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Original scientific paper

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GLOBAL FRAMEWORK FOR FISCAL BALANCE AND POLICIES IN BOSNIA AND HERZEGOVINA

Summary: *Applying the fiscal policy, the state helps carrying out their economic goals. Fiscal policy is a powerful instrument that can direct economic flows and economic activity. The main function of the tax is collection of public revenues. However, taxes have additional features reflected in the allocation of social resources, the redistribution of national income, the stabilization of economic trends and the like. Creating an appropriate tax structure and choosing tax rates, the state may affect the balance of prices, investment, employment, savings, trade flows, exports increase, imports reduction, social problems. The tax structure of certain countries can be seen by the impact of certain forms of tax in the total public revenues. The fiscal system of modern states is a combination of a large number of taxes designed to favour a given economic and social goals, i.e. to represent the achievement of the objectives of the fiscal policy of the country. Tax systems are different primarily because states have different requirements for funds which finance public expenditures. One of the most important indicators attributed to the public sector is the level of tax burden of individual tax revenues in the total gross domestic product.*

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INTRODUCTION

Being a member state of the EU means not only respecting the rules and standards of the EU, but also that the country is economically suitable for membership. As such, it can certainly take advantage of all the benefits of EU accession, while also contributing to the growth and prosperity of the EU economy.

The economy of Bosnia and Herzegovina belongs to the group of small open economies, vulnerable to global developments and external shocks.

In the context of fiscal sustainability and the European Union, it is necessary to do a review and assessment of the previous economic and fiscal programs of the European Commission. Bosnian economic and fiscal program also refers to the priorities of the European partnership. However, they are not generally implemented through concrete policies and supporting activities.

1. ECONOMIC TRENDS IN BIH

Economic integration is achieved in the area which includes the territories of several countries, with the aim to remove barriers to the movement of goods, but also services and factors of production (Ristić 2015/2016, 326). BiH is the subject of a regional approach of the European Union to the countries of the Western Balkans through the Stabilisation and Association Process, as well as the element of strategy of conditionality from 1997. Political dialogue, trade liberalization, cooperation in the field of justice and internal affairs, and the stabilization and association process are guidelines of integrating BiH into the political and economic mainstream of the Union. Becoming a Member State of the EU means not only to respect the rules and standards of the EU, it also means that the country becomes economically suitable for membership so it would be able to take advantage of all the benefits of EU accession, while also contributing to the growth and

prosperity of the EU economy. Based on the experience of EU member states in the European Semester, the Commission strengthens its support to improving the economic management and competitiveness in the enlargement countries. This should help the countries included in enlargement to exploit the potential for sustainable growth and job creation, to better plan and deploy structural reforms and ultimately to meet the economic criteria. Bosnia and Herzegovina is at an early stage in approaching European standards. Some level of preparedness has been made in terms of public procurement and the internal market. Further sustained efforts are required, and in particular with regard to issues of justice, freedom and security in the area of competition, industry and small and medium enterprises, agriculture, environmental policy and climate change, energy, information society and media.

1.1 Movement of the main economic indicators in Bosnia and Herzegovina

Although the real growth of economic activity in BiH compared to the previous quarter during the first two quarters of 2015 amounted to only 0.7%, activity growth per annum was much higher. The largest part of the annual increase was actually realized in the fourth quarter of 2014, when the activity was increased compared to the third quarter by a significant 1.6%. Thus, despite the modest quarterly increase in the next two quarters, economic activity in the first quarter was higher by 2.3%, whereas in the second by a significant 4.4% higher compared to the same period in 2014. The intensification of the annual growth in the second quarter was largely a consequence of the fall in GDP in the same period of the previous year due to heavy floods in the country.

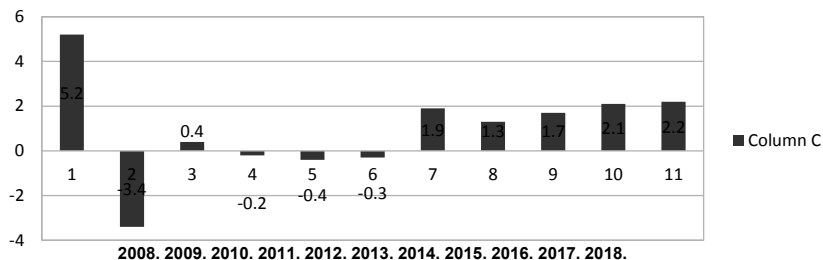


Figure 1. GDP – real growth in %
 Source: Agency for Statistics of Bosnia and Herzegovina

