

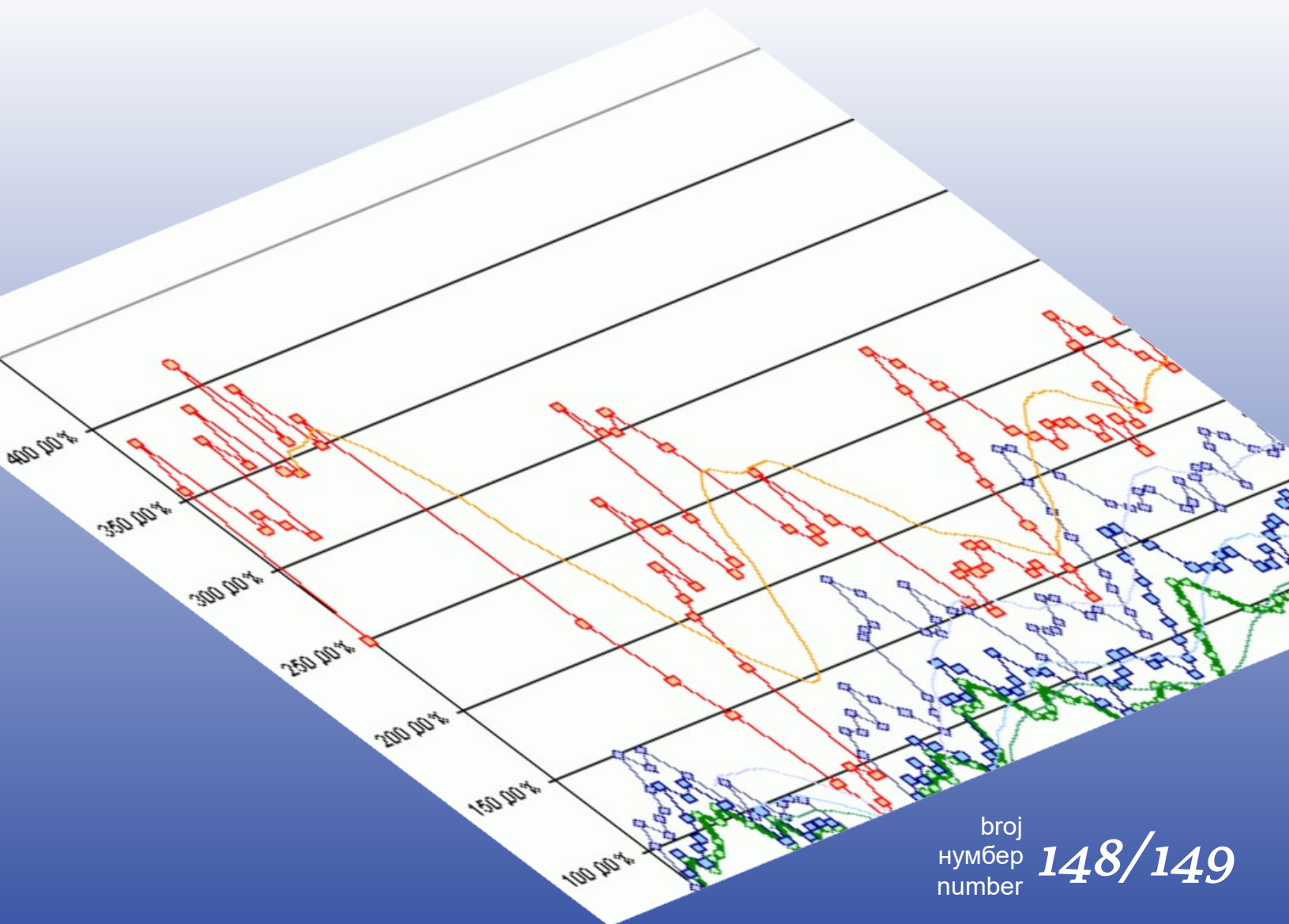
Bosna i Hercegovina
Odjeljenje za makroekonomsku analizu
Upravnog odbora Uprave za indirektno-
neizravno oporezivanje



Босна и Херцеговина
Одјељење за макроекономску анализу
Управног одбора Управе за indirektno-
неizravno опорезивање

Macroeconomic Unit of the Governing Board of the Indirect Tax Authority

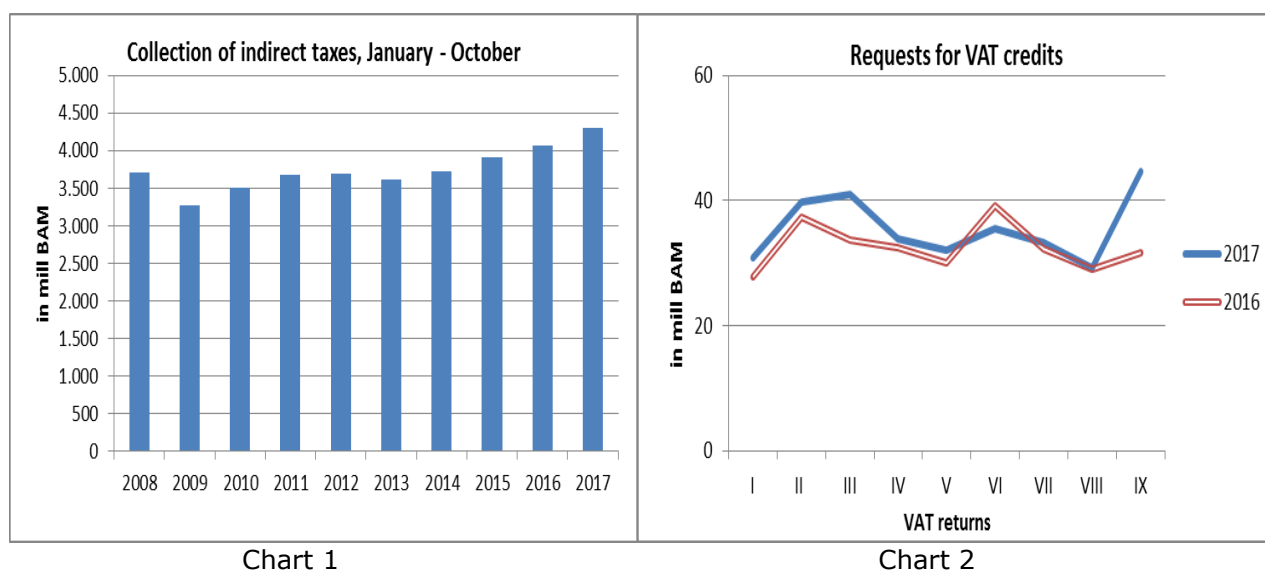
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With this issue

According to the preliminary cash flow report, in October 2017 the ITA on the Single Account collected 619,4 million BAM of gross revenue from indirect taxes i.e. 4,2% more than in the same month of 2016. However, due to increased refund payments, by 33 million BAM more than in October 2016, net revenue from indirect taxes was lower by 8,2 million BAM, i.e. by 1,6%. At the level of ten months in 2017, 386,3 million BAM of gross revenue was collected more than in the same period of 2016, while funds were paid in the amount of 163,9 million BAM more than in 2016. Finally, net collection was higher by 222,4 million BAM, i.e. 4,9% more than in the same period of 2016. Overall, the growth of revenue from indirect taxes throughout the year is remarkable since the establishment of the ITA (Chart 1) and above all expectations and projections.



