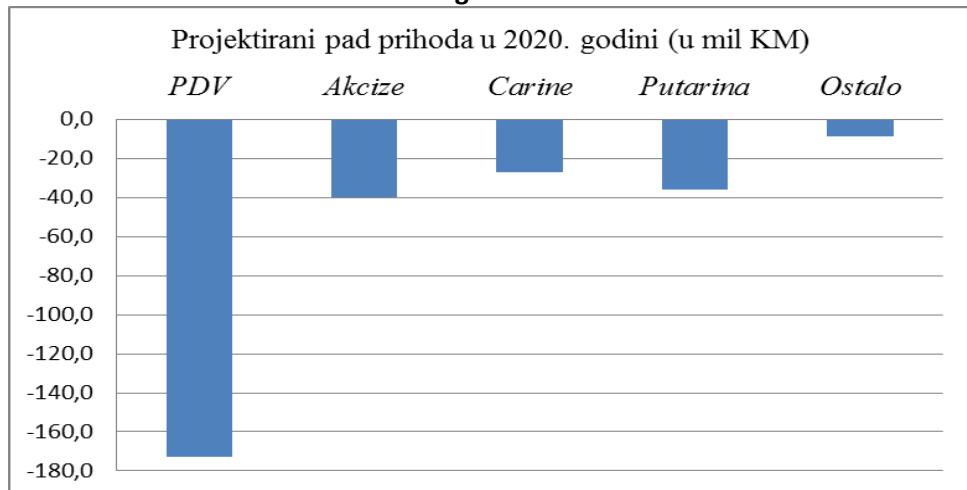
In the first quarter of 2020, net collection of indirect taxes revenues was by 64.6 million BAM higher than collection in the first quarter of 2019, i.e. by 4.4 per cent. The achieved growth rate in the first quarter is by 1.4 p.p. Higher than the projected rate of annual growth for 2020 in OMA projections from October 2019. In view of the current situation caused by the COVID-19 pandemics, and on the basis of projections of macroeconomic indicators (DEP, May 2020), we may be sure that the positive collection trends recorded in the first quarter will not continue in the remaining part of the year. A 119.5 million BAM or 22.2 per cent decrease in the net collection of revenues in comparison to April 2019 was recorded in April. The cumulative gross collection of revenues for the first four months of 2020 decreased by 96.8 million BAM in comparison to collection in the same period of 2019. At the same time, refund payments decreased by 41.8 million BAM, thus mitigating the total negative impact on cumulative collections. This resulted in the decrease in final net collection of indirect taxes by 55.0 million BAM or 2.7 per cent.

On the basis of the available data on collection of revenues and the basis premises of DEP projections stating that the crisis will be overcome in the second half of the year, we may expect a strong downturn of revenues in the second quarter of 2020 and a gradual recovery of collection in the second half.

The projected net collection of indirect tax revenues for 2020 amounts to 6.257.9 million BAM, i.e. 4.3 per cent less than in 2019. The projected decrease of revenues in the absolute amount is 284.0 million Figure 2.19. shows participation of certain types of revenues in the projected absolute decrease of total revenues (in million BAM).

⁴⁰ Official Gazette of Bosnia and Herzegovina, 91/17.

Figure 2.:



Source: OMA projections, June 2020

VAT

On the basis of the data on collection of revenues for the first four months, the projected negative effects of the corona virus pandemics and spending developments projections, import and export in 2020, it is expected that the collection of VAT revenues will amount to 3.849.6 million BAM, which is by 4.3 per cent lower than collection in the previous year. The projected VAT decrease rate is higher than the projected rate of private spending decrease. This is in accordance with the multi-annual data on VAT revenues elasticity in comparison to private spending in BiH and the findings of the IMF study indicating that the changes in taxes collection are more prominent than changes in the corresponding basis from the national accounts.⁴¹

Excise duties and toll

The projected amount of toll in 2020 amounts to 1,493.6 million BAM, which is by 39.8 million BAM or 2.6 per cent more than the results achieved in 2019.

Revenues from excise duties on oil derivatives and tolls

The previous two years recorded strong changes on the oil derivatives market due to the amendments to the Law on Excise Duties in 2017 (effective as of 1 February 2018)⁴². Significant changes occurred in the structure of the basis of excise duties⁴³ on oil derivatives. The share of heating oil in the basis significantly decreased, from 5.0 per cent in 2017 to 3.4 per cent in 2019. The share of kerosene, as the component with the lowers

⁴¹ Sancak, Velloso and Xing, „Tax Revenue Response to Business Cycle“, IMF Working Paper, 2010

⁴²Changes in the policy of excise duties on oil derivatives and tolls in 2017 pertained to the following: increase of the excise duty rate on heating oil, from 0.30 to 0.45 BAM/L; introduction of excise duty on bio-fuels and bio-liquids (0.30 BAM/L); increase in the rate of the dedicated toll, from 0.10 to 0.25 BAM/L (including separation of rates and funds by their purpose for motorways and other roads); and changes in the scope of the toll basis in view of inclusion of bio-fuels and bio-liquids and liquid oil gas for motor vehicles (*Official Gazette of BiH*, 91/17).