Economic growth in the region in the first half was more intense than in the first half of 2014 with a slight intensification rate in the second compared to the first quarter. The impact of fiscal policy on economic growth in 2015 was quite modest both in terms of final consumption and transfers, and in terms of public investment. The projections for economic growth and employment in the region for 2015 were much more favourable than the growth from 2014. Strengthening the growth should be continued also in 2016, although in somewhat more modest rates. Thus, the projected economic growth of the Euro zone of 1.5% for 2015 is well above the rate of 0.9% in 2014. Furthermore, there is more modest improvement in the rate of 1.9% in 2016. Truly, this is not accompanied by a significant improvement in the unemployment rate projection which is only slightly improved compared to 2014, and remains high (10.5%) in 2016.

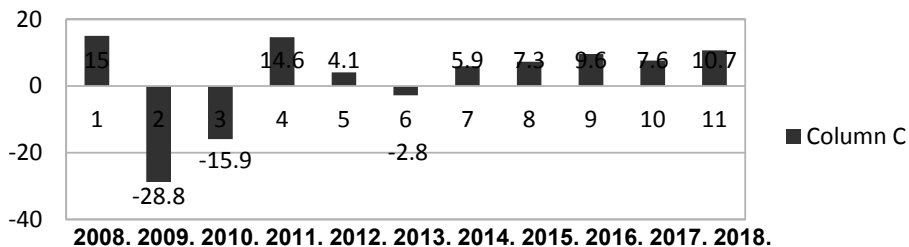


Figure 2. Final consumption – growth in %
 Source: Agency for Statistics of Bosnia and Herzegovina

Among the major countries in the region, the most significant progress is expected in Italy and Croatia, which decline by 0.4% in 2014 was stopped in 2015. Positive rates are expected in Italy of 0.6% and in Croatia 0.3%, and strong progress in these countries should be continued in 2016. On the other hand, in Slovenia there could be a gradual slowdown in economic growth during 2015 and 2016. In addition to external assumptions, presumptions of BH projections do not include the repetition of bad weather in the coming period that could (temporarily or permanently) disable the existing production capacities, and significantly impact on agriculture, power generation, etc. Gross national product and its formation from domestic sources (investment, development), as well as from foreign sources, is the basic macroeconomic aggregate (Ristić et al 2015, 548).

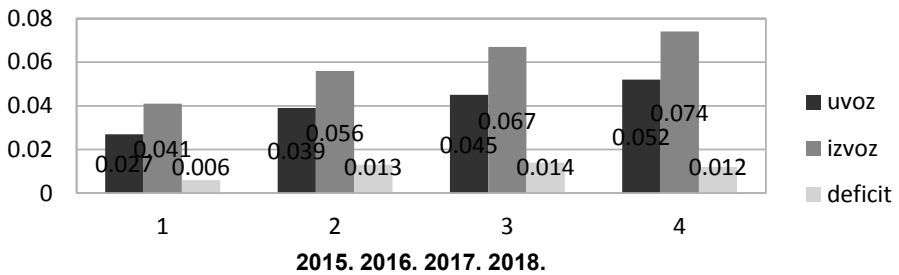


Figure 3. Investment – growth in %
 Source: Agency for Statistics of Bosnia and Herzegovina

In this regard, in 2015 economic growth of 2.5% was expected, after which would follow further acceleration in 2016 with a real growth rate of 3.1%. The normal political environment without major crises that could jeopardize the adoption of the budget and public expenditure is assumed. All this should result in economic growth of 2.5% in 2015 and 3.1% in 2016 in BiH. This growth should primarily be carried by domestic demand and to a lesser extent by a significantly slower growth of foreign trade deficit. Better external environment should lead to the strengthening of export demand and exports, but also to improvement of foreign cash inflows used to finance domestic demand. This should lead to real growth of final consumption by 1.3% in 2015 and 1.7% in 2016. In addition, a significant investment growth in 2015 of 7.3% is expected, with a further growth rate

of 9.6% in 2016. Thus, the total domestic demand growth amounted 2.3% in 2015 and 2.9% in 2016.