VAT refund growth of 37,5% in October was expected, because, due to the slowdown in refund payments during the implementation of comprehensive controls of taxpayers by the ITA in September, there was a change in the refund payment pattern, which led to a slowdown in payments. In the coming months, a strong refund payment growth could be expected, not only due to the outstanding payments but also because of the growth in requests for VAT refunds, as a result of a strong growth in imports and exports. On the other hand, taxpayers reacted on comprehensive refund controls by increased requests for tax credits. According to data on processing VAT returns from September the amount of reported tax credits was by 30% higher than in the same month of 2016 (Chart 2). If the trend continues in the coming months, it is possible to expect a slowdown in gross VAT collection.

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REVISED INDIRECT TAX REVENUE PROJECTIONS 2017-2020

I ASSUMPTIONS

Indirect tax revenue projections for the period 2017-2020 imply baseline projections. The program scenario will be prepared if amendments to the Excise Law in B&H are adopted.

The assumptions for drafting the basic projection scenario are as follows:

- Forecasts of macroeconomic indicators by Directorate of Economic Planning (DEP) for the period 2017-2020 from September 2017;
- Continuation of harmonization of excise duties on cigarettes with EU standards and the application of the new taxation policy on fine-cut tobacco¹;
- The effects of the Free Trade Agreement between Bosnia and Herzegovina and EFTA² in the period 2015-2017;
- Effects of the application of the Adapted Stabilization and Association Agreement (SAA) in force since 1 February 2017;
- Current trends in indirect tax revenue collection.

The policy of excise duty on tobacco in 2017 is determined by the Excise Law and the ITA GB Decision³. The policy of excise duty on tobacco in the period 2017-2019 includes continuous annual increase in the specific excise duty on cigarettes of 0,15 BAM per package, determination of minimum excise duty on cigarettes (minimum 60% of weighted average price of cigarettes) and harmonisation of the specific excise on cut tobacco with the excise duty on cigarettes (minimum 80% of the minimum excise duty on cigarettes). It is expected that the minimum excise duty on cigarettes in the EU for all price categories of cigarettes will be reached in 2019.

II CURRENT TRENDS IN COLLECTION

2.1. Total collection

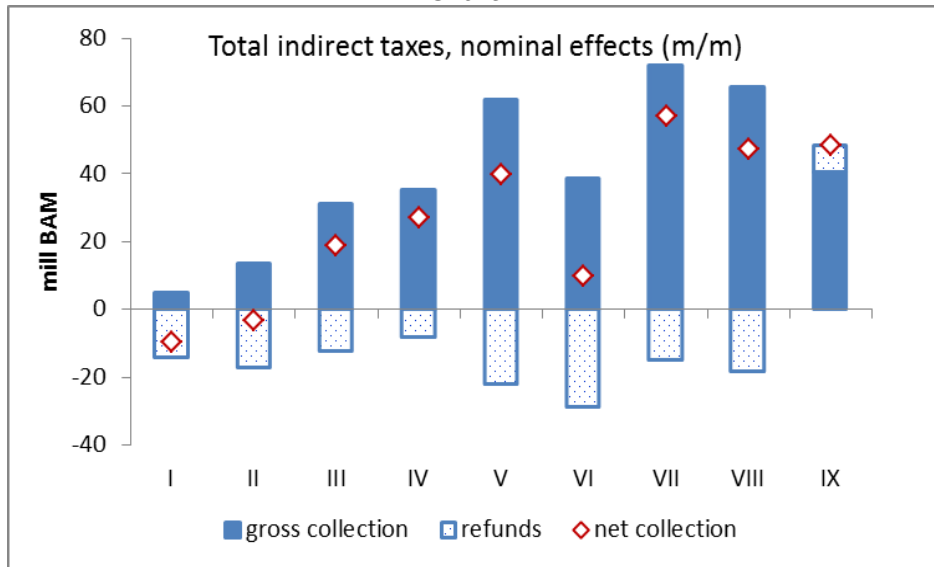
According to the preliminary report on cash flow on the ITA Single Account in September 2017 gross revenue of indirect taxes amounted to 637,3 million BAM, which is an increase of 38,8 million BAM. At the same time, it was paid 8,1 million BAM less refunds so that, in the end, the net collection increased by 9,2% i.e. 46,9 million BAM compared to September 2016. Strong revenue growth in September was positively reflected in cumulative collection in nine months. Gross collection increased by 361,5 mil BAM, while net collection, due to increased refund payments of 130,7 mil BAM, was higher by 230,9 mil BAM, i.e. by 5,7% compared to the net collection in the same period in 2016.

¹ The new policy is in effect since 1 August 2014. (Amendments to the Excise Law in B&H „Official Gazette of B&H“ No. 49/14)

² „Official Gazette of B&H – International Agreements“ No. 18/14.

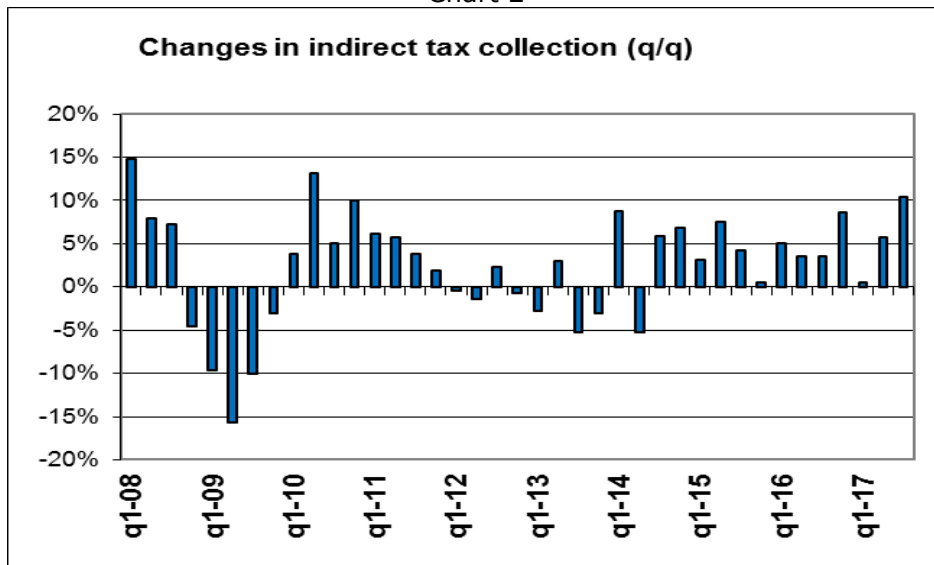
³ Decision on determination of specific and minimum excise duty on cigarettes and the amount of excise duty on smoking tobacco for 2017 (Official Gazette of B&H, No. 84/2016).

Chart 1



The comparison of collection in 2017 and 2016 by months (Chart 1) and quarterly (Chart 2) shows a stable positive trend. After a modest growth in revenues in the first quarter of 0,5%, in the second quarter growth was 5,7% and in the third it was 10,3% (Chart 2). The analysis of revenue collection structure indicates a growing trend of collection effects from quarter to quarter. The first quarter brought only 6 million BAM of net effects, the second brought 77 million BAM and the third one 153 million BAM. Unlike the growing trend in gross collection, refund payments were significantly higher than in 2016. However, in September refund payments were lower compared to the same month in 2016, which further increased the net effects of the third quarter. The reason for the reduction of refunds is extensive control of VAT refunds carried out by the ITA, which inevitably led to a delay in approving VAT refunds and moving the usual refund pattern to exporters and other taxpayers.