⁴³ The term “basis” implies quantities calculated by OMA: For excise duties, it includes the quantity of imported oil derivatives and bio-fuels and the quantity of marketed domestic derivatives and bio-fuels. The quantities in excise duties reports were taken with a time delay, m-1, in order to correctly represent the basis in accordance with the provisions of the Law on Occurrence of Liability and Excise Duty Payment.

aggregate taxation rate in view of the excise duty and toll, increased from 1.4 to 2.1 per cent.⁴⁴ Despite the lowest excise duty rate (0.3 BAM/L), the high share of diesel in the basis, in addition to stable spending growth rates, resulted in this derivative generating the highest growth in view revenues from excise duties on derivatives in the period between 2017 and 2019. The component of unleaded gasoline (as well as its share in the excise duties basis) decreased and negatively affected the revenues growth rate in the stated period. The total excise duties basis, i.e. the quantity of taxable derivatives increased by only 1.5 per cent in the stated period. The stated rate is significantly below the two-year growth rate of real GDP and spending, and the reasons may be found in the increase of oil derivative prices in the observed period.⁴⁵

When it comes to tolls, the situation is quite different. In 2019, the tolls collected were by 70.1 per cent higher than in 2017. This is a multiplied effect of the taxation rate growth of 60 per cent and the 6.3 taxation basis in the stated period.⁴⁶ When it comes to the components that were not included in 2017, the changes in the basis structure did not have the impact recorded in excise duties due to the unique rate of taxation of derivatives through tolls. The exception is represented by the widening of the basis for bio-fuels and liquid oil gas for motor vehicles, which generated additional revenues.

The corona virus pandemics caused further turbulences in the oil derivatives market. Quarantine and isolation, reduced private and business travelling, gathering restrictions, inter-city transport and movement due to the curfew resulted in the loss of revenues from excise duties in the restrictions period. Consumption of food staples recorded a rigid downturn, while the consumption of numerous other goods (e.g. Furniture) is expected to be partially compensated in the period following the relaxation of measures. On the other hand, a significant portion of oil derivatives consumption in the restrictions period will be permanently lost and irreplaceable.

Decreases in oil prices should stimulate consumption in the following period. In their document entitled “2020-2023 Macroeconomic projections” (DEP, May 2020), DEP mention projections of the European Commission⁴⁷ and the IMF⁴⁸ whereby significantly lower crude oil prices are expected in 2020 and 2021 in comparison to 2019.

Table 2.4 Crude oil projections, \$/barrel (ECB and IFO)

	2019	2020	2021	2022	2023
European Commission projection (May 2020)	64.1	38.4	40.2	n/a	n/a
IMF (April 2020)	61.4	35.6	37.9	n/a	n/a

Source: EC and IMF, taken from 2020-2023 Macroeconomic projections (DEP, May 2020)

⁴⁴ It must be kept in mind that these two categories of derivatives might not have had a significant impact on the development of total basis and revenues, as their ponder in the basis is low.

⁴⁵ In 2019, 2.7 per cent more net revenues from excise duties on oil derivatives were collected than in 2017 (the corrected amount including collected revenues from excise duties through VAT claims).

⁴⁶ The reasons behind the higher basis growth in view of excise duties are as follows: (1) the decreases heating oil consumption, as one of the main objectives of the amendments to the Law, through decreased misuse of heating oil as fuel; (2) widening of the baseline for toll on liquid oil gas, which was not included in the toll baseline for 2017; (3) decrease in the consumption of exempted diesel fuel used for the needs of mines, thermal power plants and railways in the stated period.

⁴⁷ European Commission, European Economic Forecast, Spring 2020, Institutional Paper 125, May 2020

⁴⁸ IMF, World Economic Outlook, April 2020

On the basis of the above stated and taking into account projections of real macroeconomic indicators developments, gross revenues from excise duties on oil derivatives and tolls are expected to decrease by 5.3 and 5.5 per cent in 2020, respectively, in comparison to gross collection in 2019.