On the other hand, export growth should be higher than imports, which would take the negative impact of the foreign trade deficit to a minimum during 2016. Similar assumptions are expected for the period 2017-2018 with some modest improvement of external assumptions in relation to the previous period. Related to this, in BiH the economic growth by 3.2% in 2017 and 4.1% in 2018 is expected. Similar to the above, this growth should be borne by domestic demand, with a modest negative contribution of the external sector. This implies a gradual strengthening of final consumption and investment accompanied by a slight increase in foreign trade deficit.

1.2 Exports growth in Bosnia and Herzegovina

Preliminary data indicate a stable growth trend when it comes to foreign trade of Bosnia and Herzegovina with the world. In the period January – July 2015 foreign trade in BiH has been characterized by an increase in total trade, exports and to a lesser extent imports, reduction of the deficit and better coverage of imports by exports compared to the same period in 2014. This positive trend has continued thanks to the strengthening of export demand in major BH trading partners, as evidenced by numerous short-term indicators such as the seasonally adjusted GDP growth in the first two quarters of about 0.5%, increase in production in the manufacturing industry of the EU countries of 1.6%, and months of growth in the index of composite index of economic expectations ESI (Economic sentiment Indicator), which in July 2015 reached a value of 106,6. Improving export demand resulted in an increase in economic activity in BiH, and in particular it relates to the production growth in BiH processing industry by 3.3%, which was a key determinant of BH foreign trade movements.

During 2016 the nominal growth of total BH exports of 5.6% is expected compared to the previous year, with an expected nominal growth of exports of goods of 6% and exports of services by 4.4%. On the other hand, given the structure of BiH economy and expressed high propensity to import, an increase of final consumption and a higher level of business activity, it is realistic to expect an increase in BH imports. Thus, in 2016, a nominal

increase in total BH imports by 3.9% is expected, while the expected imports of goods would increase by 4% and imports of services by 1.8%. This would result in a moderate increase in the foreign trade deficit of 1.3%. For the period 2017 – 2018, a complete normalization of economic opportunities and somewhat more secure economic growth is foreseen, accompanied by growth in both domestic and foreign demand for goods. The stated growth should result in an increase of foreign trade (Blanchard 2011, 342), and somewhat higher growth rate of exports of goods in comparison to imports. The holder of BH exports in this period should be within the manufacturing industry within which in addition to the traditional exports sectors an additional contribution should be given by other activities that can realize its export potential. Moreover, reform processes and improvement of all – the business environment, standardization, and greater diversification of export markets should significantly strengthen the BH exports. Bearing in mind the importance of the sector for the production of electricity in the structure of BiH exports, a continual positive contribution from this sector is also expected.

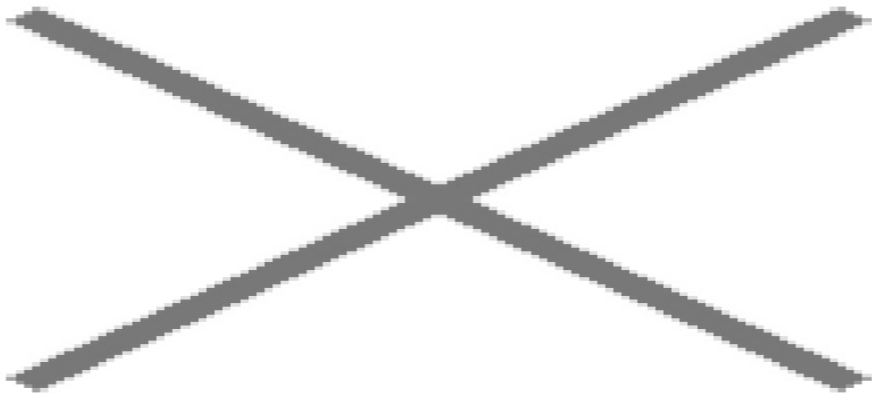


Figure 4. Movement of imports, exports and trade balance in BiH (DEP projections)

Observed by countries, the most important part of BH exports amounting 72% was placed on the EU market, and in 2015 it increased by 1.6% compared to the previous year. Within the EU, the main export markets

are Germany (1.3 billion KM), Italy (1.2 billion KM), Croatia (955 million KM), Austria (755 million KM) and Slovenia (697 million KM). The most significant increase in exports was registered to Italy amounting 19,4% and Austria 10%, while exports to Germany stagnated 0.5%. Exports to Croatia have been significantly reduced by about 20% due to changes in the foreign trade regime because of Croatian accession to the EU. CEFTA countries make up 16% of BiH exports, and in 2015 exports to these markets increased by 1.7% compared to the previous year. The most significant share refers to Serbia in the amount of 800 million KM, and in 2015 it increased by 4.5%, while exports to the market of Montenegro amounted to 293 million KM and it increased for 8.5% compared to 2014.