Chart 2



The effect of the refund delay due to the implementation of the control is estimated at 20-30 million BAM, which corresponds to 0,5 – 0,7 p.p. of the growth in total indirect tax revenues for nine months of 2017.

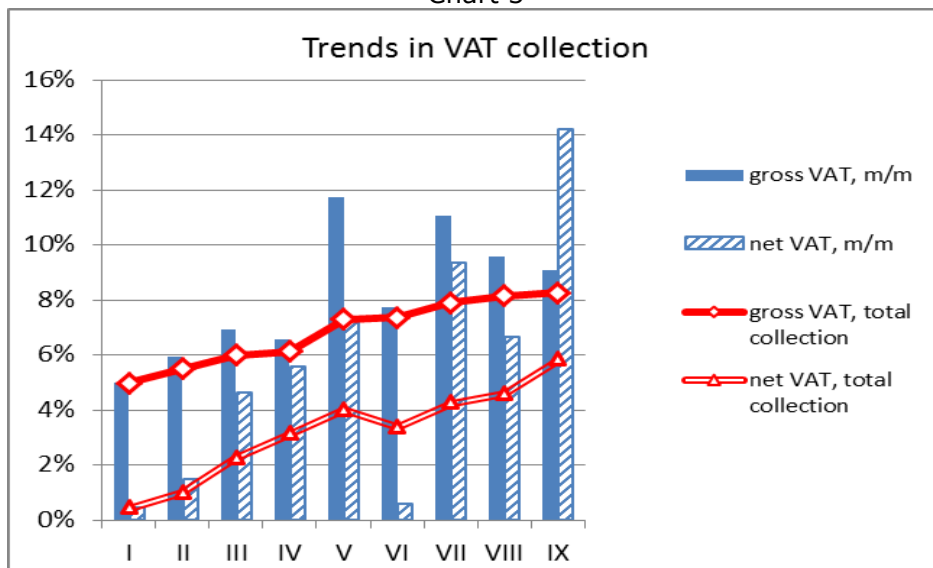
2.2. Collection by type of revenue

In the period January – September the highest growth was recorded in VAT, 146,2 million BAM, and in excise and road fee revenue, total 68,1 million BAM. There was also a significant increase in revenues from customs duties of 17,6 million BAM. It should be borne in mind that according to the preliminary report there are additional 17,3 million BAM of unadjusted revenues which were not classified by types in the ITA preliminary report.

VAT

The net revenue collection from VAT in the current part of 2017 is characterized by a steady growth trend despite strong monthly oscillations in gross collection, while net VAT grew slower than gross collection due to increased refund payments (Chart 3). Cumulative collection fluctuated around the growth rate of 4% of the most observed period. Due to postponing refund payments in September the net increase in collection was up to 14,2%, which increased the growth rate of cumulative VAT collection to 5,8%. Given that according to the preliminary report 17,3 million BAM revenue was unadjusted, a higher increase in net VAT is expected after the adjustment. It was necessary to emphasize that postponed refunds from September had impacted the realized growth rate of net VAT for nine months ranging from 0,8 to 1,2 p.p.

Chart 3



Quarterly trends (Chart 4) point to growing positive trends in VAT collection. In the first quarter the net VAT growth rate was 2,3%, in the second 4,4% and in the third it was 10,2%. Analysis of gross VAT components indicates positive trends, especially in the last five months. Thanks to the high growth rates of imports throughout the year 2017, VAT component on import is constantly in a positive zone with very high growth rates. In September VAT growth on import was 12,1%, which increased the cumulative growth to 11,8%. On the other hand, the collection of domestic VAT was increased by 5% in September, which increased the cumulative collection of domestic VAT to 3,2%. Quarterly analysis shows a constantly high growth rate of VAT on imports, 12,8% in the first quarter, 11,2% in the second and 11,5% in the third quarter of 2017 (Chart 5). On the other hand, when it comes to domestic VAT, in the first quarter there was a drop in collection of

2,5% but in the second and third quarter there was a sharp improvement, with growth rates of 4,3% and 7,6%, respectively. Adjusting the unadjusted revenue for September, whose structure is largely a component of VAT, will surely increase the rates of domestic VAT growth.

Chart 4

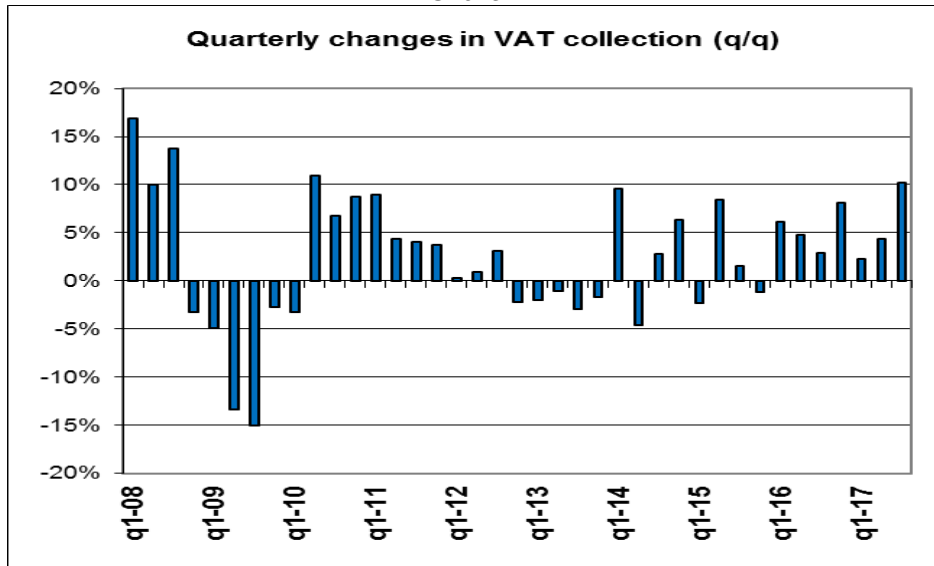
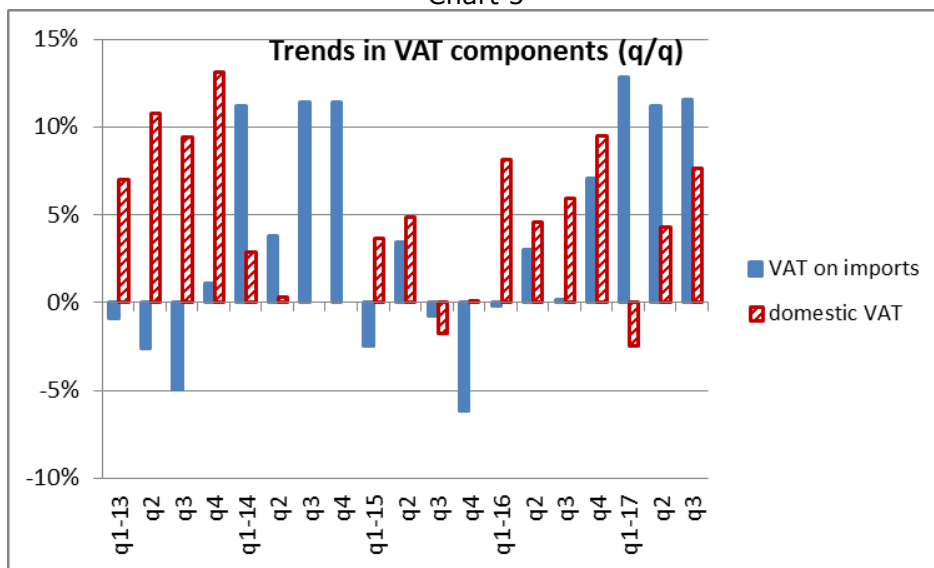


