

*Part I*

**Economic and Social Reforms:  
Path Towards the European Union**



## *Chapter 1*

# **Reform Agenda for Bosnia and Herzegovina: Conception and Early Progress**

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Socioeconomic and related reforms were long delayed in Bosnia and Herzegovina (BiH) and, as each year passed, the economy fell further behind its neighbors in terms of the business environment and the policies necessary to spur investment and create jobs. As a result, the overall unemployment rate stands at over a quarter of the workforce and the rate of youth unemployment is among the highest in Europe. A bloated government sector cannot deliver basic services and moribund public enterprises distort opportunities in the economy.

Social disturbances at the beginning of 2014 highlighted the fact that urgent reform was necessary. But the people of BiH had been listening to the cry for reform for many years and, despite the rhetoric, nothing significant had changed. The challenge for the international community was to convince the public and the authorities that true reforms could deliver prosperity, jobs and greater opportunity. The challenge was met by agreeing on a set of priority measures that would re-ignite the process of modernizing the economy. This Reform Agenda would, it was hoped, create growth and generate further momentum for change.

The Reform Agenda emerged in mid-2015 from an eighteen-month process of consultation and negotiation that reflected the European Union's renewed emphasis on socioeconomic and related reforms in BiH. The authorities took ownership of the Agenda during the negotiation process and this has been crucial to the progress achieved. Meanwhile, the European Union (EU) and International Financial Institutions (IFIs) agreed that—based on their experience with disappointing reform programs in 2009–2014—no financial assistance would be available until a significant commitment to reforms had first been demonstrated. This

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<sup>1</sup> Any opinions expressed do not necessarily represent the opinion of the EU or EUSR. The authors would like to use this opportunity to thank their colleagues from the EUSR and EU Delegation in Bosnia and Herzegovina for their valuable input and contributions to this paper, in particular our former colleagues Dr. Renzo Daviddi and Thomas Busch who were instrumental in getting the Reform Agenda adopted and launched.

strategy—to insist on reforms before financial support was disbursed—has also been productive.

The authorities' commitment to reforms put them back on the road to EU accession and bolstered political support for some difficult measures. In addition, the Reform Agenda benefitted from an unprecedented degree of cooperation between the EU and IFIs. Different institutions assumed responsibility for leading assistance to reforms in various areas, but these efforts have been fully consistent with one another and properly harmonized. The EU and IFIs are supporting the authorities' Agenda with a well-sequenced package of measures and, if it is to succeed, this package must be implemented in full: from an economic perspective, jobs need to be created in the private sector if the public sector is to be downsized; and, from a social perspective, the creation of opportunities for the young must be combined with adequate concern for the dignity and comfort of the elderly.

After protracted negotiations and the implementation of a series of early reforms (including long-delayed labor laws and the liquidation of some bankrupt banks), the IMF approved a three-year arrangement under its Extended Fund Facility (EFF) in September of 2016. The World Bank approved an Employment Project in January 2017 and a Development Policy Loan (DPL) in March 2017 (after securing other reforms including long-overdue limits on pharmaceutical prices). These flagship programs guide assistance to the socioeconomic aspects of the Reform Agenda and are designed to facilitate the provision of 800–850 million euros in direct budget support from the EU and IFIs during 2016–2019. A further 500 million euros in investment, largely in infrastructure, is expected to follow. They also provide the umbrella for a set of subsidiary programs and technical assistance. Meanwhile, the EU is leading efforts to secure meaningful reforms to the rule of law, governance and public administration.

## **Background and Approach to Reform Agenda**

### *Recent Experience with Reform Programs*

Two sets of reform programs in 2009–2014 did succeed in preserving financial stability in BiH after the global financial crisis, but they did not achieve significant structural reforms. The IMF, EU, and World Bank made significant resources available for a worst-case fallout from the global financial crisis but, as it turned out, the crisis in BiH was not as severe as it might have been. Meanwhile, the authorities were content to accept the

cash that was available at the beginning of each program, but never undertook the structural reforms that were delayed to the end of each. Neither set of programs was fully completed.

The two programs did help BiH survive through a very difficult period that began in 2009. Real economic growth averaged almost 6 percent per annum during 2005–2008 but turned sharply negative (3 percent) in 2009 and recovery was sluggish through 2014. In these circumstances—and in the context of severe floods that hampered growth and amplified budget deficits in 2014—a rising government deficit was twice corrected and set on a downward path. Fiscal stability was maintained and the banking sector was not undermined.

However, the experience with structural reforms was mixed at best. In 2011, a review of the World Bank Country Partnership Strategy (CPS, for 2008–2011) concluded that its assistance:

[...] partially succeeded in accelerating corporate restructuring and privatization, and had marginal success in improving the business climate. [It] helped deliver better municipal services and primary healthcare ... but the targeting of social services did not improve as expected under the program. Moreover, contrary to program objectives, government spending as a share of GDP increased ... while fiscal coordination among the entities that make up BiH suffered setbacks. The overall program [was deemed] *moderately satisfactory*.<sup>2</sup>

The 2011 review recommended that the World Bank explore ways of dealing effectively with what it saw as the main problem—political stalemate between the entities.

The IMF also struggled to make progress on structural reforms and there was significant policy drift after October 2010 elections that “weakened the national policy coordination needed to design an effective response to the emerging challenges.”<sup>3</sup> By the time the next review of progress (of the CPS for 2012–2015) came around in 2014, the World Bank still concluded that “political fragmentation and stalemate [had] undermined reform processes.” “The authorities [had] failed to advance sensitive reforms of social and veteran benefits that would have improved the quality of spending.” Consequently, the World Bank cancelled a series

<sup>2</sup> World Bank Group. 2011. *BiH-Country Assistance Strategy Completion Report Review for the Period FY2008-11*: IEG review. p.1.

<sup>3</sup> IMF. 2011. *Press Release No.11/426: Statement by the IMF Staff Mission to BiH*.

of planned public expenditure reforms (DPLs)—aimed at reforms to the civil service, pensions, and social benefits—and switched its focus to support for the business environment (that would be less politically sensitive). Meanwhile, it noted that “political fragmentation and stalemate remain the principal risks for delivery of the program.”<sup>4</sup>

This experience during 2009–2014 led to the following conclusions:

- There was a need to link reforms to disbursements, including front-loading reforms in future programs and delaying financing until reforms are enacted.
- There was a need to cultivate a shared sense of ownership of reforms across both entities.
- There was a need for close cooperation and coordination between the EU and the IFIs.

#### ***2014: A New EU Approach and International Coordination***

In early 2014, there was a set of sustained public disturbances in BiH that demonstrated public frustration with the overall state of the economy and social services. These triggered significant political concerns but also presented an opportunity to try and change the political atmosphere in the country.

At the same time, the EU adopted a renewed focus on implementing economic reforms, improving economic governance and focusing on structural impediments to growth across the countries of the Western Balkans (WB). In its Enlargement Strategy for 2014–2015, the European Commission identified economic governance as one of the key challenges for the WB countries on their path towards EU accession. It recognized that these countries faced the major structural economic challenges of high unemployment, low foreign direct investment and low levels of competitiveness. Moreover, weaknesses with the rule of law and public financial management (PFM) exacerbated the risk of corruption and negatively impacted good governance of the economy and the investment climate. It noted that none of the WB countries had yet met the Copenhagen economic criteria.<sup>5</sup> It was clear that the new approach was particularly appropriate and urgent for BiH.

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<sup>4</sup> World Bank Group. 2014. *Country Partnership Strategy Progress Report for BiH for the Period FY12-FY15*, p.2.

<sup>5</sup> European Commission. 2014. *Enlargement Strategy and Main Challenges 2014-15*.

In this context, the EU and IFIs launched an initiative to draft a *Compact for Growth and Jobs* that would aim to identify and build support for a package of 5–6 concrete measures intended to re-ignite the process of modernizing the economy. The *Compact* would be drafted in ample time to inform the election campaign of October 2014 and would be presented to the citizens of BiH as a concrete and significant step toward a brighter future. It would seek to address many of the concerns that had been expressed during the public disturbances and would be widely publicized. Reforms would be presented in a manner that was clearly related to improving people’s lives.