BiH imports from the EU countries increased by 4.8%, and seen by countries, the highest growth rates were achieved in the context of imports from Italy (11.6%) and Germany (7.8%), while imports from Croatia fell by 5, 4% compared to the 2014. Imports from CEFTA countries makes 11% of total BiH imports, while the major part relates to imports from Serbia (1.63 billion KM), which increased by 10% compared to 2014. In regards to other parts of BiH imports, a significant place in the structure is occupied by Russia (1.3 billion KM), China (1.35 billion KM) and Turkey (580 million KM). In 2014, due to the drop in oil prices compared to 2013, imports of goods from Russia decreased by 15%, while there was an increase in imports from China for 48% and from Turkey for 18%.

According to available projections DG ECFIN-a (spring edition) in EU countries is expected a more intensive economic recovery, with an expected growth rate of 1.5%. Besides, according to the DGECFIN report, a low level of oil prices, the depreciation of the euro and quantitative eases - Extended Asset Purchase Programme by the ECB, and European investment plan - EU Investment Plan will constitute the main mechanisms for increase of economic activity and more intense foreign trade both within EU and with third countries. All of these measures in the external environment, with the expected economic growth, a higher level of investment and an increase in industrial production, should result in an increase of foreign trade in Bosnia and Herzegovina. Although, projections of world prices by international institutions are not in favour of BiH exporters, it is yet expected that an increase of production of traditionally export-oriented

branches of BiH manufacturing industry, with a significant contribution of the sector for electricity generation could result in a significant increase in BiH exports.

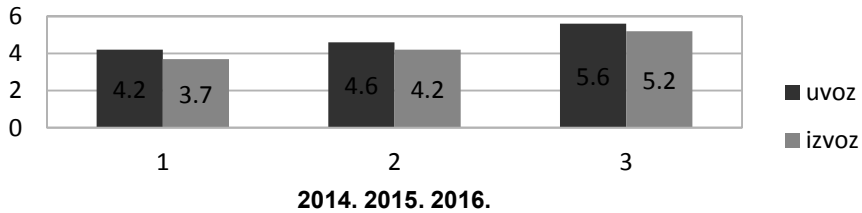


Figure 5. Projections for EU (DG ECFIN Spring Forecast 2015)

1.3 Industrial production in Bosnia and Herzegovina

In the past few years, the main determinant of industrial production in Bosnia and Herzegovina was the international economic environment, i.e. the movement of export demand in major trading partners. This primarily refers to the processing industry, which is largely export-oriented, while developments in the sectors of electricity and mining were defined by internal dynamics in BiH.

Table 1 Indices of industrial production in BiH for the period 2010 – 2013 (Directorate for Economic Planning of Bosnia and Herzegovina)

Indeksi g/g		2010	2011	2012	2013
Industrijska proizvodnja fizički obim	FBiH	104,2	102,5	95,7	107,3
	RS	105	104,7	95,8	104,1
	BiH	101,6	105,6	94,8	106,7

Industrial production in BiH during 2010 recorded an increase in production volume of 1.6%. Observed by the Entities, growth in industrial production was a lot stronger and amounted to 4.2% in FBiH and 5% in the RS compared to 2009. Thus, the BiH industrial production in December 2010 was increased by 8.7% compared to December 2009. The growth

in industrial production in December 2010 in FBiH amounted to 12.7%, while the growth rate in RS was 14.1% compared to the same month of 2009.

In December 2011, there was an evident stagnation (up 0.4%) of the physical volume of industrial production in BiH compared to the same month of 2010. In December 2011 there was an improvement in production in the manufacturing industry and the mining sector by 6.5% and 5%, while the sector of electricity generation recorded a decline in production of about 16% compared to December 2010, which is the main cause of the stagnation of the total index of industrial production in BiH.