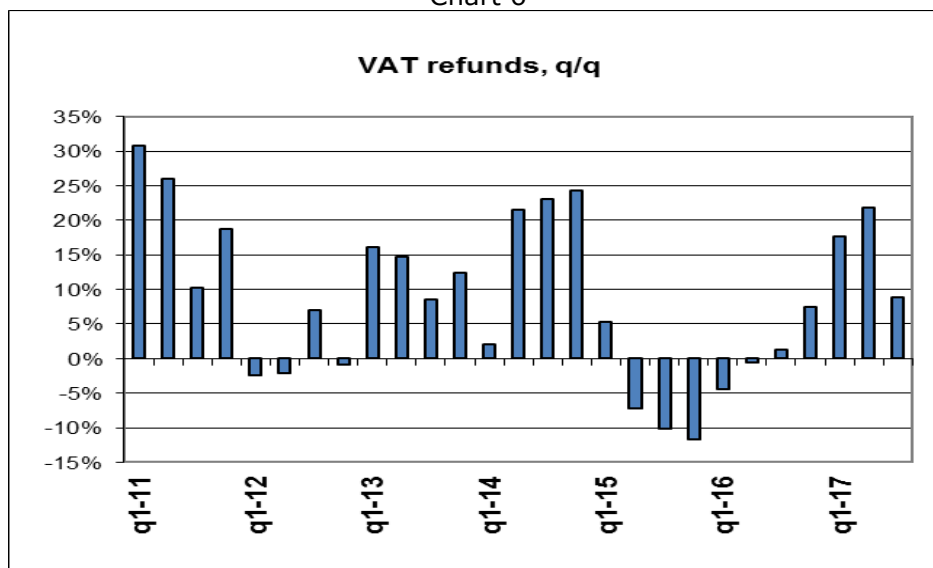
Chart 5



In September, a drop in VAT refund payments to taxpayers was recorded as a result of the delay in refunds due to implementation of comprehensive refund controls by the ITA. Refund payment retention has reduced negative trends to a lesser extent so the growth of VAT refunds to taxpayers was 16,5% and to international projects 14,7%. At the level of nine months 119,9 million BAM more was paid to taxpayers than in the same period in 2016, while 9,8 million BAM more was paid to international organizations and projects than in nine months of 2016.

Due to the move of refund payment pattern in September the share of VAT refunds in gross collection was slightly reduced to 25,7% but still it was by 1,7 p.p more than the refund share in the same period of 2016.

Chart 6



The quarterly refund payment analysis shows a progressive growth in refund payments that began in the fourth quarter of 2016 corresponding to the growth of B&H imports and exports. The effect of postponement of refund payments in September was also noticeable in trends in the third quarter of 2017 (Chart 6).

Customs duties

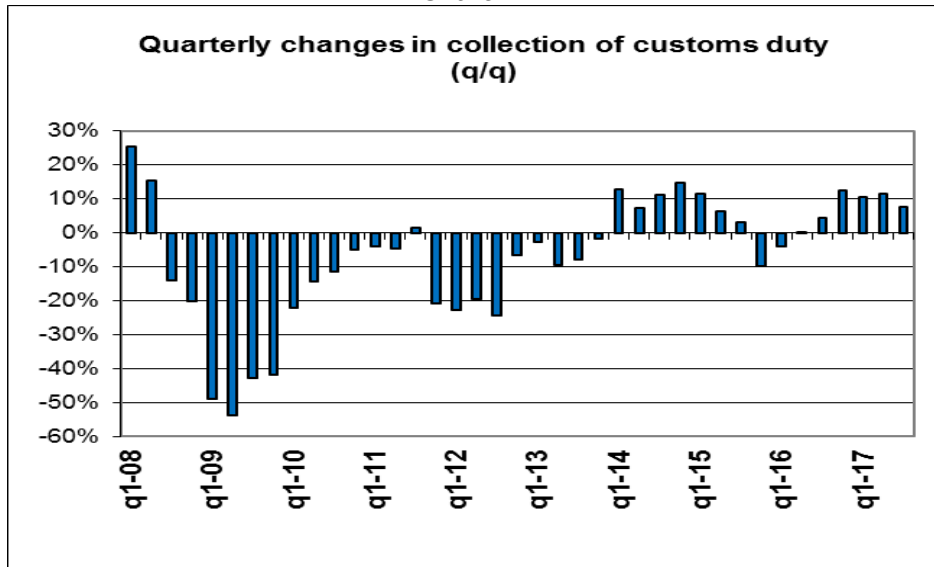
The 2017 trend has marked a positive trend in collecting revenue from customs duties with strong oscillations in monthly collection which grew up to 30%. Customs revenue growth is completely unexpected as domestic and international institutions have predicted a significant fall in revenue due to the application of the adapted SAA. The decline was estimated at up to 50 million BAM on an annual basis, bearing in mind that share in EU imports under the customs regime constitutes 1/3 of B&H imports on which customs duties are levied. However, not only that there was no fall in revenue but there was an increase of 9,8% at the level of nine months. Quarterly review shows that the first quarter brought revenue growth of 10,4%, the second quarter 11,6% and the third one 7,7% (Chart 7).

The growing trend of growth in the last two months is a result of the recovery of imports from third countries⁴ and imports of goods from the EU on which customs duties are still being levied⁵. Although due to the application of the adapted SAA since 1 February 2017 a significant drop in customs revenue from EU tariffs was expected, according to the ITA data in eight months of 2017, it was collected 5% more customs revenue on goods originating in the EU than in the same period of 2016. Analytical data by Member States indicate that the loss in customs revenue was only achieved in exchange with Croatia, while in exchange with other EU Member states, due to the strong growth in imports from the EU, more customs duties are collected than in 2016. This was resulted in annulment of the loss in customs revenue from the exchange with Croatia. It is obvious that the application of adapted SAA will not produce expected losses in tax revenue in B&H.

⁴ According to data of Agency for Statistics of B&H imports from China increased by 7,3% in the period January – August 2017 and by 9,3% from Asian countries. A strong growth of imports from Russia of 11,8% is also achieved. Source: www.bhas.ba.

⁵ According to data of Agency for Statistics of B&H imports from the EU increased at the rate of 10,7% in the period January - August 2017. Source: www.bhas.ba.

