

WORKING TRANSLATION

Reform Agenda for Bosnia and Herzegovina 2015 - 2018

— Final —

1. The Council of Ministers of Bosnia and Herzegovina and the Governments of the Federation of Bosnia and Herzegovina, the Republika Srpska, the governments of: Una-Sana Canton, Posavina Canton, Tuzla Canton, Zenica-Doboj Canton, Bosnia-Podrinje Canton, Central Bosnia Canton, Herzegovina-Neretva Canton, West Herzegovina Canton, Sarajevo Canton, Canton 10 (West Bosnia Canton), and the Government of Brcko District recognise an urgent need to initiate a process of rehabilitating and modernising the economy with a view to: fostering sustainable, efficient, socially just and steady economic growth; creating new jobs; increasing and more-appropriately targeting social assistance; and creating a favourable and just social environment. Concrete actions aimed at fiscal and financial sustainability and socio-economic reform will be augmented by targeted measures: to strengthen the rule of law and the fight against corruption; and to strengthen administrative capabilities and increase efficiency in public institutions at all levels of government (the term "all levels of government" hereinafter includes state, entity and cantonal levels of government and the Brcko District).
2. This **Reform Agenda** sets out the main plans for socio-economic and related reforms of all levels of government during the remainder of their democratic mandates and largely reflects their programmes of government that have already been initiated. The Reform Agenda is also intended to respond to the call of the Foreign Affairs Council of December 2014 to develop an initial agenda for reforms, in line with the EU acquis. All levels of government are mindful that meaningful progress on the implementation of the agenda for reform will be necessary for a membership application to be considered by the EU.
3. The priorities for reform were previously discussed with International Financial Institutions (IFIs) and the EU. As such, the reforms could also form the basis for negotiating individual programmes of financial and technical assistance from the IFIs and the EU as well as from other donors and partners who may wish to support the Reform Agenda. While each of these institutions will negotiate its individual programmes and monitor progress on its own priorities, the programmes will be closely coordinated and complementary to the overall reform effort.
4. In addition, the Reform Agenda is closely aligned with the aims of the EU's new approach to economic governance in the Western Balkans and is in conformity with the Economic Reform Programme as a fundamental element to encourage comprehensive structural reforms to maintain macroeconomic stability and to boost growth and competitiveness.
5. Implementation of the Reform Agenda will begin immediately. A broad set of **medium-term priorities**—as set out below—will be distilled into specific **initial measures and undertakings** that will be prepared and implemented during the remainder of 2015 and in early 2016 individually with each institution. Specifically, these initial measures and undertakings will be further refined in consultation

with the IFIs and the EU and will lead to follow-up specific measures that will bring the Agenda beyond its initial horizon and into the medium term.

6. The state of public finances at all levels of government in BiH is such that it is necessary to implement fiscal consolidation that will gradually reduce the budget deficit and put the public debt on a downward medium-term trajectory. Therefore, the authorities in BiH have opted for a strong three-year program of fiscal consolidation. In order to avoid unfavourable external financing conditions, the authorities in BiH expect to conclude financial arrangements with the International Monetary Fund, the World Bank and the European Commission, which will provide financial support for the implementation of fiscal consolidation measures.
7. Fiscal consolidation aims to provide a stable macroeconomic environment. But for stable, positive real growth in the medium and long term it is necessary to implement a number of structural reforms in the areas of: labour legislation; public administration reform and employment policy in the public sector; improvements in the business climate and competitiveness; the restructuring of public enterprises; reform of social welfare; health sector reform; and the rule of law.

The Reform Agenda is expressed in six areas of importance as follows:

Public Finance, Taxation and Fiscal Sustainability

8. Budgets will be placed and maintained on a firm medium-term fiscal foundation to be agreed with the IMF in a successor arrangement to the current SBA. This new fiscal framework will set the level of public debt on a downward trajectory, while creating room for an increase in public investment and, at the same time, reducing the size of the government sector in the economy. Fiscal consolidation will be carried out by reducing public spending, as well as increasing public revenues. The increase of public revenues will be achieved by increasing revenues from consumption taxes, expanding the tax base, reducing the grey economy, reducing tax exemptions and improving tax administration operations. If the above measures prove to be insufficient by the end of 2015, additional measures, including a VAT increase, will be considered, in consultation with the IMF, on the basis of a thorough assessment, and as discussed at a high level meeting.
 - While reforms to taxation systems and public expenditure levels will need to be conducted in an overall fiscal envelope that will ensure medium-term fiscal sustainability, there is also 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.
 - Fiscal consolidation must lead to a reduction of the budget deficit and stop the growth of public debt. The taxation system will be reformed, in order to reduce the burden on labour, but these reforms cannot be implemented within the existing fiscal framework.
 - Reduction of the burden on labour needs to be implemented by reducing contributions for health insurance, coupled at the same time with the need to ensure additional revenues for extra-budgetary funds to cover the losses generated as a result of the reduced contribution rate.
 - It is necessary to limit the total fund of salaries and all current expenditure across all levels of government, without the possibility of an increase regardless of the growth in tax revenues.