However, if we look at the results on an annual basis, it can be concluded that there has been a partial recovery of BiH industrial production in 2011 compared to the previous years. The growth in export demand in the first half of 2011 resulted in an increase of production in export-oriented processing industry of 5% and an increase in production in the sector of mining of over 15% on annual level, while production growth in the sector of electricity generation due to unfavourable hydrological situation was not even at the level of the previous years and amounted to only 2% compared to 2010. Thus, BiH during 2011 recorded an annual growth of physical volume of industrial production of 5.6% compared to 2010.

Then in 2012, BiH registered a drop in the physical volume of industrial production of 5.2% compared to 2011. The main reason for the decline in industrial production was the weakening of foreign demand that resulted in annual decline in production in export-oriented manufacturing industry of 4.7%. Looking at the performance of industrial production in 2012, it can be concluded that the negative economic developments in the narrow and wider environment and extremely unfavourable weather conditions during the first quarter determined the overall score of BiH industrial production at the end of 2012.

In 2013, the calendar adjusted growth of physical volume of industrial production in BiH amounted to 6.7% compared to 2012. However, it should be noted that this growth was achieved mainly thanks to an extremely low base in 2012, favourable weather conditions and a slight improvement in exports in 2013. This relatively high rate of growth seems quite surprising if one bears in mind that at the BiH level there has not been an increase in the number of employees, and that the most of the main trading partners

(except Serbia) in 2013 recorded a decline in industrial production.

In 2014, BiH recorded a stagnation of physical volume of industrial production. After an encouraging growth of industrial production of 4.5% achieved in the first quarter of 2014, during the second quarter due to the floods in May there was a sharp decline in production which, despite some positive developments in the second half of the year, failed to recover significantly by the end of 2014. Observed by sectors, the positive contribution of industrial production was recorded only in the field of manufacturing industry of 3.8%. In 2015 the trend of strengthening economic activity was continued in BiH. Thus, thanks to positive developments in the international economic environment in 2015 in BiH there was an increase of industrial production by 2.7% compared to 2014. If BiH industrial production in 2015 is observed by sectors, it is evident that the main generator of growth was manufacturing industry which achieved an increase in production of 4.8%.

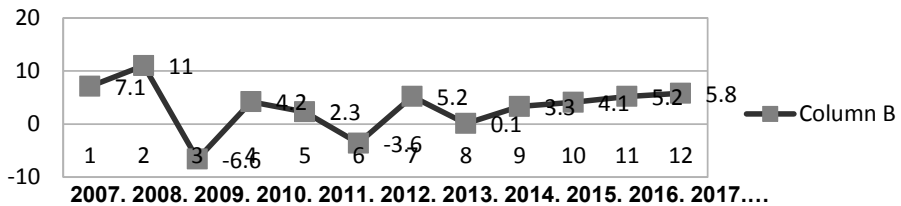


Figure 6. Industrial production in BiH for the period 2014 – 2015 by classification of mayor industrial production groups – GIG (Directorate for Economic Planning of Bosnia and Herzegovina)

Since the full recovery of most industries in the EU is expected in the period 2017-2018, it is likely to expect that these developments would also enable full recovery of industrial production in BiH. In this period, the full consolidation of the EU market is expected, also the recovery of private consumption, overcoming of problems in financing companies and the intensification of foreign trade between the EU countries. A positive contribution to industrial production in the EU should be expected from the measures relating to strengthening of the industrial base and competitiveness

in the EU countries. The positive developments in the immediate environment should result in increased utilization of industrial capacity in BiH, which is reflected in the increased volume of production, higher levels of investment both foreign and domestic investment, which should result in a more considerable increase in employment in BiH. Planned investments in infrastructure and energy, also should significantly contribute to the strengthening of both the construction sector in BiH and those branches of the processing industry closely related to the construction industry. Also, it is expected that the energy sector, which in the past period was one of the pillars of industrial production, continues the positive trend of production growth and further strengthens the industrial production in BiH in the mentioned period. All this should result in an annual increase of BiH industrial production of over 5% compared to the previous year.