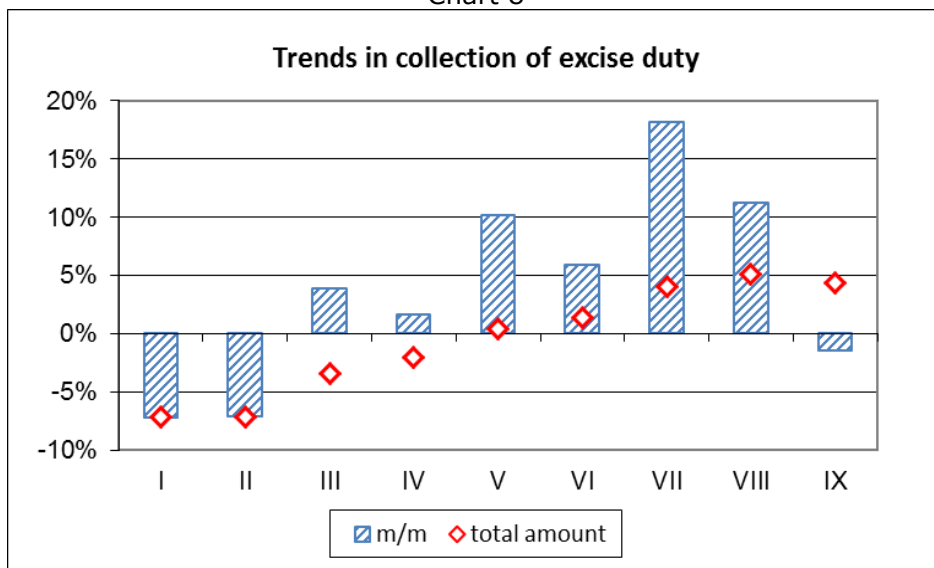
Chart 7



Excise duties

Unlike in August when excise duties on all types of excise products had a positive collection, in September trends have deteriorated with a 1,5% drop in collected excise duties (Chart 8).

Chart 8

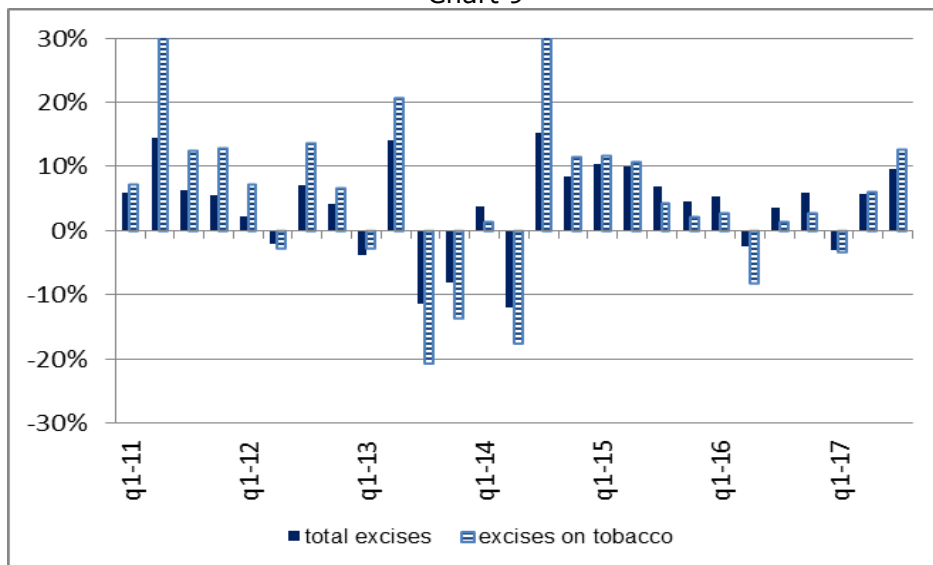


Positive trends in September were recorded only at excise duty on beer, non-alcoholic beverages and domestic tobacco products. However, the negative trends in excise collection in September did not greatly deteriorate the cumulative growth of individual excise groups, especially those that dominate in the structure of excise revenue such as excise duty on tobacco and oil derivatives. In September the fall in excise collection slightly slowed down the positive accumulation of excise cumulative growth and grew by 4,4% for nine months (Chart 8).

Quarterly trends in total excise collection show a fall of 3,4% in the first quarter of 2017 and a sharp increase in the second and third quarters of 5,8% and 9,4% respectively (Chart 9). Excise duties on tobacco products have similar trends in collection so it can be concluded that the growth in excise duty on tobacco products of 5,5% is the main reason for the strong growth in total excise revenue in former part of 2017.

In 2017 a drop in revenue from excise duty on tobacco products was expected for a number of reasons. The constant increase in retail cigarette prices since 2009 due to excise growth has halved the legal consumption of cigarettes stimulating the substitution of cigarette consumption by fine cut tobacco consumption and strengthening the illegal tobacco and cigarette market in B&H. In the first quarter there was a drop in revenue from excise duty on tobacco products of 3,2%. However, in the second quarter the growth was 6,1%. The reason is the increase in retail prices of cigarettes of dominant importers and domestic tobacco industry by the middle of the year. Expecting increased demand for tobacco products prior to raising the prices, tobacco companies have accumulated stocks resulting in increased withdrawal of excise stamps and increased excise duties. Given that the effects of rising retail prices of imported cigarettes should be exhausted in August, the strong growth in excise revenue of 12,7% in the third quarter also indicates other growth factors which may be related to the expansion of border and transit traffic with non-residents. On the other hand, the fall in revenues in September also points to the seasonal nature of this factor's impact, which is also closely linked to the extraordinary tourist season in Croatia. Another significant growth factor of border and transit traffic is low price of oil derivatives in B&H as a consequence of the lowest tax burden in the region. In this respect, non-residents from Croatia and those in transit, besides derivatives, also buy other commodities in B&H, including tobacco and cigarettes which are cheaper in B&H.

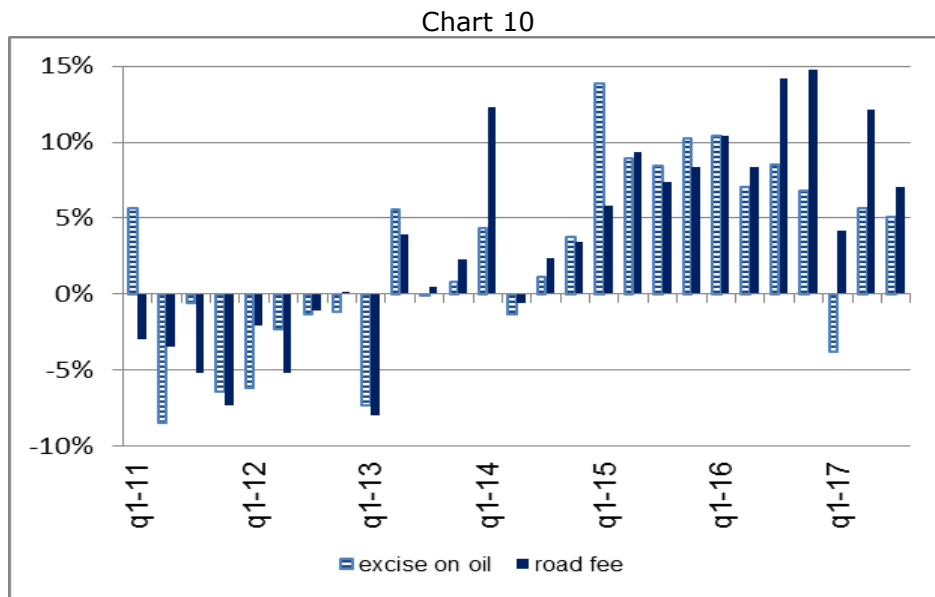
Chart 9



Similar trends in collection are also recorded in excise duty on oil derivatives (Chart 10). According to the ITA data the surplus on gross revenues from excise duties on oil derivatives for nine months amounted to 9,8 million BAM. Due to oil price growth in the world market, the fall in derivative consumption was recorded in the first quarter and a drop of 3,8% in collection of excise duty on oil derivative. Although the relevant international agencies forecast higher oil price growth in the world market, there was still price stabilization and then the fall in prices, which was further strengthened by the weakening of US dollar. The fall in derivative prices in B&H has had a positive impact on consumption and collection of excise duty in the second quarter when it was by 5,6%

higher. Growth of derivative consumption was also influenced by the growth of border and transit traffic with non-residents and stockpiling in the country due to constant discussions regarding the increase in excise duty on derivative. Growth in consumption continued in the third quarter while in September due to rising prices in the world market and the strengthening of the US dollar, there has been a growth in retail prices, fall in imports of derivatives and domestic consumption, and consequently, a drop in revenues from excise duties. This ultimately led to the growth slowdown to 5% in the third quarter and at the level of nine months to 2,6%.