The development of the content of the *Compact* was discussed and coordinated between the EU, IMF, World Bank Group and EBRD. This gave operational content to an earlier agreement between the EU and IFIs at a High-Level meeting in November 2013 to jointly review their policies and strategies. The *Compact for Growth and Jobs in BiH* would allow them to implement a joint commitment to increase “cooperation on the ground” while allowing each IFI to operate “within the remit of the respective mandate of each institution.”<sup>6</sup>

The content of the *Compact* would be kept to a bare minimum so that the essential priorities for reform would get the full attention of policy makers and the public. They would be explained in simple terms and not complicated by too many elements. At the same time, it would be important to build significant local political ownership of the agenda for reform. Of course, it was clear from the outset that this would take time.

### ***A Compact for Growth and Jobs: Focus on Inclusion and Local Ownership***

A package of six urgent reform priorities was chosen at the *Forum for Prosperity and Jobs* in May of 2014, which was attended by a broad spectrum of civil, academic, business and political society in BiH. It was supported by the EU and IFIs—and by others in the international community. Further consultations with local, regional and international experts, as well as on the social media, produced a final package—a *Compact for Growth and Jobs*—that was launched in July 2014. The main measures focused on lowering the tax wedge on labor and other labor market reforms; improvements to the business climate as measured by the World Bank’s *Doing*

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<sup>6</sup> *Joint Conclusions* of the High-Level meeting between the European Commission and Financial Institutions on the Western Balkans from 5 November 2013.

*Business Report*; the restructuring of state-owned enterprises (SOEs); fighting corruption; and improved targeting of social protection.

A full-scale public relations campaign—launched with the support of Norway—encouraged the public to support change and encouraged the political leadership to embrace reforms. Political parties were urged to endorse the *Compact* prior to upcoming elections and the campaign had a marked influence on election results. New governments designed their programs around many of these themes.

Meanwhile, in December 2014, the Foreign Affairs Council (FAC) of the EU urged for rapid reform progress by incoming governments, which would make a real difference to the lives of ordinary citizens and re-energize BiH's European path. They suggested that, in return for a promise of reforms, the FAC would consider implementing BiH's Stabilization and Association Agreement with the EU (that had been suspended for eight years). They asked for a written pledge from political leaders to pursue reforms and this was delivered in January of 2015. The FAC noted that "meaningful progress" with the *Compact* agenda would be necessary for an EU membership application to seriously be considered.

## **Choosing Priorities for Reform**

The FAC Conclusions of December 2014 made clear that, before it could join the EU, BiH would have to demonstrate that it had a functioning market economy and had the capacity to cope with competitive pressures within the EU. It noted that the reform package identified in the *Compact* would help BiH get closer to EU standards in the economic sphere and urged the authorities to turn this into a reform agenda whose overall objective would be to establish functionality and efficiency at all levels of government. This agenda would also need to include complementary reforms to the rule of law and good governance.

### ***Drafting the Reform Agenda***

The newly elected governments at the State and entity levels began the process of agreeing on a Reform Agenda in early May of 2015. A high-level intergovernmental Retreat compared the three sets of programs for government and considered proposals and analysis from the IFIs and EU. Government representatives agreed that there needed to be a renewal of confidence that short-term sacrifices were worth making in pursuit of



medium-term growth and jobs. This level of trust could only be established on the basis of a firm commitment by all political leaders and institutions to comprehensive reforms.

The Reform Agenda for 2015–2018 went through thirteen drafts before it was eventually agreed in late July and this arduous process attests to the seriousness with which each measure was considered and negotiated. The process itself lent a high degree of credibility to the final product and governments adopted it with a high degree of commitment and ownership. The Agenda, as summarized in Table 1, is divided into six categories (that broadly conform to the six areas set out in the *Compact*). These are:

1. Public Finance, Taxation and Fiscal Sustainability
2. The Business Climate and Competitiveness
3. The Labor Market
4. Social Welfare and Pension Reform
5. Rule of Law and Good Governance
6. Public Administration Reform

The measures set out in the Agenda often overlap and reinforce one another in their effectiveness. And they cover a broad set of problems in the economy. More generally, governments recognized that it was important to view the Agenda as a comprehensive set of reforms that would need to be pursued as a complete package. A broad set of reforms was necessary in order to secure growth and jobs and it was also recognized that any sacrifices would need to be shared in order to ensure broad political commitment. If the Agenda was treated as a selection box—with different groups supporting different aspects—it would surely come apart and fail to deliver its goals. Moreover, the reforms would need to be properly sequenced and planned if they were to succeed. Important goals—like combating corruption and political patronage—cut across all measures.

### ***Sequencing and Momentum***

Table 1 presents the six categories of reforms in three phases—as they would be implemented over a three- to four-year period. The first phase, introduced in 2016, concentrated on those areas where reforms could be planned and implemented quickly. These were not necessarily the easiest reforms—from a political perspective—and governments agreed that it would be necessary to establish early momentum to ensure the success of the entire Agenda. Significant measures were required in order to signal

Table 1. BiH Reform Agenda – Major Themes and Sequencing

	I 2016	II 2017	III 2018	III 2019+
<b>Themes:</b>				
<b>Phases:</b>				
<b>1 Public Finance, Taxation &amp; Fiscal Sustainability</b>				
a <b>Fiscal consolidation and sustainability</b>				
• Put debt levels on a downward trajectory				-----
• Reduce current spending (especially, on wages) and create room for investment		Salary freezes and moratorium on hiring	Public-sector rightsizing and flexible wage determination	Investment with effective planning and use of PIPs
• Public investment programmes (PIPs)		Approve PIPs	Implement PIPs	
b <b>Strengthen tax collection + broaden base</b>				-----
• Strengthen revenue collection		Regular data exchange between four tax authorities and measures to broaden and harmonise tax bases		
• Broaden and simplify revenue base		Amend tax laws	Harmonise tax laws	
c <b>Improve fiscal control and responsibility</b>				
• Enhance budget/debt rules and control		New laws to strengthen control. Toughen constraints on budgets and accumulation of debt.		
• Public Internal Financial Control (PIFC)		----- Strengthen Public Internal Financial Control	-----	
• Tackle loss-making state-owned enterprises		Improve control on SOEs	Catalogue arrears in SOEs and place limits on further arrears	
d <b>Cut taxes on labour</b>				
• Amend contribution structure.		Gradually reduce taxes on labour and compensate with higher excises and broader tax base.		
e <b>Combat the grey economy</b>				
• Combat tax evasion		Improve tax procedures.	New laws and procedures on tax collection.	
• Make it easier to pay taxes		Prevent wage under-reporting and limit tax exemptions.	Introduce e-services for income taxes and VAT.	
f <b>Health reform</b>				
• Reorganise health systems		Introduce norms/guidelines.	Comprehensive health sector reforms agreed and implemented with the World Bank.	
• Improve financial controls		Introduce Health to treasury system and combat arrears.	Introduce new models of health funding.	
g <b>Debt management</b>				
• New debt management strategy.		Exchange of data on structure and composition of debt		
<b>2 The Business Climate and Competitiveness</b>				
a <b>Improve the business environment</b>				
• Attract foreign investors				
• Make it easier to do business and invest				
• Reduce local regulation and para-fiscal burden				
b <b>Strengthen investor protection</b>				
• Improve corporate governance				
• Strengthen insolvency frameworks				
• FBiH to introduce commercial courts				
c <b>Restructure State Owned Enterprises (SOEs)</b>				
• Restructure State Owned Enterprises (SOEs)				
d <b>Safeguard financial sector stability</b>				
• Address problem banks				
• Strengthen bank supervision				
• Adopt new banking legislation				
• Revive bank lending and liquidity				
e <b>Simplify customs procedures</b>				
• Law on Customs Policy		Inspections reform	Strengthen national quality control	
• Audit and liquidate banks.		Promote bank consolidation.		
• Review operations of Banking Agencies and restructure and train where necessary.				Consider merging Agencies.
• Agree on new bank laws.		Adopt harmonised banking legislation and practices in both entities, including resolution.		
• New Laws on Payments				
• Law on Customs Policy				
• New Laws on Companies and Investment .				
• Shorter bankruptcy procedures. Introduce pre-bankruptcy options.				
• Undertake a Feasibility Study. Legislate and train (also in RS). Restructure relevant court structure.				
• List viable and non-viable SOEs. Restructure railways & mines. Restructure and privatise other SOEs.				
• Prepare for one-stop-shop. Introduce and enhance one-stop-shop. registers of pair-fiscal fees. Introduce controls/monitoring on local fees.				
• Expedite permits.				
• New Laws on Foreign Direct Investment and simplification of business registration.				
• Prepare for one-stop-shop. Introduce and enhance one-stop-shop. registers of pair-fiscal fees. Introduce controls/monitoring on local fees.				
• Expedite permits.				