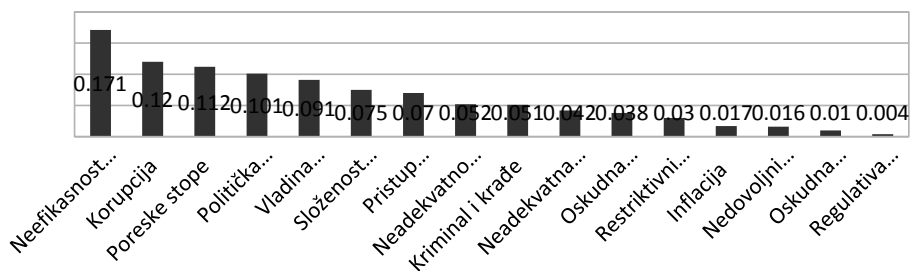


Figure 7. Growth of Industrial Production in BiH in the period 2007 – 2018 (Directorate for Economic Planning of Bosnia and Herzegovina)

Although some progress has been made in the post-war period when the manufacturing industry of BiH grew in rates of even 10%, this was stopped in the period during and after the Great Depression in the world (including BiH) in 2009. Progress and still low competitiveness are perhaps the best illustrated by the so-called “Competitiveness Industrial Performance” (CIP) published by UNIDO, according to which BiH has a very low 83rd position (on the list of 133 countries), and this despite the progress of the 13 places in the period 2000-2012. The structure of the CIP index shows quite

clearly why Bosnia and Herzegovina has a weaker competitive position in relation to other competitive countries. Namely, BiH has a considerably lower level of participation of manufacturing industry in GDP (10.2% in 2014) compared with the countries of Central and Eastern Europe, and the value added per capita in this sector is lower only in Serbia. In addition, the share of medium and high technology products in the processing industry in BiH of 29.2% according to the last report is much lower compared to Central and Eastern Europe (CEE), whose average is 44.5%.

Investments in new capacities are essential to maximize the low capital equipment of labour and increase productivity, and hence the competitiveness of BiH economy. The question of competitiveness is extremely important for BiH given the very low standard of living and a high foreign trade deficit. Unfavourable business environment in comparison with other countries is among the main reasons of insufficient investment in BiH. The same causes probably refuse foreign investors, hence the low level of foreign direct investment (FDI). In doing so, the assessment of individual parameters included in a collective assessment of the “Doing Business” - “Ease of doing business” in the level of the last to the penultimate place in comparison with selected countries. In the absence of the possibility of impact on some external factors and events, BiH should pay attention to what can be relatively easily and quickly changed, such as the elimination of unnecessary administrative barriers and reducing the number of necessary permits to start a business and construction. Special emphasis should be given to the area of “economic rights” relating to the enforcement of contracts and protection of the rights of investors (Blanchard, 2011).

In addition to the usual risks of attracting foreign capital, risks arising from future foreign investment in the energy sector should be specially mentioned. In fact, a significant part of the FDI up to now and in the coming period relates to investment in major projects in the mining and electricity generation from coal (thermal power plants). As a problem in the future, which could reduce the competitiveness of BiH in attracting FDI appears the permissible limit of CO₂ emissions in the European Union. By BiH joining the EU, the price paid by Bosnia and Herzegovina in the form of fines (paid per tonne of CO₂ emissions) could significantly increase the cost of electricity generation that is produced in thermal power plants. This

would certainly reduce competitiveness in this area in attracting FDI and would have an impact on future domestic investment in projects of generating electricity from coal.

Other significant risk to competitiveness in further attracting of FDI is the introduction of sanctions against BiH by the Energy Community Secretariat, which brings together countries of the European Union and the countries of the Balkans due to the failure to adopt an energy strategy, and also the Law on Gas at the state level.

All this indicates that although Bosnia and Herzegovina and other Western Balkan countries in the process of economic transition made some progress in terms of overall macroeconomic stability, monetary stability and inflation, structural reforms aimed at encouraging investment in order to strengthen the competitiveness of industry and exports remain key challenges to catch a rope in the process of economic convergence with the EU28 countries.

2. FISCAL GOALS AND FISCAL POLICIES IN BIH

Monetary policy in BiH is within the sole jurisdiction of the Central Bank, whose independence and the prohibition of financing government deficit are set by the law. BiH is in the currency board regime, with fixed exchange rate against the euro. The condition for joining the Economic and Monetary Union boils down to the ability to meet the basic criteria, in a sustainable way (Maastricht criteria) which is related to: price stability, the annual government deficit and public debt, the stability of the currency, annual interest rates on long-term loans (Klinčov Vujaković 2015, 514).

The primary fiscal balance, as defined in accordance with Article 1, Paragraph 2 of the Law on Fiscal Council in Bosnia and Herzegovina, is planned in 2015 as a deficit in the amount of 324.8 million KM or 1.1% of the projected GDP for 2015, out of which:

- BiH Institutions plan deficit of 49,0 million KM,
- Republic of Srpska plans deficit of 292,1 million KM,
- Federation of BiH plans surplus of 4,5 million KM and
- Brčko District plans surplus of 11,8 million KM.