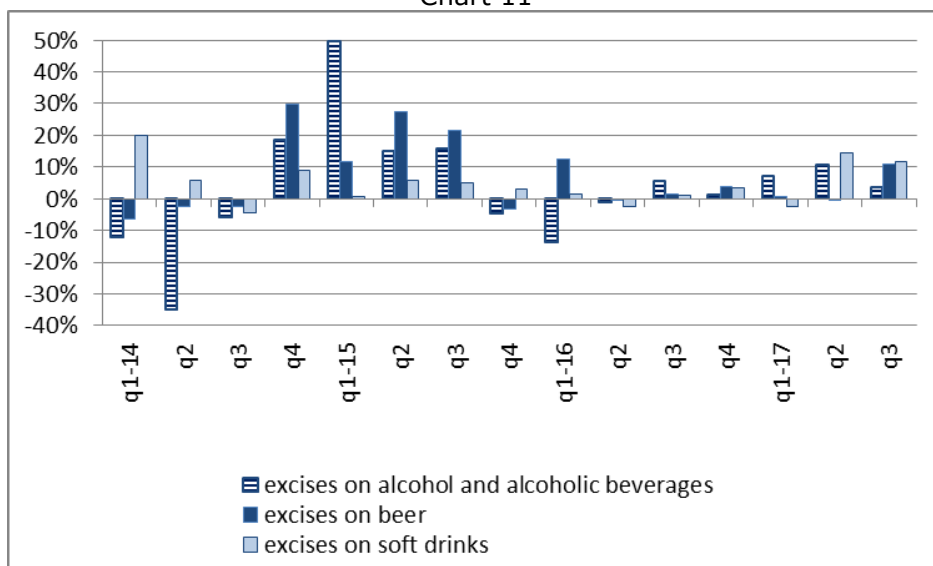
In contrast to excise duty on derivatives, revenues from road fees had a positive growth in all three quarters of 2017, but negative trends were reflected in the collection in September (Chart 10).



Quarterly analysis shows that revenues from excise duties on coffee are consecutively in the negative growth zone for four quarters and in the third quarter of 2017 they reached the collection level from the same quarter of 2016. This all suggests that trends in the collection are significantly below the collection from the previous years.

Trends in the collection of excise revenues on the product group beer, alcohol, alcoholic and non-alcoholic beverages are much better than in 2016. Excise revenues from alcohol and alcoholic beverages are continually in all three quarters in a positive growth zone with growth rates of 7%, 10,8% and 3,6% (Chart 11). Revenue growth in excise duties on non-alcoholic beverages was negative -2,6% in the first quarter but in the second and third quarters unprecedentedly high growth rates of 14,3% and 11,7% were achieved which can be related to the growth of cross-border and transitory consumption (Chart 11).

Chart 11



The collection of beer excises was affected by the fall in excise duty on imported beer which could not be compensated by the increase in collection of excise duties on domestic beer due to the small share of domestic beer in the B&H market. In the first quarter revenue growth of 0,6% was achieved but in the second there was a drop of 0,5%. However, in the third quarter a high growth rate of 11,1% was achieved due to the strong growth of domestic excise duties and the recovery of beer imports (Chart 11).

Growth factors of indirect tax revenue

Summing up the effects of the main factors of a strong indirect tax revenue growth in the period January – September 2017, it can be concluded that the total factor effect, with a one-off character, corresponds to 2,4 p.p. of indirect tax revenue growth (Table 1). The rest of 3,3 p.p. refers to the effects of import growth, the fall in oil prices in the world market, the growth of the economy and consumption, the increase of the collection efficiency and the slight reduction of cumulated debts on the basis of VAT.

Table 1

One – off growth factors	Estimated effects (p.p. of indirect tax revenue growth)
Unrealized estimates of customs revenue losses due to SAA+VAT adaptation	0,8 p.p.
Postponement of VAT refund payments	0,6 p.p.
External demand for tobacco products + VAT	1,0 p.p.
TOTAL	2,4 p.p.

III REVISED INDIRECT TAX REVENUE PROJECTIONS (2017-2020), OCTOBER 2017

Table 2: Revised projections (2017-2020)

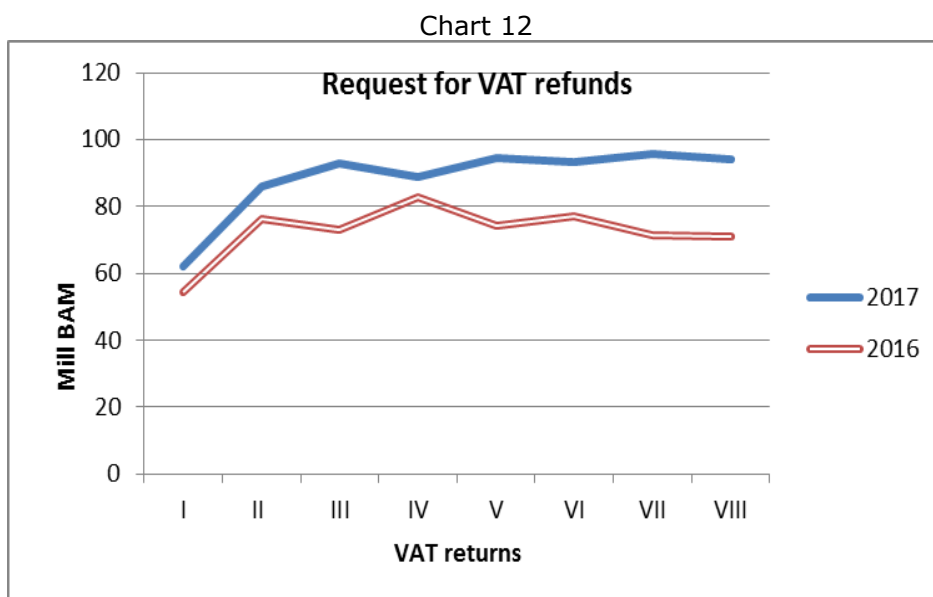
Type of revenue (net)	in million BAM					Projected growth rate			
	Execution	Projection							
	2016	2017	2018	2019	2020	2017	2018	2019	2020
VAT	3.433,8	3.621,9	3.770,5	3.933,2	4.113,1	5,5%	4,1%	4,3%	4,6%
Excise duties	1.448,9	1.497,1	1.514,2	1.533,8	1.581,5	3,3%	1,1%	1,3%	3,1%
Customs duties	248,2	272,0	288,7	306,3	325,3	9,6%	6,2%	6,1%	6,2%
Road fees	358,8	379,9	387,9	395,7	404,0	5,9%	2,1%	2,0%	2,1%
Other	41,0	41,2	41,4	41,6	41,8	0,5%	0,5%	0,5%	0,5%
TOTAL	5.530,7	5.812,0	6.002,7	6.210,6	6.465,7	5,1%	3,3%	3,5%	4,1%
Road fee (0,10 BAM/l)	143,5	152,0	155,2	158,3	161,6	5,9%	2,1%	2,0%	2,1%
FUNDS FOR DISTRIBUTION	5.387,2	5.660,0	5.847,6	6.052,3	6.304,1	5,1%	3,3%	3,5%	4,2%

3.1. Projections for 2017

Based on the trends of revenue collection, annual macroeconomic projections and the estimate of the effects of amendments to the Excise Law, the application of the adapted SAA and the Free Trade Agreement between B&H and EFTA, the projected net collection of indirect tax revenues for 2017 amounts to 5,812 billion BAM which is for 5,1% more than in 2016 (Table 2).