Themas:	Phases:	Table 1 (concluded), BiH Reform Agenda – Major Themes and Sequencing		
		I 2016	II 2017	III 2018+
<p><b>3 The Labour Market</b></p> <ul style="list-style-type: none"> <li>a Stimulate new employment                             <ul style="list-style-type: none"> <li>• Improve flexibility, limit collective agreements and enforce workers' rights</li> </ul> </li> <li>b Encourage labour-market participation                             <ul style="list-style-type: none"> <li>• Support schemes for first-time job seekers &amp; encourage participation in labour market.</li> </ul> </li> <li>c Improve employment targeting and skills                             <ul style="list-style-type: none"> <li>• Improve mediation in labour search</li> <li>• Education linked to labour market</li> </ul> </li> </ul>	<p>Introduce new Labour Laws and Collective Agreements.</p> <p>Budget for wage subsidies. Prepare ALMP schemes.</p> <p>Delink Health and Employment. Review TVET system.</p>	<p>Reinforce labour inspections</p> <p>Support first-time job seekers. Introduce ALMP schemes.</p> <p>Improved targeting of unemployed and advertising/training. Reform of education system</p>	<p>Reinforce labour inspections</p> <p>Support first-time job seekers. Extend ALMP schemes.</p> <p>Reform of education system</p>	<p>New collective agreements</p>
<p><b>4 Social Welfare and Pension Reform</b></p> <ul style="list-style-type: none"> <li>a Ensure sustainability of pension systems</li> <li>b Improve efficiency of social welfare support                             <ul style="list-style-type: none"> <li>• Improve targeting of social assistance</li> <li>• Provide incentives to work</li> </ul> </li> <li>c Clear arrears in social funds in FBiH</li> <li>d Introduce voluntary pension systems</li> </ul>	<p>Agree/adapt new Laws in FBiH.</p> <p>Continue beneficiary audits. Review benefits/disincentives. Identify arrears &amp; legislate. Laws on Voluntary Funds.</p>	<p>Implement new Laws in FBiH.</p> <p>Establish database of beneficiaries. Introduce incentives for return to labour market. Commence arrears payments and legislate retirements. Introduce regulations.</p>	<p>Review pension sustainability in RS.</p>	
<p><b>5 Rule of Law and Good Governance</b></p> <ul style="list-style-type: none"> <li>a Judicial reform</li> <li>b Integrity and cooperation in law enforcement</li> <li>c Anti-corruption capacity building</li> <li>d Improve asset seizure</li> <li>e Money laundering and terror financing</li> <li>f Harmonize Laws on Weapons</li> <li>g Integrated border management (IBM)</li> </ul>	<p>Agree Judicial Reform Strategy. Appraise/improve cooperation. Adopt anti-corruption docs. Plan for improvements. Adopt Action Plan for FATF. Draft Laws. Agree IBM Strategy.</p>	<p>Implement Judicial Reform Strategy (and guidelines on corruption). Implement recommendations from the appraisal. Set up anti-corruption monitoring and prevention bodies. Adopt mechanisms pursuant to minimum principles. Adopt legislation in line with international standards. Adopt Laws with agreed common principles. Implement IBM Strategy.</p>		
<p><b>6 Public Administration Reform (PAR)</b></p> <ul style="list-style-type: none"> <li>a Key principles of PAR                             <ul style="list-style-type: none"> <li>• Adopt key principles of PAR</li> <li>• Reform of Public Financial Management (PFM)</li> </ul> </li> <li>b Civil service reform                             <ul style="list-style-type: none"> <li>• Introduce greater flexibility in working</li> <li>• Public sector right-sizing</li> </ul> </li> <li>c Limits on hiring and wages</li> <li>d Transparency in procurement and hiring</li> <li>e Census Implementation</li> </ul>	<p>New SIGMA baselines. Agree PFM Reform Strategy</p> <p>Amend Laws on Civil Service. Plan significant reorganization. Introduce nominal wage freeze</p> <p>Introduce Procurement Appeals. Agree and conclude.</p>	<p>Adopt new PAR Reform Strategy and adopt further principles via Special Group on PAR.</p> <p>Implement PFM Reform Strategy</p> <p>Amend working practices and compensation schemes for flexibility and incentives. Implement reorganization and restructuring of public service. Revise human resources and recruitment plans. Eligibility criteria and competence tests for civil service. Only employ the best candidates.</p>		

the fact that a serious process had begun. Also, governments noted that countries that embrace economic reforms often get significant and early benefits that can lead to a virtuous cycle of reform and growth. For example, the three Baltic countries, who initiated a second round of reforms after 2008, posted by far the strongest growth rates in the whole of the EU and Central and Eastern Europe in 2011–2014.

Other reforms would take longer to introduce and would fall into later phases. Three factors could explain why certain measures needed to be delayed:

- a. Some reforms would require a significant amount of preparation and planning before they could be launched. This applied, for example, to the need to restructure the civil service and SOEs. Nevertheless, this second set of reforms would need to be carefully planned while the first phase of reforms was being introduced so that momentum would not be lost between the different phases.
- b. Some reforms involve a significant degree of institution-building that can only take place slowly. They require that laws be adopted and technical assistance be provided so that the relevant institutions would evolve properly over time. This applies, for example, to many aspects of Public Administration Reform (PAR). But it may also be necessary to adopt short-term corrective measures in these areas that will, ultimately, allow the corrective process to take root. This applies, for example, to the need to introduce greater flexibility in the civil service so that a medium-term development process can begin.
- c. Governments cannot reform all sectors of the economy at once and it is often best to address different political constituencies in sequence (while maintaining the promise to pursue the whole Agenda in time). Thus, for example, the Federation (FBiH) government chose to tackle problems with pensions in the early stages and to defer potential layoffs in the public sector until later (when they could be properly planned and implemented).

For these reasons, it is useful to view the Reform Agenda as divided into three connected phases (as in Table 1):

- I. A first round of significant reforms was intended to demonstrate the commitment of the authorities to the reform process. It was a long list and, as a result, there were some delays. But all reforms were eventually concluded or introduced—as confirmed by the approval

of the new IMF and World Bank agreements. These included difficult political measures like: new Labor Laws in both entities; new collective agreements in both entities; sensible budgets at all levels, as well as some early privatization in the FBiH. Both entities introduced legislation to improve controls over spending—especially at social funds and at lower levels of government—and to strengthen the accountability of managers.

- II. A cooperative atmosphere was created during the first phase of reforms in 2016 that stimulated significant and impromptu plans to harmonize legislation across entities, particularly when it comes to fighting the gray economy and business regulation. As a result, the second phase began somewhat earlier than planned and included: the harmonization of Corporate Income Tax Laws between the entities, a new Bankruptcy Law in Republika Srpska (RS) that would be soon matched by a harmonized Law in the FBiH, the harmonization of laws on banks; and improved cooperation on banking supervision and bank resolution. Also, the FBiH government adopted a comprehensive set of pension reforms in 2016. The new FBiH Pension and Disability Law is now pending adoption by the FBiH Parliament and will be discussed as this book goes to print.
- III. Planning for the third phase of reforms in 2018 also began during 2016 and will continue during 2017. These plans will include meaningful restructuring in the public services at all levels (assisted by the World Bank), including long-overdue health reforms; the implementation of new Principles for PAR; the restructuring of SOEs, including railways and the large-scale liquidation of dormant enterprises in the FBiH (after resolving problems with unpaid social contributions for workers); and the privatization of some SOEs in the FBiH. These will be very difficult reforms—from a political perspective—but will (hopefully) benefit from momentum in the earlier phases.