The level of public expenditure as a share of GDP in the period 2015-2017 should be reduced in order to have the level of public expenditure from 2016 consolidated at the BiH level below 40% of GDP.

Table 2. Total Public Expenditures in BiH in the period 2014-2017 (in million KM) (Directorate for Economic Planning of Bosnia and Herzegovina)

Expenditures	2014	2015	2016	2017
BiH Common Institutions	950	950	950	950
Federation of BiH	7.018	6.753	6.736	6.714
Republic of Srpska	3.761	3.870	3.801	3.683
Brčko District	196	197	210	210
Total Expenditures (Consolidated)	11.925	11.771	11.697	11.558
GDP	29.289	30.889	32.664	34.798
BiH Common Institutions	3,2%	3,1%	2,9%	2,7%
Federation of BiH	24,0%	21,9%	20,6%	19,3%
Republic of Srpska	12,8%	12,5%	11,6%	10,6%
Brčko District	0,7%	0,6%	0,6%	0,6%
Total in GDP	40,7%	38,1%	35,8%	33,2

Table 3. Framework of the Budget of BiH Institutions (in million KM) (Directorate for Economic Planning of Bosnia and Herzegovina)

BiH INSTITUTIONS	2014	2015	2016	2017
Revenues	914,0	901,0	879,0	876,0
Tax Revenues	750,0	750,0	750,0	750,0
Indirect Taxes	750,0	750,0	750,0	750,0
Direct Taxes	0,0	0,0	0,0	0,0
Other Tax Revenues	0,0	0,0	0,0	0,0
Contributions	0,0	0,0	0,0	0,0
Grants and transfers	4,0	3,0	1,0	1,0
Other incomes	160,0	148,0	128,0	125,0
Expenditures	950,0	950,0	950,0	950,0

Gross Salaries and Wages	646,0	652,0	660,0	670,0
Expenses for material and services	217,0	183,0	178,0	176,0
Interests	1,0	1,0	1,0	1,0
Subsidies, social benefits and transfers	12,0	10,0	10,0	10,0
Other expenses	24,0	30,0	30,0	30,0
Net expenditures for non-financial assets	50,0	74,0	71,0	63,0
Balance	-36,0	-49,0	-71,0	-74,0
Funding	36,0	49,0	71,0	74,0
Domestic	6,0	49,0	16,0	10,0
Repayment of domestic debt	0,0	0,0	0,0	0,0
Other (+/-)	6,0	49,0	16,0	10,0
External	30,0	0,0	25,0	22,0
Withdrawal of foreign loans	30,0	0,0	25,0	22,0
Principal repayments of foreign loans	0,0	0,0	0,0	0,0
Statistical differences and uncovered expenditures	0,0	0,0	30,0	42,0

Restrictions on the amount of debt at all levels of government in Bosnia and Herzegovina are established by the following laws:

- Law on Borrowing, Debt and Guarantees of Bosnia and Herzegovina (“Official Gazette of Bosnia and Herzegovina”, 52/05)
- Law on Borrowing, Debt and Guarantees of Republic of Srpska (“Official Gazette of Republic of Srpska” No. 71/12 and 52/14), and
- Law on Debt, Borrowing and Guarantees of Federation of Bosnia and Herzegovina (“Official Gazette of Federation of BiH”, No. 86/07).

These laws at BiH level and in the Federation of BiH, with slight differences when it comes to guarantees, stipulate that in the period of debt creation the amount for servicing a long-term debt (internal and external), according to the proposed debt and the overall matured outstanding existing debt, in any of the following years does not exceed 18% of regular incomes realized in the previous fiscal year.

Taking into account the statutory limitations on the amount of government debt and the debt of the entities, and the fact that the excessive borrowing of BiH institutions or any entity would endanger the fiscal stability and credit rating of Bosnia and Herzegovina, it is necessary to define the upper limits of the amounts of indebtedness in 2016, in line with legal regulations of each entity. Accordingly, the consolidated amount of debt for the Federation of BiH (the level of the Federation, cantons and municipalities) in 2016 should not be above the level at which the annual repayment would amount 666.0 million KM maximally.