VAT

VAT collection went in the direction of April projections until August. The growing trend of VAT on imports, as a consequence of significant import growth, double above the March's DEP projections, was largely offset by the oscillating trend of domestic VAT. However, in September there was an enormous increase in VAT collection due to the cumulative effect of three factors: a high rate of import growth, a strong growth of domestic consumption and a delay in VAT refunds due to the extensive ITA controls. The effects of delaying refunds on the VAT net growth rate in September are estimated to be as high as 7 p.p. and at the level of nine months 1 p.p. An overview of amounts of VAT refund requests (Chart 12) indicates a deterioration of trends in VAT refund requests in the last three months. On the other hand, the chart shows how unrealistic refund payments to taxpayers were in September⁶.



Bearing in mind the continuation of the high growth of imports and exports, in the coming months a continuation of negative trend in refund requests can also be expected. In addition, increased refunds on international projects can also be expected as the end of the year is approaching. Given the magnitude of the effect of postponing VAT refund payments in September, administering refunds in the following months will be of major importance for the implementation of VAT revenue projections in 2017 and 2018 as well. If the ITA returns to the current refund pattern, without waiting for the final deadlines for VAT refunds, payments of outstanding refunds with increasing current refunds will significantly reduce the collection of indirect tax revenue in the fourth quarter of 2017. An important limiting factor for increased refund payments can be increasing foreign debt tranches due to be paid in the fourth quarter of 2017 and which, together with refunds, reduce the transfer of indirect taxes to Entities. In such circumstances, the Unit

⁶ According to the ITA preliminary report in September 73,3 million BAM was paid to taxpayers on the basis of VAT.

assumed that the ITA would, having in mind the interests of taxpayers, return to current refund payment pattern but progressively, meaning that the greater part of the effects of increased refund payments would affect net VAT collection in the fourth quarter of 2017 and the smaller part will be transferred in 2018.

Bearing in mind the aforementioned assumptions regarding refund payments and the expected continuation of the current positive growth trend of VAT on imports and domestic VAT above macroeconomic projections of DEP, VAT revenue growth in 2017 was projected in the amount of 5,5%.

Customs duties

Imports from third countries and imports of goods from the EU that are still under the customs regime determinate trends in customs revenue collection. The analysis of the effects of the application of the adapted SAA showed minimal losses of customs revenues from trade with Croatia which were compensated by the growth of imported goods from the EU under the customs regime. The current trends in import and customs collection from the EU and the third countries are expected to continue in the fourth quarter of 2017 so the customs revenue growth according to this assumption is projected in the amount of 9,6%. The projections also covered the effects of the implementation of the Free Trade Agreement between B&H and EFTA members in the period 2015-2017, which are not fiscally significant, given the small weight of the share of imports of these goods from EFTA members in total imports under the customs regime⁷.

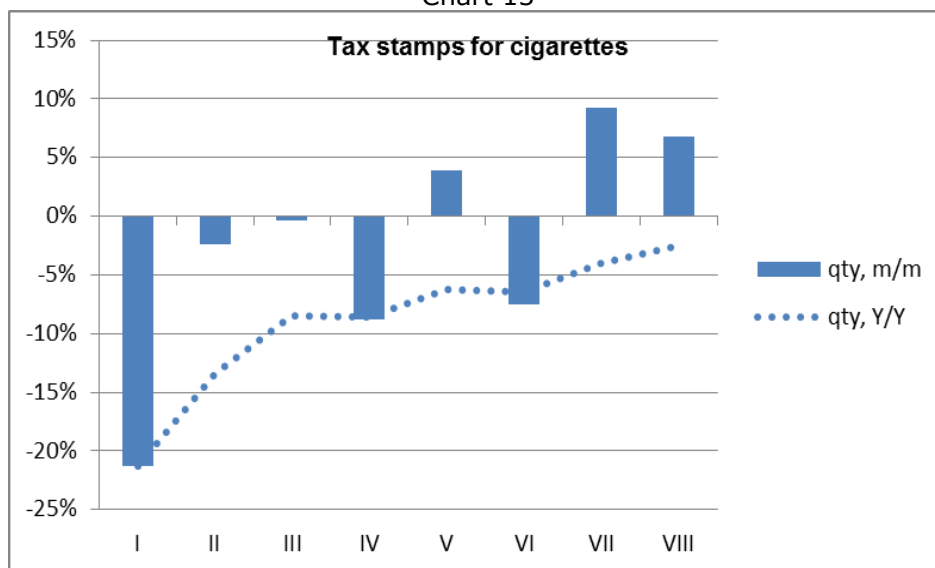
Excise duties and road fees

Excise revenues generate 17% of the planned surplus in 2017. Observed together with road fees this revenue group accounts 24,6% of the planned annual surplus of indirect tax revenue.

Projections of excise revenues on tobacco products are significantly revised upwards so most of the planned surplus from excise revenues is related to excise duties on tobacco products. The main reasons are positive trends in the tobacco market in the previous eight months which are reflected in the growth of cigarette market value by 5,1% and the fall in cigarette consumption by only 2,4% (Chart 13) although the average weighted cigarette price rose by 9,8%. Likewise, the cut tobacco market, due to external demand, grew by 16,9% and the amount of taxed cut tobacco by 7,9%, in spite of the increase in the excise burden.

⁷ According to the ITA data the share of customs revenue collected on goods imported from the EFTA members in the total amount of customs revenue collected in 2016 was 1,6%.

Chart 13



Projections for the fourth quarter are based on the assumption that the effects of the external factors which generated demand in the last few months are mostly used up and thus the growth of tobacco product revenues that have compensated for the strengthening of the black tobacco and cigarette market within B&H. The big unknown for the revenue projections like every year is also the business policy of tobacco companies before a new increase of the specific excise duty on 1 January 2018 in terms of the extent and the course of overcoming the new tax burden. Although the practice of previous years was that tobacco companies accumulated cigarette stocks by the end of the year due to increased demand of citizens, this did not happen last year because the companies decided to raise prices for the second or the beginning of the third quarter of the next year. Given that such policy proved to be a successful, the Unit does not expect a sharp withdrawal of excise stamps and stockpiling cigarettes in the fourth quarter of 2017. Keeping this in mind, a minimum increase in revenues from excise duties on tobacco products could be expected in the fourth quarter which should slow down the current growth rate for nine months of 2017.