### ***Support from the EU and International Financial Institutions***

The IFIs and EU were involved at all stages of the negotiation of the Reform Agenda and endorsed the final draft as a blueprint for the types of measures that could warrant medium-term financial support and other assistance. However, having learned the lessons from previous programs when structural reforms were never implemented, it was agreed that the authorities would need to demonstrate an early commitment to reforms, before any financial assistance was provided. As a result, the authorities

had to meet a long list of “prior actions” before the IMF’s EFF and World Bank’s DPL could be approved. In addition, the World Bank adopted an Employment Support Project in January 2017 and prepared separate programs that will support reforms in the health systems and in the railway sector (during later phases of the Reform Agenda).

Furthermore, the International Finance Corporation (IFC) is supporting the authorities in improving and harmonizing business legislation, as well as easier business registration. The United States Agency for International Development (USAID) completed work (ahead of time) on registers of para fiscal fees and the European Bank for Reconstruction and Development (EBRD) is providing assistance with the restructuring of SOEs in both entities (and could help finance a significant portfolio of infrastructure development).

To help defray the costs of reforms, the EU, IMF and World Bank plan to provide 800–850 million euros in direct budget support during 2016–2019. The IMF will provide 550 million euros while the World Bank and EU plan to provide some 150–160 million euros each. In addition, the World Bank and EBRD (and others) hope to facilitate or provide an additional 500 million euros in investment over three years. Private foreign investors will be also encouraged by reforms and the injection of these significant funds should help to boost growth and job creation.

## **Implementing the First Phase of Reforms and Planning for Later Phases**

This section provides a brief background on the need for reforms in each of the six categories of the Reform Agenda and briefly summarizes the progress achieved and upcoming measures.

### ***Public Finance, Taxation, and Fiscal Sustainability***

In its Report on BiH for 2015, the IMF identified three key fiscal weaknesses:<sup>7</sup>

- *An outsized public sector* with a high share of current spending. General government spending is among the largest in the region (see Chart 1a) and has the highest share of spending on wages and goods and services. The quality of public spending on health care and social

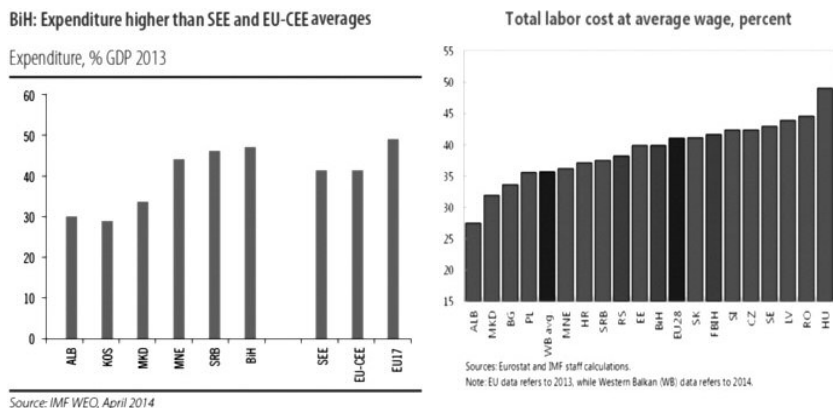
<sup>7</sup> IMF. 2015. *IMF Country Report No. 15/298*. p.12-13.

assistance is among the worst in the region, even though it is very high.

- *High tax burden on labor.* The tax wedge—comprising both personal income taxes and social security contributions—is relatively high in both entities compared to elsewhere in the region (Chart 1b). The high burden on labor is a strong disincentive for people to move from informal to formal employment or to enter the labor market.
- *Serious deficiencies in tax policy and revenue administration.* Revenues from corporate and personal income taxation are very low (even at high rates), mainly because of narrow tax bases. Generous incentives and low compliance erode revenues.

Particular progress has been made in:

- Adopting sound budgets in line with IMF recommendations for a second year in a row in 2017, including limits on hiring and a public-sector wage freeze. The authorities have committed themselves to reducing the overall government deficit to below 0.3 percent of GDP by 2018 with a view to reducing public debt gradually to below 40 percent of GDP over the medium term. Public debt is currently close to 45 percent of GDP.
- The four tax agencies combined all taxpayer information—as well as comprehensive company information from the entity business information agencies—into a database that is available and fully searchable in each of the four tax agencies.
- Both entities improved their revenue collection—by bolstering tax inspectorates and administrations—as witnessed by record levels of collection of indirect and direct tax revenues during 2016. In May of 2016, the Republika Srpska (RS) adopted a package of four laws to tackle the gray economy and there have been other combined measures by the entities to tackle the gray economy together.
- The World Bank has completed registries of arrears in the health sectors that will allow it to finalize concrete proposals for the reform of health sectors in both entities—to be supported by World Bank loans. The RS Government has already agreed with the World Bank on a comprehensive restructuring plan for the health sector to be launched in the second half of 2017.
- The FBiH government adopted new Laws on Personal Income Taxes and Contributions and a public debate about the need for tax reform is ready to begin in the fall of 2017. The laws will lower the employer's

**Figure 1. (a) Government Expenditure<sup>8</sup> and (b) Tax Wedge<sup>9</sup>**

tax burden (to promote the creation of new jobs), eliminate loopholes and make the calculation of salaries easier and more time efficient. Furthermore, the FBiH reduced contribution rates for low earners to a fixed amount. In December 2017, the RS undertook some initial steps towards lowering the tax burden on labour by eliminating the special solidarity contribution that was introduced following the 2014 floods.

- In late 2016, the RS adopted a new Corporate Income Tax Law that is harmonized with the FBiH Law and in line with international best practices, to foster consistency and avoid double taxation between the entities.
- Both entities have strengthened controls over lower levels of government, extra-budgetary funds and SOEs and the BiH Council of Ministers and the RS adopted new Public Internal Financial Control Strategies.
- In April 2016, the BiH Council of Ministers adopted amendments to the Law on Borrowing, Debt and Guarantees, and proceeded to adopt BiH's first medium-term debt management strategy.

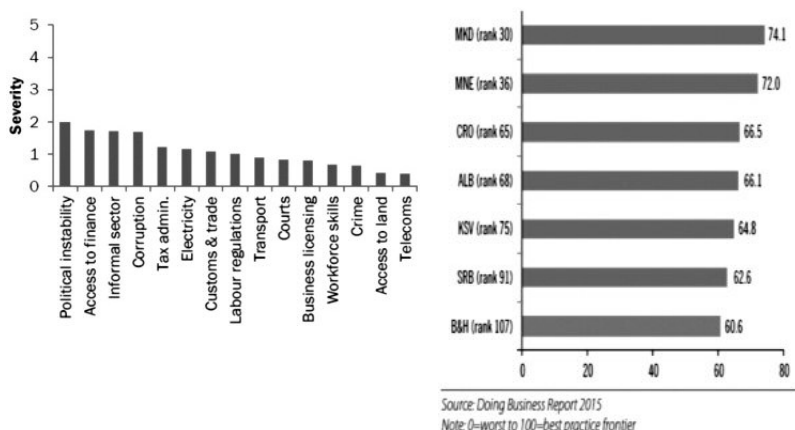
As of August 2017, the BiH Parliamentary Assembly has still not adopted the necessary legislation to raise fuel excises that are intended to generate

<sup>8</sup> World Bank Group. 2015. *Rebalancing Bosnia and Herzegovina—A Systematic Country Diagnostic*. p.42.

<sup>9</sup> IMF. 2016. *IMF Country Report No. 16/291*. p.8.



**Figure 2. (a) Obstacles to Doing Business<sup>10</sup> and (b) Regional Ranking<sup>11</sup>**



the resources necessary for the completion of the central motorway through the country. The legislation failed by one vote in April 2017 and has ever since been a victim of populism and political short-termism. This has caused delays with the IMF's EFF and, as a result, many other reforms are delayed as well. Moreover, the FBiH plans to provide loan or grant financing to cantons that restrain wages and reduce overall employment and it will amend its Law on Public Revenue Allocation to provide incentives for savings. In addition, the FBiH needs to amend its Law on Debt, Borrowing and Guarantees to improve financial control. Finally, the RS Government is expanding its treasury systems to the health sector to increase control.