- Measures to improve tax compliance will be actively pursued. This will include further efforts to share information across the four tax authorities and implementing a risk-based approach for audits and inspections, all according to the constitutional competencies of each of the tax agencies and within the concluded memorandum of understanding as well as increased efforts to collect outstanding tax debts. E-services for VAT and income taxes will be introduced.
- Expenditure cuts will mostly result from implementing public administration reforms—including strict controls on employment and total public-sector wages—and from pension and social welfare reform, as well as from more transparent, prioritized planning and execution of public investment.
- The entities, the Cantons and Brcko District will improve fiscal controls and financial management. New Laws on Fiscal Responsibility (in the RS) and on Financial Control and Management (in the FBiH) will be enacted and all levels of government will adopt new Public Internal Financial Control (PIFC) development strategies.
- Measures to strengthen controls over lower levels of government, extra-budgetary funds, and public enterprises will be actively pursued (as agreed with the IMF and World Bank). Comprehensive strategies to tackle remaining loss-making state-owned enterprises, which also have a sizable stock of unpaid social security contributions, will be adopted and implemented by the governments of the Entities, Cantons and Brcko District.
- The governments of the Entities, Cantons and Brcko District will seek financial and technical assistance of the World Bank to implement the reform of the health sector. The reform is to include a solution for outstanding debts in the health sector, introduction of the treasury system and the definition of new models and sources of funding, with a more precise regulation of the network of health care institutions. Through a DPL programme, the World Bank will be asked to provide technical and financial support for the reorganisation of the health sector. The Entity, Cantonal and Brcko District governments will use these funds for the settlement of outstanding liabilities of the health sector (contributions in particular) by the end of 2015. In parallel, the authorities in BiH will support an increase in excise duties on tobacco and alcohol which will be the direct income of the health insurance fund of the RS and health insurance funds in the FBiH, Cantons and Brcko District by the end of 2015.
- Sustainability of public debt is central to maintaining the stability of public finances but it can only be achieved through reducing budget deficits. Efforts to share information about the debt portfolio structure, gross borrowing needs and plans as well as arrears recognition and clearance will ensure realism of the medium term fiscal framework.

The Business Climate and Competitiveness

9. Future growth and prosperity must be based on attracting investment. There is a need to boost competitiveness by eliminating well-documented barriers to investment. In addition, there is a need to level and clear the playing field for investment by removing hidden subsidies and other assistance to many large enterprises and improving bankruptcy procedures and moving ahead with the resolution of unviable enterprises. Moreover, there are inconsistencies and complexities in the regulatory frameworks and tax systems that pose major problems for potential investors in the economy and these are compounded by high administrative barriers:
 - Reforms to the business environment will include: in the FBiH, new Laws on Companies and on Foreign Direct Investment and simplifying and automatizing business registration; expediting procedures for getting construction permits and electricity; facilitating exports by continuing the

inspections reform and strengthening national quality control in line with EU requirements; examining the feasibility to pursue fiscally sound public-private partnerships and greater private sector participation in infrastructure development; and every level of government will prepare a comprehensive listing (and publication) of para-fiscal fees to reduce them and make them more transparent in accordance with the distribution of competencies.

- Better investor protection laws and practices are needed including improved corporate governance, strengthened risk-management practices to improve access to financing (especially for new enterprises), improved protection for minority shareholders and more-efficient insolvency frameworks that would be achieved by amending legislation on bankruptcy which will introduce a new process of "pre-liquidation procedure" with the aim of financial restructuring of the debtor to avoid bankruptcy in order to preserve jobs and the continued performance of the core business of the company. Both entities will review their bankruptcy laws with a view to shortening bankruptcy proceedings. The FBiH will introduce commercial courts.
- Public enterprises will be classified into those that are viable (with minor or major restructuring requirements) and those that are not. These lists will form the basis for comprehensive Entity restructuring and privatisation/liquidation medium-term programmes. The Entity Governments will seek financial and technical assistance from the World Bank to prepare and to implement the restructuring programme for public companies. Special attention will be paid to restructuring railroads (in both entities) and mines (in the Federation of BiH), which implies a new organisation and number of employees. Early plans will be designed to prepare BH Telecom for partial privatisation in the FBiH.
- Further efforts to safeguard financial sector stability and create the conditions necessary to revive bank lending will be actively pursued in consultation with the Central Bank of Bosnia and Herzegovina and with the IMF. As a part of this, financial sector legislation will be adapted to EU Directives and Basel requirements, as applicable to the level of development of the domestic financial market, and at the same time the oversight of banks will be strengthened by the Entity Banking Agencies.
- A new Law on Customs Policy will be implemented that will simplify customs processing procedures and reduce administrative requirements thereby facilitating trade.