Excise duties on tobacco

Collection of revenues from excise duties on tobacco products basically depends on business policies of three major global tobacco industry companies, i.e. their estimates of the factor of market growth and impact of external factors and risks. As the excise duties on tobacco products are paid upon taking up the excise duties stamps, i.e. a month or a month and a half prior to import of cigarettes, the collection of revenues from excise duties in the case of tobacco products does not show the actual final buyers spending, but the expected trading projected by the tobacco companies for the future period. The high growth in collection of revenues from excise duties achieved in February was expected as the companies have taken up large quantities of excise duties stamps in the end of 2019. These quantities were sufficient for the initial 2020 consumption, but the 37.1 per cent growth in March can be interpreted in two ways. It is either that the tobacco companies did not expect a significant down trading in the second quarter despite the epidemics in Europe and subsequently in BiH⁴⁹, or that they wanted to increase their tobacco product stocks as they became aware of the problems related to import, although they were facing financial damages due to payment of excise duties prior to the planned deadlines. April saw a 2 per cent decrease in the number of issued excise duties stamps, implying optimistic assumptions of the tobacco industry in view of relaxation of restrictive measures and opening of BiH borders. Opening of borders on 1 June 2020 represents a positive breakthrough in terms of increased spending of primarily non-residents, diaspora and BiH citizens temporary employed abroad. The other factor of recovery of collection of revenues from excise duties on tobacco products is the speed of the recovery of the economy, i.e. efficiency of measures adopted by Entity governments, which are primarily directed toward preservation of jobs and employment. Due to income and employment downturn, it is possible that the cut tobacco segment will rise at the expense of the decrease consumption of cigarettes which decreases the collection of excise duties as cut tobacco is taxed at a lower rate in comparison to cigarettes.

In such circumstances, the estimates related to the cigarettes market growth in the following quarters are not optimistic, but it is expected that the 9 per cent growth of excise duties revenues in the first quarter will largely compensate for negative trends in the remaining part of the year. In case the pandemics ends by fall, it is evident that growth may be expected in the fourth quarter in case the situation on BiH borders normalises, thus enabling undisturbed arrival of diaspora, tourists and other non-residents. It is assumed that the companies will not increase cigarettes retail prices in these turbulent and uncertain times, even more so as the last increase at the beginning of 2020 resulted in the 5 per cent increase of the average weighted price of cigarettes in comparison to 2019. If observed in terms of the stated assumptions, it might be expected that revenues will decrease by 0.6 per cent in 2020 in comparison to collection in 2019. The stated growth is the result of the growth in the cut tobacco segment.

Custom duties

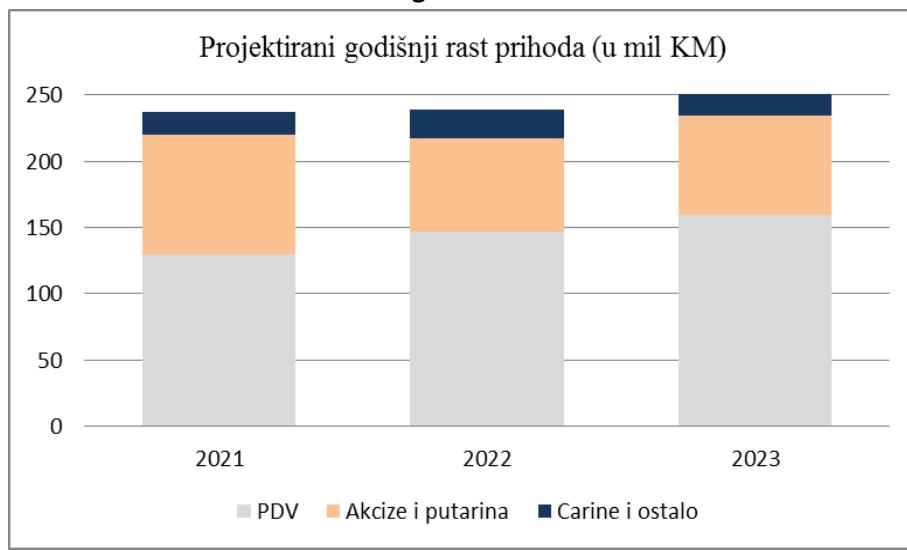
The projected amount of customs in 2020 amounts to 273.7 million BAM, which is by 9.0 per below the results achieved in 2019. The projections observe trends in export and customs developments in the first four months of 2020 and previous years, as well as import developments projections (DEP).

⁴⁹ The first case of corona virus in BiH was confirmed on 5 March 2020.

2021-2023 Projections

The projected rates of growth of revenues for 2021, 2022 and 2023 are 3.8, 3.7 and 3.9 per cent, respectively. Projection of revenues in the stated period is based on the projected relevant macroeconomic indicators, historical collection scheme and projections for certain categories of revenues in 2020. As this was the case in 2020, the projections are carried out 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. Figure 2.20 shows the projected annual growth of revenues by type.

Figure 2.20:



Source: OMA projections, June 2020

The biggest generator of the absolute growth of revenues from indirect taxes in that period is VAT, considering its significant participation in revenues and planned stable growth rates in accordance with projected spending growth rates. In all three stated years, VAT revenues generate more than 54 per cent of absolute annual projected revenues growth rate.

Revenues from toll do not contribute significantly to the projected absolute revenues growth in the 2021-2023 period due to exhaustion of the effects of tax rates growth. The highest growth of the toll rate in this period is expected in 2021, due to the lower basis in 2020 because of the permanently lost spending in the second quarter caused by travelling restrictions during the period of restrictions related to corona virus.⁵⁰

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 (see Table 2.2).