### *The Business Climate and Competitiveness*

The business environment in BiH is the worst in South East Europe by many measures and needs major reform if the country is to boost private investment and improve competitiveness. The poor business climate requires entrepreneurs to overcome burdensome institutional and regulatory barriers that, ultimately, discourage new investment or expansion.

<sup>10</sup> EBRD. 2015. *Business Environment and Enterprise Performance Survey*. p.1.

<sup>11</sup> World Bank Group. 2015. *Rebalancing Bosnia and Herzegovina - A Systematic Country Diagnostic*. p.xiii.

Figure 2 sets out (a) the main obstacles to doing business (as reported in surveys) and (b) how BiH compares to other countries in the region. BiH suffers from perceptions of political instability, corruption and a lack of access to finance. The 2015 Doing Business report ranked BiH at 107<sup>th</sup> in the world and BiH is particularly bad when it comes to starting a business (147<sup>th</sup>), dealing with construction permits (182<sup>nd</sup>), paying taxes (151<sup>st</sup>) and getting electricity (163<sup>rd</sup>). These particular results indicate that starting a new business poses significant challenges.

In addition, firms are forced to spend a significant amount of time paying taxes and this can waste time and encourage tax evasion. Entrepreneurs face significant challenges from high social contributions, high fiscal and para-fiscal fees, restricted access to export markets, and a complicated and non-harmonized regulatory environment. Regional competitors like FYROM and Montenegro actively target improvements in these areas—to promote investment—and have had a good deal of success and higher growth that, in turn, gives momentum to further reform. Moreover, corporate governance is weak in BiH and offers insufficient protection to investors. Codes of corporate governance are not always implemented and there are significant differences between the existing corporate regimes in the entities.

The private sector's overall performance is stifled by the size of the public sector. Formal government expenditures are close to 50 percent of GDP but are likely to be far higher when SOEs are taken into account. This diverts resources—including labor, land and capital—away from the productive private sector. And, while the banking sector weathered the global financial crisis relatively well, non-performing loans increased and poor lending practices and a weak regulatory agency in the RS allowed serious problems to develop in two banks owned or connected to the government. In this context, credit to the private sector dried up and banks hold excess reserves at the Central Bank instead of lending to enterprises.

The Reform Agenda set out a comprehensive program to tackle these difficulties and particular progress has been made in:

- Improving the business environment: A new Law on Foreign Direct Investments was adopted at all three levels of government and the FBiH adopted a Law on Companies to create a more favorable business environment and attract foreign investors.
- The IFC and UK Embassy are supporting a project in Sarajevo Canton to tackle the longstanding issues of obtaining construction and

electricity permits (as noted above). Furthermore, Sarajevo Canton reduced costs and waiting times for business registration and recorded an increase of almost 20 percent in newly registered businesses. These measures should soon be mirrored in other cantons and the City of Banja Luka has just embarked on a similar project.

- USAID helped to complete registries of para-fiscal fees in all local governments and the RS adopted a law to codify them. The law (to be followed by a similar one in the FBiH) will increase transparency and tackle corruption by deeming as illegal any unregistered fees (that do not appear on the public online register). This will allow investors to plan ahead and should, in time, lead to reductions in administrative barriers and fees.
- A new Bankruptcy Law in the RS established a more efficient insolvency framework by introducing a process of “pre-liquidation” to allow financial restructuring while a business is still in operation (and allow the business to preserve jobs). A harmonized law has been adopted in the FBiH in first reading and is currently going through public debate.
- Both entities adopted new banking legislation and the State will amend the Law on Deposit Insurance to strengthen supervisors’ corrective and enforcement powers, introduce cross-entity supervision of banking groups, and introduce a comprehensive bank resolution framework. These strengthened banking structures should encourage bank lending to the private sector. In addition, two problem banks in the RS were liquidated and private depositors were compensated.
- The entities classified their SOEs and public companies into those that are strategic, those requiring minor or major restructuring, and companies in which the government holds a minority share. The governments will address the status of SOEs either through the restructuring and possible privatization of viable enterprises or the bankruptcy/liquidation of those that are not viable. The FBiH disposed of its minority stakes in two companies and most of the funds went to the rehabilitation of the pension fund in order to help ensure the regular payment of pensions. In 2017, the FBiH will contract reputable international advisors to conduct the financial and operational due diligence of BH Telecom and HT Mostar with the objective of restructuring and/or selling of shares.

- The World Bank presented its analysis on options for railways in both entities at the end of 2016 and the RS Government, in agreement with the unions, has already undertaken the first steps to restructure the entire sector. The FBiH is still considering options
- A new Law on Customs Policy entered into force in August of 2015 simplifying customs processing procedures and reducing administrative requirements. Activities on continuing the inspections reform and strengthening national quality control in line with EU requirements are well advanced.
- The World Bank presented a Feasibility Study for Establishing Commercial Courts in the FBiH in late 2016 and recommended that existing commercial case departments be reorganized and strengthened rather than establish new courts (as initially envisaged under the Reform Agenda). The RS will strengthen its commercial courts.
- In cooperation with the IFC, the FBiH has made significant progress toward establishing “one-stop shops” for business registration—in line with systems already in place in the RS—and both entities will simplify and establish joint online registration procedures by the summer 2017.

### *The Labor Market*

The labor market in BiH is characterized by notably worse outcomes than in most other countries in emerging Europe, including many countries in the Western Balkans. In 2013, the unemployment rate stood at 27.5 percent according to the annual Labor Force Survey conducted by the BiH Agency for Statistics.<sup>12</sup> This situation was further complicated by a high rate of long-term unemployment and a youth unemployment rate of around 60 percent—the worst in the region (see Chart 3a). Surveys revealed that restrictive labor regulations are regarded as a major constraint to employment (see Chart 3b).

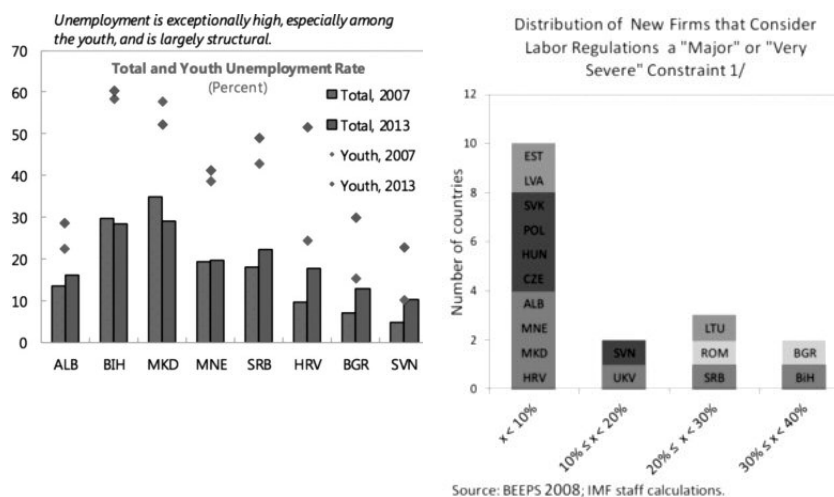
More generally, private sector employment creation was hampered by: high administrative barriers for employees; the need to grant extensive benefits; complicated and inconsistent laws that are not harmonized across jurisdictions; and different interpretations of labor relations by the courts that create uncertainty for both employers and employees.<sup>13,14</sup> Further-

<sup>12</sup> BiH Agency for Statistics. 2013. *Labor Force Survey 2013*.

<sup>13</sup> South East Europe Legal Group. 2011. *Employment Guide 2011*.

<sup>14</sup> Foreign Investors Council. 2013. *White Book 2012/13*.

**Figure 3. (a) Total and Youth Unemployment Rates<sup>15</sup> and (b) Labor Regulations<sup>16</sup>**



more, the high costs of starting to work were matched by high costs of terminating employment that included the requirement to continue to pay social contributions while a business is in liquidation. Difficulties in terminating employment severely discourage employers from hiring workers in the first place. Employers need to have a measure of flexibility before they will employ an expensive workforce that is subject to high taxes and influenced by high wages in the public sector.

In these circumstances, many people have given up on the prospect of finding work and, as a result, BiH has the lowest rate of labor market participation (or “activity”) in Europe at just 43.6 percent.<sup>17</sup> According to World Bank calculations, there are too few people with formal private sector jobs—too few to sustain a country aspiring to become an EU member.