The Labour Market

10. In order to gain a footing on the road to sustainable growth, Bosnia and Herzegovina must embrace its strategic advantages. These include significant potential in the workforce which is not sufficiently utilised at present. The low activity rate of the working-age population and the high unemployment rate are often the result of mismatches between supply and demand for skilled labour that restrict development opportunities. In BiH, there is a significant number of long-term unemployed who are discouraged to seek employment. Existing labour laws no longer reflect the social and economic relations in BiH and some provisions of these codes are contradictory to other laws while other provisions are vague and insufficiently flexible. The culture of collective bargaining and social dialogue is underdeveloped and often burdened by unrealistic demands of the social partners.
 - A significant reduction in social security contributions (especially for low-wage earners) would reduce labour costs, help to attract investors and bring more employees into the formal sector (and reduce the prevalence of informal sector employment); yet this cannot be implemented without securing additional funding for extra-budgetary funds.

- Reforms of the education system will be undertaken over the medium term with the aim of enhancing its connection to the demands of the labour market.
- The introduction of support schemes for first-time job seekers will be considered.
- Working in the grey economy will be actively discouraged, including by preventing the underreporting of wages as the basis for the calculation and payment of taxes and contributions.
- Other labour market reforms will be enacted as agreed with the IMF and World Bank and in consultation with the social partners. Entity governments will improve the drafts of new labour codes in consultations with social partners, in order to increase flexibility in working conditions (including the facilitation of part-time employment) and allow differentiated wage setting based on skills, qualifications, level of experience, and performance.
- At the same time, the entities will step up labour inspections and increase penalties for labour law violations and endeavour to protect workers' rights consistent with ILO labour standards and EU labour directives. The employment services will introduce management practices to improve efficiency in getting people back to work and the provision of mandatory health insurance for the unemployed will be delinked from the function of mediating in recruitment.

Social Welfare and Pension Reform

11. In addition to promoting initiative and efficient industry, a modern and caring society must provide for those who cannot take care of themselves. At the same time, social welfare systems must not distort incentives in the economy and must be fiscally sustainable. To achieve these ends, the governments of the Entities, Cantons and Brcko District must improve the targeting of social assistance through a set of measures that would make social protection policies more effective, efficient and equitable. Social protection needs to work for those who really need it—or who pay for it—and must be put on a sustainable financial footing. Pension systems also need to be put on a sustainable financial path if the accumulated rights of workers are to be met over the medium term.
 - Social welfare systems will be reformed (in consultation with the World Bank and IMF), including improved targeting for non-contributory social assistance and establishing a centralized database in the FBiH of all beneficiaries of social transfers. Reform efforts will seek to provide incentives to beneficiaries to become active participants in the economy while protecting and increasing social assistance for those who are most in need.
 - In FBiH, insurance-based systems must be put on a firm financial footing through: containing the cost of privileged pensions and reducing early retirement options for hazardous occupations; the introduction of reasonable penalties for early retirement and bonuses for late retirement in order to raise the effective retirement age; and the introduction of sustainable benefit indexation.
 - Audits to verify the eligibility of existing beneficiaries will be accelerated throughout the FBiH and the Cantonal Governments will strengthen the legislative framework to improve the audit process. There will be accelerated implementation of pension reforms based on a new pension law in the FBiH.
 - The FBiH will seek assistance from the World Bank in addressing arrears in employee contributions to the social funds.
 - In the RS, the government will re-examine the need for parametric reforms of the pension system.
 - Both entities will work more vigorously on developing voluntary-pensions scheme proposals. The FBiH will work on crafting the required legislation while the RS will continue work to establish the first voluntary pension fund.