⁵⁰ The Directorate for Economic Planning does not submit estimated spending by categories. On the basis of the available data on collection of indirect taxes by types, OMA predicts that the decrease in oil derivatives spending in 2020 will be higher than the downturn in total spending and that the increase in oil derivatives spending in 2021 will be higher than the total spending growth due to the lower basis.

It might be expected that the end of the pandemics and normalisation of circumstances both on borders and in BiH will result in stabilisation and subsequently recovery of the tobacco products market, especially in terms of spending of non-residents. Achievement of stated prognosis depends on the recovery of the economy, increased employment and growth of revenues which might encourage smokers who started smoking cut tobacco earlier because of high prices of cigarettes to return to cigarettes consumption. In such circumstances, it is realistic to expect stagnation at first and subsequently decrease in the cut tobacco market. 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 at the 2020 level, result in increase in cigarettes spending. In the stated circumstances, it might be expected that revenues from excise duties on tobacco will increase by 2.8 per cent in 2021, while these are expected to grow in 2022 and 2023 by 3.5 and 3.6 per cent, respectively. 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.

Differences in comparison with previous projections

DEP's 2020-2022 Macroeconomic Projections from September 2019 estimated that the GDP will nominally grow by 4.4 per cent in 2020, and by 5.0 and 5.1 per cent in 2021 and 2020, respectively.

After exclusion of the estimates of the effects of the corona virus pandemics, in the DEP's document 2020-2023 Macroeconomic Projections from April 2020, the projected GDP growth rates were changed from high and stable (projected in 2019) to the negative zone (see Figures 1-3 in part 1.1 Macroeconomic indicators projections). The document states that the prognosis were prepared when the statistical data for March, when both the demand and offer sides were hit, were not available. Likewise, it is stated that, at the moment of preparation of their report, numerous internationally referent institutions (IMF, World Bank, EC) revised on a weekly basis, projections of economic developments in 2020 due to the uncertainties related to the duration and quantification of corona virus consequences.

On 1 June 2020, DEP submitted to OMA revised projections of macroeconomic indicators (DEP, May 2020)⁵¹ assuming a two-fold nominal downturn of GDP in 2020 than the one envisaged in their April projections.⁵¹ The most revised projections are the projections of private spending⁵², which have a significant influence on projections of revenues from indirect taxes.

The differences in indirect taxes projections in June 2020 in comparison to projections in April 2020 and October 2019 are the results of changes in collection trends in view of certain types of revenues and changes in macroeconomic indicators projections, represented in Tables 2.4 and 2.5 below.

⁵¹ Projections from May envisage nominal decrease of GDP by 3.1 per cent, while the decrease envisaged in April projections is 1.5 per cent.

⁵² DEP May projections envisage a two-fold nominal decrease of private spending in comparison to DEP April 2020 projections.

Differences of indirect taxes projections in comparison to October 2019 projections

Table 2.5 shows the differences in projections of indirect taxes (June 2020) in comparison to OMA October 2019 projections.

Table 2.5 The differences in projections of indirect taxes (June 2020) in comparison to OMA October 2019 projections

	in million BAM				in % of GDP *)			
	2019**)	2020	2021	2022	2019	2020	2021	2022
VAT	19.7	-282.6	-291.9	-302.0	0.1%	-0.8%	-0.8%	-0.8%
Excise duties	12.1	-60.9	-45.7	-40.8	0.0%	-0.2%	-0.1%	-0.1%
Custom duties	-0.9	-48.3	-57.6	-67.4	0.0%	-0.1%	-0.2%	-0.2%
Toll	-7.1	-55.3	-32.9	-27.2	0.0%	-0.2%	-0.1%	-0.1%
Other	5.4	-3.8	-2.9	-2.0	0.0%	0.0%	0.0%	0.0%
TOTAL	29.2	-450.8	-431.0	-439.4	0.1%	-1.3%	-1.2%	-1.2%

*) GDP projection, DEP, May 2020

**) Data for 2019 represent execution of revenues

Differences in execution of revenues in 2019 and projections from October 2019

Collection of revenues from indirect taxes in 2019 was by 29.2 million BAM higher than the revised October 2019 projections (Table 2.5). Net VAT revenues were exceeded by 19.7 million BAM, while the revenues from excise duties were exceeded by 12.1 million BAM. Revenues from customs and tolls achieved were by 0.9 and 7.1 million BAM below the October projections, respectively. The positive difference of 5.4 million BAM relates to other revenues (other unaligned revenues of the ITA Single Account).

An unexpectedly high growth of net VAT revenues (11.5 per cent) was recorded in December 2019 as the result of the strong 8.6 per cent growth of gross revenues and the low VAT refund at the rate of 1.4 per cent.