Young people, because they have little employment history, are at a particular disadvantage. And because they are often willing to accept temporary arrangements in order to get a start in life, they are even more damaged and discouraged by restrictive hiring practices, a lack of flexibility in col-

<sup>15</sup> IMF. 2016. *IMF Country Report No. 16/291*. p.6.

<sup>16</sup> IMF. 2016. *IMF Country Report No. 15/299*. p.23.

<sup>17</sup> See IMF Working Paper. 2014. *Boosting Job Growth in the Western Balkans*. p. 5 for the European comparison and BiH Agency for Statistics. 2013. *Labor Force Survey 2013* for the data.

lective agreements (between employers and unions) and barriers to temporary work. They are often driven into a gray market that offers little or no training.<sup>18</sup>

The Reform Agenda set out three sets of measures to improve the labor market and particular progress has been made in:

- Making the labor market more flexible by introducing new and harmonized labor laws in both entities that: (i) impose term limits on the duration of collective agreements and mandated the renegotiation of existing agreements; (ii) allow wages to be better linked to performance; (iii) reduce disincentives for hiring by increasing opportunities for part-time work and fixed-term contracts and by limiting severance payments to no more than six months of wages; (iv) better protect workers' rights and reduce informal employment by increasing penalties for labor code violations; and (v) in the RS, eliminate a take-home pay protection. These new laws are supported by stepped-up labor inspections and increased penalties for violations to protect workers' rights that are consistent with ILO labor standards and EU labor directives.
- A new General Collective Agreement in the FBiH entered into force in July 2016, and the FBiH had completed negotiations on 24 out of 29 new branch collective agreements as of early 2017. The RS completed negotiations on its new General Collective Agreement in January 2017.
- The World Bank approved an Employment Support Project in February 2017 that will streamline active labor market policies, strengthen employment bureaus and provide modern retraining. It aims to separate the administration of health insurance from the role that employment bureaus play in mediating employment and allow them to concentrate on the latter role. Also, in order to increase labor market participation, both entities have introduced support schemes for first-time job seekers and the self-employed.

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<sup>18</sup> There is a general perception that access to a first job depends on being on the "inside" and surveys list corruption and nepotism as the main barriers to youth employment (see Pavelic, D. 2007. *Study on Youth Employment in Bosnia and Herzegovina*. p.43). Young people aged 15-24—who make up one tenth of BiH's population—are the most vulnerable group on the labor market. In 2013, young people presented only 5.9% of BiH's overall employment, while the unemployment rate was more than twice as high compared to the rest of the population (see Friedrich Ebert Stiftung. 2014. *Youth Study Bosnia and Herzegovina*. p.63). By comparison, in the European Union a third of young people had a job in 2013 (see European Commission. 2014. *EU Employment and Social Situation, Quarterly Review*. p.5).

- Finally, in order to better link the education system to the demands of the labor market, the RS adopted a Development Education Strategy for 2016–2021, as well as a Strategy for Scientific Research and Technology Development for 2017–2020.

### ***Social Welfare and Pension Reform***

In addition to promoting initiative and industry, a modern caring society must provide for those that cannot take care of themselves. There are two broad categories of social assistance in BiH: insurance-based benefits that are funded by contributions from workers—especially for pensions; and (non-insurance) cash transfers from the budget to some members of the general population. The first category is supposed to fund itself and the second category is intended to make transfers to those people who are most in need of help. Both systems are severely out of balance.<sup>19</sup>

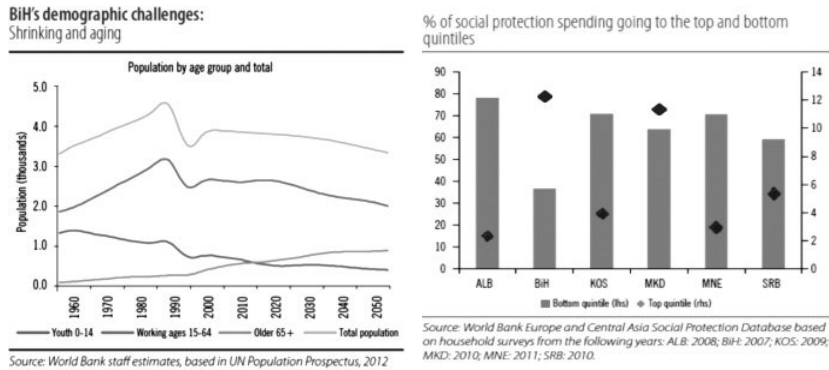
BiH spends twice as much on non-insurance cash transfers as the average in transition economies. On the whole, the social welfare system is not financially stable. And, most importantly, the dynamics and incentives are toward further deterioration in the funding base and an increase in costs. World Bank studies have concluded that a complete makeover is needed, if the system is not to implode:<sup>20</sup>

- Pension systems already have a small contribution base because of the low percentage of employed people and also have to contend with an aging population and significant emigration of the young. In 2014, for the first time, the country had more old people (over 65 years of age) than young people (see Chart 4a). As in other aging European countries this poses significant challenges for the sustainability of pension systems.
- Despite a large share of GDP used for social security and other social benefits, these benefits fail to adequately reach the poor. Only 37 percent of benefits are received by the poorest 20 percent (Chart 4b) and, at the same time, over 12 percent of public spending on social benefits reaches the wealthiest 20 percent of the population. This is significantly worse than any other country in region. At the

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<sup>19</sup> World Bank Group. 2015. *Rebalancing Bosnia and Herzegovina—A Systematic Country Diagnostic*. pp. 79–81.

<sup>20</sup> World Bank Group. 2012. *Bosnia and Herzegovina—Challenges and Directions for Reform: A Public Expenditure and Institutional Review*.

**Figure 4. (a) Age Profiles<sup>21</sup> and (b) Social Protection in BiH<sup>22</sup>**

same time, only 30 percent of the people of BiH are satisfied with the benefits that are available.

In addition to these problems:

- A comprehensive strategy is needed to tackle the issue of unpaid social security contributions by SOEs. Some 65,000 employees are still on the payroll of a large number of SOEs that no longer operate effectively but continue to build up arrears in unpaid social contributions. The SOEs cannot be closed without agreeing a settlement with workers for missing benefits and the employees do not want to move on to other employment for fear of losing their rights.
- BiH was the only country in the region that has not set regulations for voluntary pension funds. This deprives people of a safe and liquid depository for their individual pension savings and further diminishes the prospects for resolving the aging problem in BiH.

The Reform Agenda includes measures to: (a) ensure sustainability of the pension systems; (b) improve the efficiency of social welfare support, primarily through better targeting of social assistance to protect the most vulnerable while containing the costs of benefits to others by completing audits of beneficiaries; (c) clear arrears in social funds in the FBiH; and (d) introduce voluntary pension funds.

<sup>21</sup> World Bank Group. 2015. *Rebalancing Bosnia and Herzegovina—A Systematic Country Diagnostic*. p.viii.

<sup>22</sup> Ibid. p.81



Particular progress has been made in:

- Improving pension sustainability: The FBiH government adopted a pension reform package consisting of Laws on Pension and Disability Insurance and on the Organization of the Pension and Disability Insurance Fund that will hopefully be adopted in the fall of 2017. These Laws will help ensure the sustainability of the pension system by, *inter alia*, raising the retirement age, increasing the number of contributors and broadening the contribution base. The RS undertook significant reforms of its social welfare and pensions system in 2011–2012 and the measures now achieved in both entities will have a very positive fiscal and social impact. However, a second round of parametric reforms could be needed over the medium term.
- In addition, the first Voluntary Pension Fund will start its operation in the RS by the end of 2017 and the FBiH is preparing the necessary legislation to establish similar funds.
- An audit process to verify the eligibility of war veterans for benefits (including privileged pensions) should go through its final stage by the end of 2017. In addition, in order to improve the targeting of social benefits, the FBiH must prepare a plan to improve the targeting of social transfers based on a centralized database of beneficiaries that is about to be established.
- The FBiH Government has prepared lists of eligible workers, projected the relevant liabilities and plans to set aside some BAM 450 million over 11–12 years to make up for unpaid contributions for the aforementioned workers from SOEs. The payments will allow these workers to retire with full benefits and the mostly-dormant enterprises will then be closed. This major clean-up exercise will be finalized with the adoption of a Law on Missing Pension Contributions that is under preparation and should be discussed in the following months.