Rule of Law and Good Governance

12. There is a need to ensure the irreversible entrenchment of the rule of law which must be built on a foundation of concrete progress in the fight against organised crime, terrorism and corruption. All necessary institutional and operational developments will aim to provide citizens throughout BiH with a safer and corrupt-free environment. At the same time, governments at all levels in BiH will enhance their commitment to restore overall citizens' trust in rule of law institutions by developing capacities, accountability, professionalism and integrity.
- The Justice Sector Reform Strategy/Action Plan (2014-2018) will be adopted; effective prevention of corruption and conflict of interest within the judiciary will be established; professionalism and integrity will be enhanced by means of prescribing objective criteria for appointments of members of the judiciary and the adoption of integrity measures throughout the judiciary in BiH; and disciplinary accountability of the members of the judiciary will be reinforced by adopting new rules for disciplinary proceedings and introducing new disciplinary measures. Courts will have to make decisions within a reasonable time and the possibility must be considered that utility cases could be resolved out of court. Procedures for sale of seized property will be improved and the role of bailiffs will be enhanced in order to reduce the burden on the courts in the enforcement procedure.
 - The professional, effective and efficient delivery of police services is key to facing security challenges. Appraisals will be carried out to identify measures to further enhance the integrity of police agencies at all levels. Closer cooperation of policing at all levels will be enhanced and developed, in line with established constitutional competencies. Regional and international police cooperation must continue to be developed, including concluding the operational agreement with EUROPOL in accordance with the interim decision on the establishment of a system of cooperation and exchange of information between the relevant law enforcement agencies in Bosnia and Herzegovina and EUROPOL.
 - An anti-corruption strategy will be adopted and effective prevention and monitoring structures will be set up in line with relevant international standards and respective of constitutional competencies and adopted documents at all levels of authority. Rule of Law institutions shall abide by the highest integrity standards themselves, while adequate integrity measures shall be put in place at all levels of authority to ensure that corruption is prevented and sanctions effectively applied. Countering serious crime and corruption, in addition to more effective investigation, prosecution and conviction shall also be based on a solid legal and institutional framework—harmonised within agreed minimum standards—governing asset seizure and money laundering at all levels of authority in BiH.
 - It will be necessary to: adopt a new BiH counter-terrorism strategy and associated action plans; conclude the operational agreement with EUROPOL to ensure the two-way flow of confidential information on crime between BiH and Member States; enhance the flow of information between police and prosecutors by increasing the effectiveness of the data exchange system; adopt a new integrated border management strategy ensuring better cooperation between all related agencies in BiH and across its borders; and harmonise all laws on civilian possession of weapons.
 - The legal and regulatory framework for combating money laundering and the financing of terrorism will be brought fully in line with international standards and with Financial Action Task Force recommendations.

Public Administration Reform

13. Public administration reform is one of the key priorities in ensuring fiscal sustainability and the quality of public service delivery to citizens. It needs to be carried out in close relation to reforms in the socio-economic system and rule-of-law.
 - All levels of government will adopt key principles underlying the next round of public administration reform. A more modern, competent, transparent, effective, cost-efficient and accountable public administration will improve the delivery of public services and save costs. These plans will involve basic, substantial reforms to public financial management.
 - There is support for significant civil service reform at all levels of government. All levels of government will draft new laws on civil servants and employees, with the assistance of the World Bank and SIGMA, to facilitate public administration reform and introduce greater flexibility in working arrangements. These laws will be adopted shortly following the adoption of the new Entity labour laws. Candidates for public service employment will be assessed on the basis of pre-established eligibility criteria and the results of competency tests and administrations will ensure the recruitment of those ranked highest.
 - All levels of government will introduce limits on hiring in the public administration until revised staffing systems can be devised and implemented (including the use of service norms) and public-sector wages will be frozen until a revised system of wage setting according to merit can be put in place.
 - The publication of decisions on complaints in Public Procurement procedures (as a legal obligation) is central to ensuring transparency in procurement procedures—through deliberations on appeals and public access to the case law of the Procurement Review Body.
14. All levels of government will continue to consult closely with the EU on this evolving Agenda and will seek to clarify and explain any significant departures from established understandings so that progress can be clearly measured, understood and assessed on a regular basis. Regular Reports on progress will be submitted to the EU Delegation in Sarajevo. These will be very factual and technical in nature and will be brief (while, at the same time, giving the full content of any measures adopted and the circumstances behind any delays or changes in plans). The first such Report will be due on November 15, 2015.
15. Full support will be provided for the successful completion of the population and housing census in BiH in full compliance with the provisions of the Law on Census, associated regulations and EU statistical standards on census activities.
16. Representatives of the EU and IFIs will be invited for regular coordination meetings intended to clarify technical details and assist in the preparation of Reports. In addition, progress on implementation of the Reform Agenda will be reviewed with the EU and IFIs at a high level meeting to be held toward the end of November. This will present an opportunity to take stock of progress and to agree on any substantive revisions.
17. All levels of government in Bosnia and Herzegovina will undertake not to challenge, hamper or block the implementation of arrangements with International Financial Institutions who are directly and indirectly related to the reform process that is implemented or being implemented by a particular level of authority within its constitutional jurisdiction.