One of the assumptions of revised October 2019 projections was maintenance of prices of cigarettes in 2020 after completion of alignment of excise burden on cigarettes with the minimum EU excise duty in 2019, at the level of 2019. However, the announced increase of retail sale prices as of 1 January 2020 triggered cigarettes stocks in distributors at the end of the year as they expected increase consumption. As the excise duties on cigarettes are paid ex-ante, prior to consumption, the effects of the announced retail prices in 2020 overflowed from 2020 to 2019.

Therefore, it may be concluded that the main reasons of higher growth of revenues from indirect taxes in comparison to October projections were the growth in the collection of VAT and excise duties on tobacco products (by 46 per cent) in December 2019.

The differences in projections for the 2020-2022 period in comparison to October 2019 projections

In comparison to the projections in October last year, the differences in projection of revenues from indirect taxes for 2020, 2021 and 2022 amount to -450.8 million BAM, -431.0 million BAM and -439.4 million BAM, respectively. The differences are caused by huge corrections of projections of macroeconomic indicators (DEP, May 2020 in comparison to September 2019) for 2020 due to inclusion of the effects of the corona virus epidemics (Figures 1-3). As 2020 is the basis for development of projections for following years, this explains the significant differences in comparison to October projections and 2021-2022 projections.

The differences of indirect taxes projections in comparison to October 2020 projections

Table 2.6 shows the differences in projections of indirect taxes (June 2020) in comparison to OMA April 2020 projections.

Table 2.6 The differences in projections of indirect taxes (June 2020) in comparison to April 2020 projections

	in million BAM					in % of GDP *)			
	2020	2021	2022	2023		2020	2021	2022	2023
VAT	-95.3	-87.7	-83.6	-78.1		-0.3%	-0.2%	-0.2%	-0.2%
Excise duties	-21.9	-15.8	-13.1	-10.0		-0.1%	0.0%	0.0%	0.0%
Custom	-19.4	-18.2	-19.5	-21.0		-0.1%	-0.1%	-0.1%	-0.1%
Toll	-14.5	-2.7	-1.5	0.4		0.0%	0.0%	0.0%	0.0%
Other	-5.2	-4.3	-3.3	-2.2		0.0%	0.0%	0.0%	0.0%
TOTAL	-156.4	-128.7	-121.0	-111.1		-0.5%	-0.4%	-0.3%	-0.3%

*) GDP projection, DEP, May 2020

In comparison to the projections from April this year, the differences in projection of revenues from indirect taxes for 2020, 2021, 2022 and 2023 amount to -156.4 million BAM, -128.7 million BAM -121.0 million BAM and -111.1 million BAM, respectively. The differences are the result of corrections of macroeconomic indicators projections (DEP) in comparison to those used in April and on the basis of the subsequently available data on collection of revenues in April, when the first major effects of corona virus on BiH economy manifested.

Risks

The projections of indirect taxes revenues for 2020 and for the following three-year period were prepared at the moment when data on collection of revenues by types at the ITA Single Account for May were not available, whereby May was the month in which significant effects of the crisis caused by the corona virus pandemics manifested. Projections of macroeconomic indicators serving as the basis for projections of revenues were also prepared when a part of statistical data was not available for March, the month in which shocks were recorded on both the demand and the offer side. In observation of many unknown facts at the moment of preparation of projections related to the strength and the duration of the shock caused by the corona virus pandemics, and the assumptions (DEP, macroeconomic projections) that the crises will be overcome in the short term, we note that there are significant risks to achievement of projections of revenues from indirect taxes, whereby the risks resulting in an unfavourable outcome are predominant.

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 2020 and 2023 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 parameters from the projected values represents a risk to revenues projections; DEP states that the risks in achieving the stated projections might be classified into two groups, into foreign and domestic, whereby foreign risks are more certain and affect the economic growth in Bosnia and Herzegovina more. The COVID-19 pandemics represents

the main risk in terms of achievement of DEP projections. The assumption for the 2020 and medium-term projections are that the consequences of the crisis will impact the first quarter of 2020 the most, with continuation of this effect until the end of the year, although reduced. Possible prolonged duration of the epidemics would further endanger the projected rates of macroeconomic indicators developments. On the other hand, DEP states that achievement of their projections is threatened by internal challenges, i.e. internal risks in BiH (the complicated decision-making system, the slow implementation of economic reforms in the country). Likewise, they state that the possible delays in organisation of government might have a negative impact on the planned dynamics of implementation of public investments and total economic growth.

- The 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;
- The 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 would affect the oil derivatives market in BiH and 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.

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 2021 in view of a surplus, in the amount of 833.7 million BAM or 2.34 per cent of projected GDP for 2021⁵³, of which:

- BiH Institutions plan a deficit in the amount of 93.4 million BAM,
- Republika Srpska plans a deficit in the amount of 669.9 million BAM,
- FBiH plans a deficit in the amount of 70.4 million BAM and
- Brčko District plans a neutral financial result.⁵⁴

Public spending level and structure

Public expenditures level, as a part in GDP in the 2021-2023 period should be decreased with the aim of achieving a consolidated BiH public expenditures level below 40 per cent GDP.