## **Rule of Law and Good Governance**

Corruption retards development and growth and leads to the inefficient implementation of public policies. It results in a waste of public expenditure and a significant loss of tax revenue. More generally, it leads to an ineffective distribution of the talent and resources available to the economy. Incumbents benefit at the expense of others and any social consensus behind reform is undermined. A lack of trust in law enforcement and the judiciary

is detrimental both to citizens and to investors. Adherence to the rule of law and good governance is crucial to the accession process and is a precondition for economic and social development.

Corruption kills initiative and investment in any economy and potential investors often rely on surveys (like the *Corruption Perceptions Index* compiled by Transparency International) to tell them where they should not invest. BiH sits on the top rung of republics of the former Yugoslavia when it comes to perceptions of corruption and was ranked 72<sup>nd</sup> out of the 175 countries surveyed in the world (see Figure 5a) in 2013. According to other surveys, almost three quarters of business people in BiH view corruption as a significant obstacle to doing business and a significant proportion decide against investing due to fears of bribery. More broadly, corruption is ranked as the third most important obstacle to investment in the region.<sup>23</sup> And connections are regarded as being particularly important in BiH (Figure 5b)

Strategies for combating corruption, associated Action Plans, and bodies monitoring these practices are needed. Some improvements over the past few years—like the passage of Laws on Public Procurement and Whistleblowing—must be supported by stronger implementation and collaborative law-enforcement measures; notably with regards to information exchange. More generally, economic corruption will continue to thrive in an environment of complicated and semi-hidden rules and regulations and uncertainty over procedures for the issuance of licenses and permits. Therefore, there is a need for greater clarity, simplicity and transparency in administrative procedures and fees—like the aforementioned public listing of para-fiscal fees and other costs.

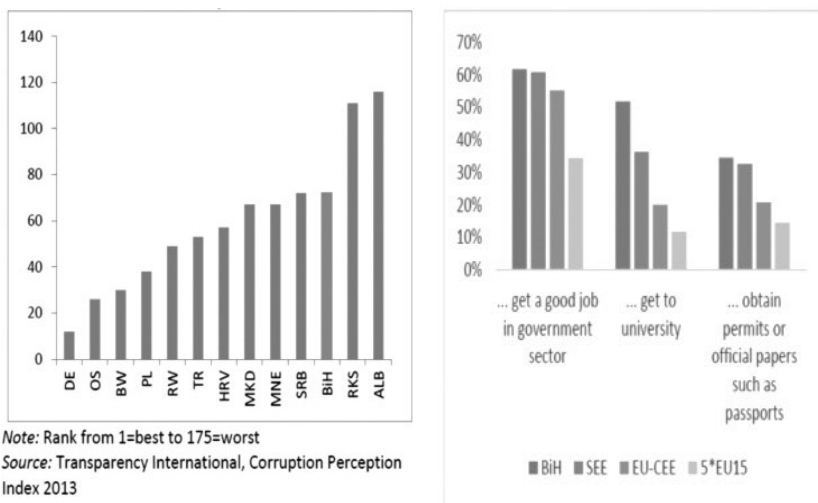
The State Institutions need to take a leading role in development of the Rule of Law and the High Judicial and Prosecutorial Council (HJPC) is the state institution that oversees the entire judiciary in BiH. Common principles need to be agreed in areas such as personal data protection, civilian possession of weapons and asset declaration.

The Reform Agenda set out an extensive list of measures to improve the rule of law and notable progress has been made in adopting a number of strategies and action plans in an effort to strengthen the judiciary and combat corruption, organized crime and terrorism. The years 2017–2018 will be dedicated to the implementation of the following:

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<sup>23</sup> UNODC. 2013. *Business, Corruption and Crime in the Western Balkans: The Impact of Bribery and Other Crime on Private Enterprise*. p.46.

**Figure 5. (a) Transparency Ranking<sup>24</sup> and (b) Percentage that believes connections are “Very Important in order to ...”<sup>25</sup>**



Note: Rank from 1=best to 175=worst  
 Source: Transparency International, Corruption Perception Index 2013

Source: LITS, 2011 and staff calculations

- A Justice Sector Reform Strategy was adopted in September 2015 and aimed at ensuring a harmonized and coordinated reform of the judiciary involving all levels of authority in BiH. This was followed by a major breakthrough with the adoption of the Justice Sector Reform Strategy Action Plan in March 2017.
- In July 2016, the HJPC adopted a number of operational guidelines to be followed by Courts and Prosecutor’s Offices throughout BiH and which are aimed at fulfilling the Reform Agenda requirements on strengthening disciplinary sanctions, combating conflict of interest in the judiciary and improving integrity.
- Concerning law enforcement, legislation was adopted to secure a greater level of financial and operational independence in the conduct of police operations (thus reducing the risk of undue political influence). As regards police cooperation, an Agreement on Mutual Assistance and Operational Cooperation was signed between the State Investigation and Protection Agency (SIPA) and the relevant bodies

<sup>24</sup> World Bank Group. 2015. *Rebalancing Bosnia and Herzegovina—A Systematic Country Diagnostic*. p.9.

<sup>25</sup> *Ibid.* p.10.

in the RS, FBiH and Brčko District in December of 2015. In addition, an Agreement on Operational and Strategic Cooperation between BiH and Europol was ratified by the BiH Presidency in March 2017.

- Strategies for combating corruption and associated Action Plans were adopted at State and entity levels and dedicated bodies are now in place at entity and state level. Structures for the prevention of corruption have been or are being established at all levels of authority and policy documents are in place or pending.
- The Integrated Border Management (IBM) Strategy and Framework Action Plan of BiH for 2015–2018 entered into force on January 1<sup>st</sup> 2016. This determines the further development of a Joint Risk Analysis Centre and establishes a risk analysis concept for BiH in general terms. However, the IBM Strategy and Action Plan require further development of the Joint Centre for Police Cooperation (in Trebinje) and additional support for the overall improvement of security policy through a more efficient fight against all forms of cross-border movement and organized crime.
- Finally, an Action Plan for implementation of the BiH Counterterrorism Strategy was adopted by the BiH Council of Ministers in October 2016.

## Public Administration Reform (PAR)

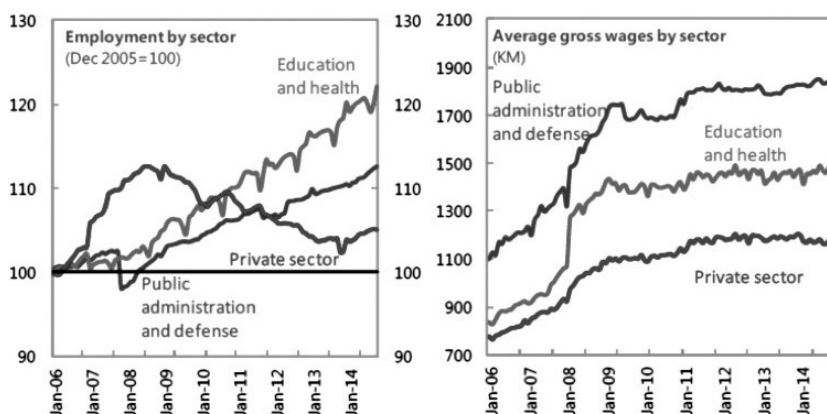
The public sector controls well over half of the economy of BiH, with direct expenditures at close to half of GDP and SOEs adding even more quasi-government control. According to the World Bank, BiH has one of the largest public sectors in the world. This state dominance retards economic growth and employment and undermines prospects for the poor and other excluded groups—like younger people. Much of public expenditure is inefficient and fails to reach the people or investment areas that most need it. Moreover, the current situation breeds opportunities for poor governance, including corruption and nepotism. And, while BiH has the largest public sector wage bill in the region, its citizens do not enjoy a correspondingly high quality of public services.<sup>26</sup>

The public sector crowds out potential private-sector activity and the situation is—if anything—getting progressively worse. Chart 6 demon-

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<sup>26</sup> World Bank Group. 2015. *Rebalancing Bosnia and Herzegovina - A Systematic Country Diagnostic*. p.33.