Law on Borrowing, Debt and Guarantees of Republic of Srpska ("Official Gazette of Republic of Srpska" No. 71/12) stipulates that the public debt of Republic of Srpska (Republic of Srpska debt, the debt of local governments and social security funds debt) at the end of the fiscal year cannot be greater than 55% of GDP for the current year (in 2015: 4.945,6 million KM), while the total debt of Republic of Srpska (public debt of Republic of Srpska, debt of public enterprises, the Investment and development Bank of Republic of Srpska and public sector institutions) at the end of the fiscal year may not exceed 60% of GDP for the current year (in 2015: 5.395,2 million KM). The Law on Amendments to the Law on Borrowing, Debt and Guarantees of Republic of Srpska ("Official Gazette of Republic of Srpska" No. 52/14) stipulates that the debt arising from borrowings to finance the rehabilitation of the damage from the Unified Register, stipulated in the Law on Solidarity Fund for the reconstruction of Republic of Srpska shall be exempt from restrictions prescribed for the total and public debt of Republic of Srpska.

CONCLUSION

The economy of Bosnia and Herzegovina belongs to the group of small open economies, vulnerable to global developments and external shocks. Therefore, the assumed gradual recovery and revival of the BiH economy is in direct dependence of economic recovery of its trading partners in the EU and the region, so any slowdown in the economic recovery of the EU and the region would have a negative impact on BiH economy. From the preceding statements it can be concluded that the projections of the movement in the fiscal sector are limited due to the economic crisis and the consequences the

crisis leave to the economy in general. This further complicates the process of monitoring and assessing fiscal sustainability.

In addition, Bosnia and Herzegovina is characterized by a complex state structure that has a direct reflection on the size and structure of public expenditure. Like many other countries, Bosnia and Herzegovina has problems with determining and defining the optimum degree of fiscal decentralization. The existing framework of fiscal policy in BiH is limited by the state regulation, which gives entities a high degree of sovereignty and leads to fragmentation of the fiscal structure. Such a system mainly leads to a lack of stronger coordination in creating a fiscal policy at the state level, which is of great importance for a small country like BiH. The final result of such a situation is unsatisfactory level of real economic growth. The inconsistency of fiscal policy that occurs due to the lack of fiscal coordination tries to be alleviated by the establishment of the Fiscal Council of BiH, which began its work in late 2008.

The reform of public finances, which aims at harmonizing the budget calendar, the introduction of medium-term budget planning and better links between the allocations of budgetary resources to priority Government policies is implemented since 2005 at all levels of government in Bosnia and Herzegovina. The results of the above mentioned reform are reflected in the achievement of the harmonization of the calendar, procedures of budget planning and the introduction of medium-term budget planning, which is achieved through the preparation of documents of the budget framework over the medium term. BiH is also facing numerous shortcomings in the field of statistics of public finances and the economy as a whole, which significantly complicates the analysis of public finances. As an example is the fact that the size of public expenditures expressed in GDP differs significantly depending on whether the GDP is accounted according to the production or to the expenditure approach. In addition, at the level of Bosnia and Herzegovina there are no consolidated and coherent data on government expenditures by functions based on COFOG classification. However, it is evident that public expenditure in BiH exceeds 40% of GDP, which is significantly higher in comparison with countries that generate a much larger share of GDP per capita in relation to Bosnia and Herzegovina. In addition to the inadequate size of public expenditure, BiH has problems relating to the structure of public expenditure. If one observes whether the economic structure of public expenditures is based on

the GFS, it can be concluded that BiH compared to other countries of the region allocates considerably more for wages and intermediate consumption. This inevitably leads to the conclusion that Bosnia and Herzegovina due to its complex state structure and duplication of government activities at different levels generates too excessive public expenditure, which ultimately leads to inefficient public sector.

Finally, in the context of fiscal sustainability and approaching to the European Union, it is necessary to do a review and assessment of the previous Economic and fiscal programme of the European Commission. It stated that the medium-term fiscal strategy of Bosnia and Herzegovina was not enough clearly and sufficiently elaborated and that there are no concrete policy measures which would adequately qualify the economic and fiscal impacts. In addition, the connection of the fiscal strategy with the assumed medium-term economic framework, overall objectives and the plan of joining the European Union is not adequately represented. Bosnia and Herzegovina Economic and fiscal programme also refers to the priorities from the European Partnership, but generally does not implement them through specific policies and supporting activities.

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