Table 3.1 2020-2023 Total Public Expenditures in BiH (in million BAM)

Expenditures	2020	2021	2022	2023
BiH institutions	991.4	1,022.4	1,022.4	1,010.7
FBiH	9,467.80	9,081.30	9,132.20	9,170.20
RS	5,519.08	5,226.35	5,097.39	4,808.71
Brčko District	256.1	236.3	243.9	251.2
Total expenditures (consolidated) (A)	16,234.38	15,566.35	15,495.89	15,240.81
GDP	34,283	35,709	37,460	39,226
BiH institutions	2.9%	2.9%	2.7%	2.6%
FBiH	27.6%	25.4%	24.4%	23.4%
RS	16.1%	14.6%	13.6%	12.3%
Brčko District	0.7%	0.7%	0.7%	0.6%
Total in GDP (A)	47.4%	43.6%	41.4%	38.9%

Source: Calculations of the BiH Fiscal Council Counselling Group

In the period between 2021 and 2023, additional efforts are necessary in order to change the structure of public spending directed toward strengthening of capital investments at the expense of current expenditure. Of course, the consequences of the global corona virus pandemic may not be overlooked, suffered primarily by the real sector and consequently by the budgets of all levels of governance in BiH, except the BiH Institutions budget. In this regard, all stated estimates and projections should be taken cautiously since these might imply revising the 2021-2023 Global Framework of Fiscal Balance and Policies of BiH, in particular its key determinants.

⁵³ In accordance with DEP projections, BiH GDP for 2021 is projected in the amount of 35.709 million BAM.

⁵⁴ See Tables from 3.2 through 3.6

Tabular budget framework 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 2019-2023 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 3.2.);
- 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 3.3.);
- 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 3.4) and
- Revenues, expenditures and BD BiH budget and funds (Table 3.5);

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

BiH institutions

Table 3.2 BiH Institutions Budget Framework (in million BAM)

BiH institutions	Execution 2019	Proposal 2020	Plan 2021	Projection 2022	Projection 2023
Revenues	926.2	926.8	929.0	927.6	936.5
Tax revenues	750.0	780.0	780.0	780.0	780.0
Indirect taxes	750.0	780.0	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	13.9	0.7	0.6	0.5	0.5
Other revenues	162.3	146.1	148.4	147.1	156.0
Expenditures	875.7	991.4	1,022.4	1,022.4	1,010.7
Gross salaries and remunerations	666.9	701.7	751.2	752.5	755.4
Expenditures for material and services	159.1	171.1	180.8	186.2	179.7
Interest	0.9	1.0	1.0	0.9	0.8
Subsidies, social contributions and transfers	13.4	17.0	13.0	13.1	13.0
Other expenditures	15.1	59.8	15.3	16.0	16.2
Net expenditures for non-financial assets	20.3	40.8	61.1	53.7	45.6
Balance	50.5	-64.6	-93.4	-94.8	-74.2
Financing	-50.5	64.6	93.4	94.8	74.2
Domestic	-47.2	69.2	98.1	6.9	7.5
Internal debt repayment	0.0	0.0	0.0	0.0	0.0
Other (+/-)	-47.2	69.2	98.1	6.9	7.5
Foreign	-3.3	-4.6	-4.7	-4.7	-16.4
Foreign credits withdrawals	0.0	0.0	0.0	0.0	0.0
Repayment of foreign credits principal	-3.3	-4.6	-4.7	-4.7	-16.4
Uncovered surplus of expenditures	0.0	0.0	0.0	92.6	83.1

Source: Ministry of Finance and Treasury of Bosnia and Herzegovina

Table 3.3 RS Budget Framework (in million BAM)

REPUBLIKA SRPSKA	Execution 2019	Plan 2020	Plan 2021	Projection 2022	Projection 2023
Revenues	4,607.9	4,505.8	4,556.4	4,692.4	4,842.2
Tax revenues	2,525.9	2,490.4	2,552.5	2,642.5	2,740.8
Indirect taxes	2,034.8	1,980.4	2,052.2	2,126.2	2,205.3
Direct taxes	460.2	474.6	459.1	474.1	491.9
Other tax revenues	30.9	35.5	41.2	42.3	43.5
Contributions	1,609.1	1,620.9	1,613.6	1,656.5	1,704.2
Grants and transfers	83.7	7.5	17.4	10.6	6.0
Other revenues	389.3	387.1	372.9	382.8	391.2
Expenditures	4,482.3	5,519.1	5,226.4	5,097.4	4,808.7
Gross salaries and remunerations	1,003.0	1,106.9	1,116.2	1,123.9	1,130.0
Expenditures for material and services	370.1	407.8	403.2	393.0	400.1
Interest	136.4	138.7	146.0	164.8	170.5
Subsidies, social contributions and transfers	2,273.1	2,538.9	2,453.5	2,466.7	2,470.4
Other expenditures	194.8	204.7	169.6	167.5	168.9
Net expenditures for non-financial assets	504.8	1,122.1	937.8	781.6	468.8
Balance	125.6	-1,013.3	-669.9	-405.0	33.5
Financing	-125.5	1,013.3	669.9	405.0	-33.5
Domestic	-152.4	499.7	237.3	184.5	-116.4
Internal debt repayment	-381.8	-274.2	-410.8	-394.2	-355.6
Other (+/-)	229.4	773.8	648.1	578.7	239.2
Foreign	34.8	513.7	349.4	176.7	62.0
Foreign credits/funds withdrawals	297.3	743.3	612.6	452.1	827.1
Repayment of foreign credits principal	-262.5	-229.6	-263.1	-275.4	-765.1
The statistical difference and uncovered excess of expenditures	-8.0	-0.1	83.2	43.8	20.9