**Figure 6. Public Sector Growth<sup>27</sup>**



Source: BIH Agency for statistics, and IMF staff calculations.

1/ Private sector employment includes workers employed by a number of state-owned enterprises.

strates (a) how public-sector employment rose at the expense of private-sector employment in 2006–2014 and (b) how gross wages in the public sector exceed private-sector wages by increasing margins. Clearly, the economy had come to a tipping point in 2014 that could see the private sector shrivel further.

The Reform Agenda recognized an urgent need for significant public administration reform in order to ensure fiscal sustainability and the improved quality of public service delivery to citizens. It expressed a clear need to reduce the size of the government sector in the economy and to significantly lower the tax burden on work and investment. These imperatives point to the need to significantly reduce public expenditure at all levels of government and to improve its efficiency. The Reform Agenda promised, at the same time, to strengthen administrative capabilities and increase efficiency in public institutions at all levels of government.

The following progress was made in:

- Placing limits on hiring and wages: Temporary restrictions on wage and employment increases in the public sector were put in place in the Laws on Budgets for 2016 and 2017 by both state-level institutions and entities and there are already signs of shrinkage in public

<sup>27</sup> IMF. 2016. *IMF Country Report No. 15/299*. p.21.

sector employment. These restrictions will remain in place until detailed strategic plans for improved wage setting mechanisms and significant cuts in employment have been agreed with the World Bank and a methodology has been put in place to put salaries in the public sector on a sustainable basis.

- **Public sector rightsizing:** The World Bank is assisting (with the support of the EU) the state institutions and entities to complete the first-ever complete registries of public employment at all levels of government in BiH and these should serve as the basis for operationalizing the strategic plans on reducing public sector employment that will be required by the IMF in 2018 (under the terms of the EFF).
- In late May 2017, the RS parliament plans to adopt a Public Financial Management Strategy that will match strategies already developed by the state institutions, FBiH and Brcko District. After a period of consultation and consolidation, a country-wide PFM strategy will be prepared. The Strategy will significantly improve the planning and coordination of fiscal policies across entities and state institutions and permit greater transparency and control in government expenditure. The strategy will also allow the EU to provide budget support to other sectors—such as energy or transport—in support of the Reform Agenda.
- **Publishing the census results:** The results of the population and housing census conducted in October 2013 were published in June of 2016 and will permit improvements in socioeconomic planning at the local level. The census was conducted in compliance with international standards, according to the International Monitoring Operation, and is the first census to be concluded since the war.
- **Adopting key principles of PAR:** An Operational Plan for the elaboration of a new PAR Strategic Framework was prepared in December 2015 with the support of the EU. It presents the key issues for strategic development, including working structures and a timeframe. And, in February 2017 the first PAR Special Group meeting between the EU and local authorities took place in Mostar. This has started the process for all levels of government to adopt a country-wide PAR Strategic Framework.
- All three governments drafted amendments to their Laws on Civil Service in order to comply with new Labor Laws. The FBiH adopted changes that place term limits on senior management positions and

launched competitions to refill these positions by mid-2016 according to clear criteria. The EU objected that the selection process could become too political but the FBiH Government sees their approach as a stop-gap measure—to demonstrate that all senior managers can be replaced and that none of them have permanent positions—until more-permanent institutions and structures can be established.

- Ensuring transparency in procurement and hiring: An electronic system for publication of decisions of the Procurement Review Body has been put in place.<sup>28</sup> The 2015 decisions of the Procurement Review Body were published in the portal, although no upload for the years before 2015 have yet been made.

## **Conclusion: Planning and Monitoring of Further Reforms**

On September 20, 2016, the General Affairs Council (GAC) of the EU welcomed “meaningful progress in the implementation of the Reform Agenda” and invited the European Commission to submit its opinion on the country’s membership application (that was submitted on February 15, 2016). Thus, thanks in part to progress under the Reform Agenda, BiH was back on its EU accession track after a hiatus of eight years from the initial signing of a Stabilization and Association Agreement (SAA) in 2008. At the same time, the GAC called on BiH to “continue its efforts to ensure effective implementation of the Reform Agenda [...] in close cooperation with the European Union, international financial institutions and international partners, as well as civil society.” There has been a greater sense of momentum behind socio-economic reforms than has ever before been achieved in BiH.

The approval of substantial programs with the IMF and World Bank also marks a very important milestone in the implementation of the socioeconomic aspects of the Reform Agenda. Both programs are designed to combat deep-rooted structural problems in the economy over a three-year period and are closely coordinated in support of the Reform Agenda. The IMF has, in this context, noted that the Reform Agenda “[...] promises perhaps the most significant reorientation of the BiH economy since the time of the Dayton Accords. The Agenda builds on the lessons learnt from earlier performance, namely the need to reform labor laws and improve the compo-

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<sup>28</sup> Available at [www.ejn.gov.ba](http://www.ejn.gov.ba).

sition of government spending. It also emphasizes the need to harmonize rules and regulations and to improve intra-governmental coordination.”<sup>29</sup>

These flagship programs will together guide the implementation of deep-rooted and long-overdue structural reforms over the next period. And they will continue to be strongly supported by complementary programs and assistance from the EU, the EBRD, USAID, the IFC and others. A lot of detailed work still needs to be completed and implemented on issues such as SOE restructuring, public employment restructuring, PAR, health sector reform and the implementation of strategies to enhance the rule of law. These reforms require strong political commitment and, given the fact that BiH enters another general elections cycle in 2018, it will unfortunately become increasingly difficult to pursue their implementation.

As regards to the monitoring of the Reform Agenda, the authorities have themselves initiated the production of quarterly Progress Reports, complete with detailed Action Plans across state institutions and entities that identify the institutions responsible for each measure, the progress made, and deadlines for completion. The March 2017 Action Plan, for example, listed around 200 measures and sub-measures that needed to be completed (or that were completed) in support of the overall Agenda. This makes the point that reforms are complicated and need to be implemented and supported by the authorities themselves—the people who know how the system operates in detail and how it needs to be changed.

Of course, it is also essential to have external encouragement and assistance, and the international community has compiled an impressive package of financial incentives and technical assistance. Progress is closely monitored according to strict conditions for the release of assistance. The IMF, in particular, will conduct quarterly reviews of performance against pre-agreed benchmarks across a whole range of issues and the disbursement of financial assistance will depend on satisfying these benchmarks. These benchmarks will guide and encourage the authorities to remain on track with the implementation schedule. The EU and World Bank have established their own conditions for disbursing financial assistance.

The Reform Agenda survived many political squalls in BiH during the second half of 2015, through the whole of 2016 and into 2017. It has—in addition to being a focus for reforms—served as a focal point for political cooperation and the pursuit of compromise. This political process—where

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<sup>29</sup> IMF. 2016. *IMF Country Report No. 16/291*. p.5.



institutions learn to adapt to one another in practical ways—is almost as important as the pursuit of reforms itself. And, sometimes, there are delays. The approval of the IMF program was delayed because of an extensive set of prior actions, for example, and there is currently a delay in approving the first review of the arrangement. But the IMF has promised to persevere and to be understanding and recognizes that significant achievements have already been made. The Reform Agenda has, therefore, succeeded in providing a framework to overcome temporary difficulties and has delivered sufficient momentum to encourage both the authorities and the EU and IFIs to persevere in the face of inevitable challenges.

Altogether, the commitment of the authorities to an Agenda that was generated in consultation with civil society and negotiated in detail across all levels of government is being strongly supported by a closely-coordinated international community. All of the necessary structures and processes are in place. But, it will take more time for the benefits of reforms to become clear to the general public and this is the last and crucial requirement for success.

So, the reform process is now at a critical juncture: reforms have begun in earnest and there have been significant political costs for governments; but broad-based political support for credible change has not yet materialized. There is an inevitable gap in confidence on all sides.

The international community has stepped into this breach with financial support for budgets and political support for a renewed EU accession process. This is intended to push the reform process into its final stages. But it remains to be seen whether this support will be enough to encourage the authorities—as brave as they have been—to stay on course until positive results become clear. This is a very important time for the people of BiH.

