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**Statement by Mr. Sigurgeirsson and Mr. Damgaard on Bosnia and Herzegovina
(Preliminary)
Executive Board Meeting
February 24, 2021**

We thank staff for the informative report and Mr. De Lannoy and Mr. Manchev for their insightful Buff statement. The economy of Bosnia and Herzegovina was severely affected by the pandemic in 2020 due to local mobility restrictions and a weakened external environment. However, the Fund's disbursement under the Rapid Financing Instrument in April 2020 provided relief to ease the economic pressures. Going forward, we encourage the authorities to adopt an ambitious structural reform agenda, which will be key to enhance potential growth and reduce the income gap with the EU. **We broadly agree with staff's appraisal and offer the following comments for emphasis.**

The fiscal support provided to stem the impact from the pandemic was appropriate, but measures should become more targeted to contain the impact on public finances. We welcome the increase in health spending in 2020 as well as the support for firms and households affected by the crisis, but these measures should gradually be phased out as the crisis abates. We see a strong case for reallocating more resources to capital spending, while keeping current spending under control, e.g. by containing the public wage bill. In addition, we see a need to strengthen policy coordination between the different layers of government to provide a unified strategy for fiscal policy. We also urge the authorities to clear their arrears as soon as possible. *In this context, we take note of the authorities' view that health sector and public enterprises arrears could only be cleared with IFI support. Could staff clarify why IFI support would be needed for this according to the authorities?*

The CBBH's decision to resist the calls for using international reserves for fiscal policy is appropriate, and we welcome the commitment to modernize the reserve-requirement framework. The authorities should closely monitor developments in banks' asset quality, which is likely to deteriorate because of the economic contraction and the phasing out of loan moratoria. We encourage the authorities to develop a comprehensive NPL action plan as well as contingency plans, should bank recapitalizations be necessary. Moreover, we encourage

the authorities to enhance the bank resolution framework, in line with the recommendations from the 2015 FSAP.

An ambitious structural reform agenda will be critical to unleash the economic potential. The role of public enterprises in the economy should be reduced, and transparency and oversight enhanced. We also encourage the authorities to implement reforms to address the high youth employment and to raise female labor force participation. Active labor market policies, enhanced education, expanded childcare, and tax reforms could be useful tools in this respect. In addition, we urge the authorities to carefully prepare the transition to a greener economy and develop plans to phase out the high energy subsidies. We are concerned about the limited progress in improving governance. The authorities should prioritize this area as corruption hampers economic development.

We note that the EU and Bosnia and Herzegovina have agreed on and signed the Memorandum of understanding for the EU's EUR 250 million support package. The agreement still requires ratification by the authorities of Bosnia and Herzegovina. The disbursement of the first tranche of up to EUR 125 million is expected for the first half of 2021. The disbursement of the second tranche (of again up to EUR 125 million) requires compliance with a set of policy conditions, which fall into four thematic areas: (1) economic governance and institution building, (2) financial sector stability, (3) transparency and fight against corruption and (4) a better functioning of the labor market. We strongly encourage the authorities to press forward with these priorities.