Source: Ministry of Finance of Republika Srpska

Table 3.4 FBiH Budget Framework (in million BAM)

FBiH	Execution 2019	Proposal 2020	Plan 2021	Projection 2022	Projection 2023
Revenues	9,424.0	8,721.4	9,010.9	9,294.8	9,548.5
Tax revenues	4,526.6	3,830.6	3,957.1	4,100.1	4,256.9
Indirect taxes	3,608.9	3,235.2	3,346.7	3,471.6	3,610.6
Direct taxes	916.8	594.6	609.6	627.7	645.4
Other tax revenues	0.9	0.8	0.8	0.8	0.9
Contributions	3,688.8	3,434.4	3,557.4	3,655.4	3,736.6
Grants and transfers	25.2	30.1	21.4	22.0	22.2
Other revenues	1,183.4	1,426.3	1,475.0	1,517.3	1,532.8
Expenditures	8,957.6	9,467.8	9,081.3	9,132.2	9,170.2
Gross salaries and remunerations	2,087.7	1,957.2	1,982.7	1,994.3	2,004.9
Expenditures for material and services	1,939.2	1,862.5	1,908.0	1,921.2	1,976.2
Interest	127.8	143.4	161.9	169.1	148.1
Subsidies, social contributions and transfers	4,024.4	4,702.5	4,179.7	4,198.0	4,216.8
Other expenditures	195.5	284.4	308.4	304.3	276.2
Net expenditures for non-financial assets	583.0	517.8	540.6	545.3	548.0
Balance	466.4	-746.4	-70.4	162.6	378.3
Financing	-466.4	746.4	70.4	-162.6	-378.3
Domestic	-135.9	368.0	-47.8	-47.8	-48.0
Internal debt repayment	-224.0	-452.0	-507.8	-637.8	-478.0
Other (+/-)	88.1	820.0	460.0	590.0	430.0
Foreign	-210.2	667.4	85.6	-350.0	-509.2
Foreign credits withdrawals	281.8	1,122.2	542.3	81.2	120.2
Repayment of foreign credits principal	-492.0	-454.8	-456.7	-431.2	-629.4
Uncovered surplus of expenditures	-120.3	-289.0	32.6	235.2	178.9

Source: FBiH Ministry of Finance

Brčko District

Table 3.5 BD BiH Budget Framework (in million BAM)

BRČKO DISTRICT	Execution 2019	Proposal 2020	Plan 2021	Projection 2022	Projection 2023
Revenues	225.3	229.5	236.3	243.9	251.2
Tax revenues	213.8	217.7	224.5	232.1	239.1
Indirect taxes	184.7	187.8	194.6	202.2	208.3
Direct taxes	29.1	29.9	29.9	29.9	30.8
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	0.6	0.0	0.0	0.0	0.1
Other revenues	10.9	11.8	11.8	11.8	12.0
Expenditures	208.1	256.1	236.3	243.9	251.2
Gross salaries and remunerations	77.0	92.0	92.4	92.6	95.5
Expenditures for material and services	30.5	39.3	36.7	37.0	38.2
Interest	9.1	9.6	8.2	8.3	8.6
Subsidies, social contributions and transfers	85.9	78.0	84.1	85.1	87.8
Other expenditures	2.8	5.0	4.7	10.6	10.9
Net expenditures for non-financial assets	2.8	32.2	10.2	10.3	10.2
Balance	17.2	-26.6	0.0	0.0	0.0
Financing	-17.2	26.6	0.0	0.0	0.0
Domestic	5.1	19.8	0.0	0.0	0.0
Internal debt repayment	-0.6	13.2	0.0	0.0	0.0
Other (+/-)	5.7	6.6	0.0	0.0	0.0
Foreign	0.5	0.0	0.0	0.0	0.0
Foreign credits withdrawals	0.5	0.0	0.0	0.0	0.0
Repayment of foreign credits principal	0.0	0.0	0.0	0.0	0.0
Uncovered surplus of expenditures	-22.8	6.8	0.0	0.0	0.0

Source: BD BiH Finance Directorate

BiH: Consolidated

Table 3.6 BiH Consolidated (in million BAM)

BiH	Execution 2019	Plan 2020	Plan 2021	Projection 2022	Projection 2023
Revenues	15,183.4	14,383.5	14,732.7	15,158.7	15,578.4
Tax revenues	8,016.3	7,318.7	7,514.1	7,754.7	8,016.8
Indirect taxes	6,578.4	6,183.4	6,373.5	6,580.0	6,804.2
Direct taxes	1,406.1	1,099.1	1,098.6	1,131.7	1,168.1
Other tax revenues	31.8	36.3	42.0	43.1	44.4
Contributions	5,297.9	5,055.3	5,171.0	5,311.9	5,440.8
Grants and transfers	123.4	38.3	39.4	33.1	28.8
Other revenues	1,745.9	1,971.3	2,008.1	2,059.0	2,092.0
Expenditures	14,523.7	16,234.4	15,566.4	15,495.9	15,240.8
Gross salaries and remunerations	3,834.6	3,857.8	3,942.5	3,963.3	3,985.8
Expenditures for material and services	2,498.9	2,480.7	2,528.7	2,537.4	2,594.2
Interest	274.2	292.7	317.1	343.1	328.0
Subsidies, social contributions and transfers	6,396.8	7,336.4	6,730.3	6,762.9	6,788.0
Other expenditures	408.2	553.9	498.0	498.4	472.2
Net expenditures for non-financial assets	1,110.9	1,712.9	1,549.7	1,390.9	1,072.6
Balance	659.7	-1,850.8	-833.7	-337.2	337.6
Financing	-659.6	1,850.9	833.7	337.2	-337.6
Domestic	-330.4	956.7	287.6	143.6	-156.9
Internal debt repayment	-606.4	-713.0	-918.6	-1,032.0	-833.6
Other (+/-)	276.0	1,669.6	1,206.2	1,175.6	676.7
Foreign	-178.2	1,176.5	430.3	-178.0	-463.6
Foreign credits withdrawals	579.6	1,865.5	1,154.9	533.3	947.3
Repayment of foreign credits principal	-757.8	-689.0	-724.5	-711.3	-1,410.9
The statistical difference and uncovered excess of expenditures	-151.1	-282.3	115.8	371.6	282.9

Source: Calculations of the BiH Fiscal Council Counselling Group

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 of the Federation of Bosnia and Herzegovina (*Official Gazette of the Federation of Bosnia and Herzegovina*, 86/07).

Republika Srpska

The Law on Borrowing, Debt and Guarantees of Republika Srpska (*Official Gazette of Republika Srpska*, 71/12, 52/14 and 114/17), defines 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 2021: 6.664.35 BAM⁵⁵), 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 2021: 7.270.2 million BAM). The Law on Amendments to the Law on Borrowing, Debt and Guarantees of Republika Srpska (*Official Gazette of RS*, 53/14) defines that the debt on the basis of borrowing for financing recovery from damages from the Single Registry, prescribed by the Law on the Solidarity and Reconstruction Fund of Republika Srpska, is excluded from the restrictions prescribed for the total and public debt of Republika Srpska.

FBiH

Total revenues of cities and municipalities in FBiH in 2019 amounted to 938.3 million BAM.

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 % of revenues achieved in the previous fiscal year. In 2019, 10 % of revenues of cities and municipalities amounts to 93.83 million BAM, representing the 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 does not exceed 10 per cent of revenues of the relevant municipality/city achieved in the previous fiscal year.

⁵⁵ The estimated GDP of Republika Srpska for 2021 amounts to 12.117 million BAM (2020-2022 RS Economic Reforms Programme (*Official Gazette of RS*, 112/19).

Total revenues of Cantons in FBiH achieved in 2019 amounts to 2.492.6 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 by cantons do not exceed 10 % of revenues achieved in the previous fiscal year. Ten per cent of revenues of Cantons achieved in 2018 amounts to 249.26 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 2019 amounts to 4.522.7 million BAM, of which:

- FBiH 2.030.1 million BAM
- Cantons 2.492.6 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 % of consolidated revenues of FBiH and Cantons achieved in 2019, i.e. 814.095.277 BAM. Annual debt servicing in 2019 of all levels of governance in FBiH may amount up to 907.53 million BAM, of which:

- Servicing of debt of municipalities and cities up to 93.83 million BAM (10 % of total revenues in 2019)
- Servicing of debt of Cantons up to 249.26 million BAM (10 % of total revenues of Cantons in 2019)
- Servicing of debt of FBiH up to 564.84 million BAM, representing a difference between 814.1 million BAM (18 % of consolidated revenues of FBiH and Cantons in 2019) and 249.26 million BAM (10 % of revenues of Cantons achieved in 2019).