Part of the projected surplus of excise revenues is also expected from excise duties on oil derivative. Turbulent fluctuations in oil prices in the world market during 2017 have generated oscillations in the derivative consumption and therefore in the collection of revenues from excise duties and road fees. Oil prices rose again in September and this trend continued in October causing a drop in excise and road fee revenue. Bearing in mind the forecasts of relevant international energy agencies in the short term, there should not be a price decline and therefore a significant recovery in the oil derivative consumption. In addition, the effects of external demand for derivatives, which in part also had a seasonal character (border and transit traffic, tourist season in Croatia), were also exhausted. Starting from the above assumptions in the fourth quarter it is expected a drop in derivative consumption and accordingly excise revenues which would annually lead to the growth rate slowdown within the frames of the domestic consumption growth. Similar effects are also expected in road fee revenue collection with the projected growth rate higher, in addition to the projected deceleration, due to positive trends in the road fee collection during 2017 which are the result of changes in the structure of oil derivative⁸.

⁸ See „Trends in the derivative market in B&H in the period January – June 2017”, MAU bulletin #146/147, September/October 2017, www.oma.uino.gov.ba.

Starting from positive current trends and macroeconomic projections, the surplus of excise revenue is also expected in the collection of excises on beer, alcohol, alcoholic and non-alcoholic beverages, but it is minimal in the nominal terms and not significant with respect to total excise revenue. Overall, the projected cumulative effect of the surplus on excise revenue in 2017 should bring the excise revenue growth rate of 3,3%.

3.2. Projections for 2018-2020

The projected revenue growth rates for 2018, 2019 and 2020 are 3,3%, 3,5% and 4,1% respectively (Table 2). Revenue projection in this period is based on projected relevant macroeconomic indicators, historical seasonal collection scheme and projections for individual revenue categories for 2017 and the effects of policy changes in the area of customs and excise duties on tobacco products.

The largest generator of surplus revenue from indirect taxes in that period is VAT, given its significant share in revenues and planned stable growth rates. Subsequently, excise duties on tobacco products, customs duties, excises on oil derivatives and road fees from derivative price are followed.

VAT projections monitor the movement of macroeconomic aggregates. It is expected the exhaustion of external factors which significantly increased the consumption in 2017 above projected consumption rates hence the collection of VAT revenues and revenues included in the base for the VAT calculation (customs duties, tobacco and derivative excises, road fees). Due to comparison with a higher statistical base, a modest increase in domestic VAT is expected, in line with historical trends. The planned growth of the economy and imports should also generate the VAT growth on imports and therefore gross VAT. Consequently, a gradual increase in VAT refunds is expected, especially in view of the planned growth of imports, exports and investments.

The projections of tobacco excise revenues in the period 2018-2019 are extremely conservative and based on current trends from the previous years as the year 2017 is not a reference year due to the strongly generated external demand for tobacco products. In addition, additional demand increased the statistical base for comparison. Significant increase in demand for cigarettes and tobacco also depends on B&H tax competitiveness in relation to the region. In the coming year, the tax competitiveness of B&H in relation to the region will weaken due to the increased tax burden, which will lead to a rise in cigarette and tobacco prices and in relation to Croatia, and due to the fact that in 2017 Croatia finishes the harmonization process and every subsequent excise increase in B&H reduces price attractiveness of cigarettes from B&H for Croatian citizens in border zones as well as for other non-residents. Similarly, external demand for tobacco products is partly indirectly generated by B&H tax competitiveness in the oil derivatives sphere. The eventual growth of oil derivatives prices caused by rising oil prices in the world market and/or by increasing excise duties will weaken B&H attractiveness for border and seasonal shopping or as transit country, which is indirectly reflected in the purchase of cigarettes, tobacco and other consumer goods.

In such circumstances, the growth of a specific excise duty in accordance with the Excise Law will also in the coming years exert strong pressure on consumers to migrate from the regular to black market of tobacco products. Further reductions of regular consumption are expected due to the rise in tax burden. In the context of the strengthening of the black market and the expectation that the increase of the excise burden in B&H will jeopardize the price competitiveness of cigarette and tobacco in relation to the environment, it is expected that the regular tobacco products market in B&H will at best grow in line with private consumption trends. This would have resulted in the minimal increase in excise revenue on tobacco products, with a growing tax burden and a fall in consumption that is consistent with the elasticity of cigarette consumption in developing

countries. Reduction of consumption outside the project can only be stopped by more vigorous measures to combat black market and smuggling, revise tobacco taxation policy and to increase citizen income.

According to the existing dynamics of cigarette retail price growth and planned dynamics of specific excise duty growth in line with the existing Law, the completion of B&H excise harmonization process with the minimum EU standards is expected in 2019. Therefore, in 2020 it is expected a stabilization of tobacco products market in terms of consumption. In such circumstances growth of excise revenue is projected in line with macroeconomic projections of consumption growth.

Projections of excise duties on derivatives and road fees in the period 2018-2020 have been made on assumptions of stopping the trend of strong growth rates of consumption due to the exhaustion of external factors that generated the growth of previous years and the deterioration in the world oil market. Extremely high growth rates of excise revenues from oil derivatives and road fees may be partly considered as a consequence of global political crisis that produces turbulences in the world oil market and partly as a result of transit position and tax competitiveness of B&H in relation to the environment. Given the latest negative prognosis⁹ regarding oil price fluctuations in the world market in 2018, the reduction or at least stagnation in consumption may be expected, primarily of diesel and heating oil. Trends from previous years show that the consumption of derivatives in B&H is not dependent only on domestic consumption, but also on regional tax competitiveness of B&H. Given the high statistical base¹⁰ and expecting that it will not come to a significant deterioration in regional competitiveness, growth rates of excise revenues and road fees should at the best move in the next three years in line with the growth of economy and consumption.

Customs duty projections are made in accordance with the planned import growth rates and the structure of imports to the countries of origin (EU, third countries).

⁹ Source: EIA, 11 October 2017 release.

¹⁰ Estimated excise revenues on oil derivatives in 2017 are by 21% higher than the average excise revenues collected in the period 2009-2014, which does not correspond to the growth of economy and consumption in B&H.

IV DIFFERENCES IN RELATION TO APRIL PROJECTIONS

The difference between revised projections compared to those made in April 2017 are the result of current trends in revenue collection, overestimated customs revenue losses due to the application of the adapted SAA, as well as expansion of cross-border and transit traffic and impacts of seasonal factors (tourist season) cumulatively leading to the growth in external demand for goods (oil derivatives, tobacco products, consumer goods). An important external revenue growth factor was also the stabilization of oil prices in the world market. The import growth that determined the VAT growth was twice as large as projections (DEP). Finally, certain differences arise from the slowdown of VAT refund payments due to extensive controls. Revised macroeconomic projections of DEP from September 2017 in terms of economic growth are pessimistic (Chart 14). This is similar to the projections of imports and exports, with great discrepancies. Revised projections of consumption are significantly below projections from March 2017 for all years in the planning period.

Table 3

Difference in relation to projections from April 2017 (in million BAM)	Projection			
	2017	2018	2019	2020
VAT	55,4	71,2	60,5	38,6
Excise Duties	70,6	84,0	105,2	147,1
Customs Duties	42,1	52,1	48,3	49,2
Road Fees	17,5	15,7	13,4	11,4
TOTAL	185,7	223,0	227,4	246,2

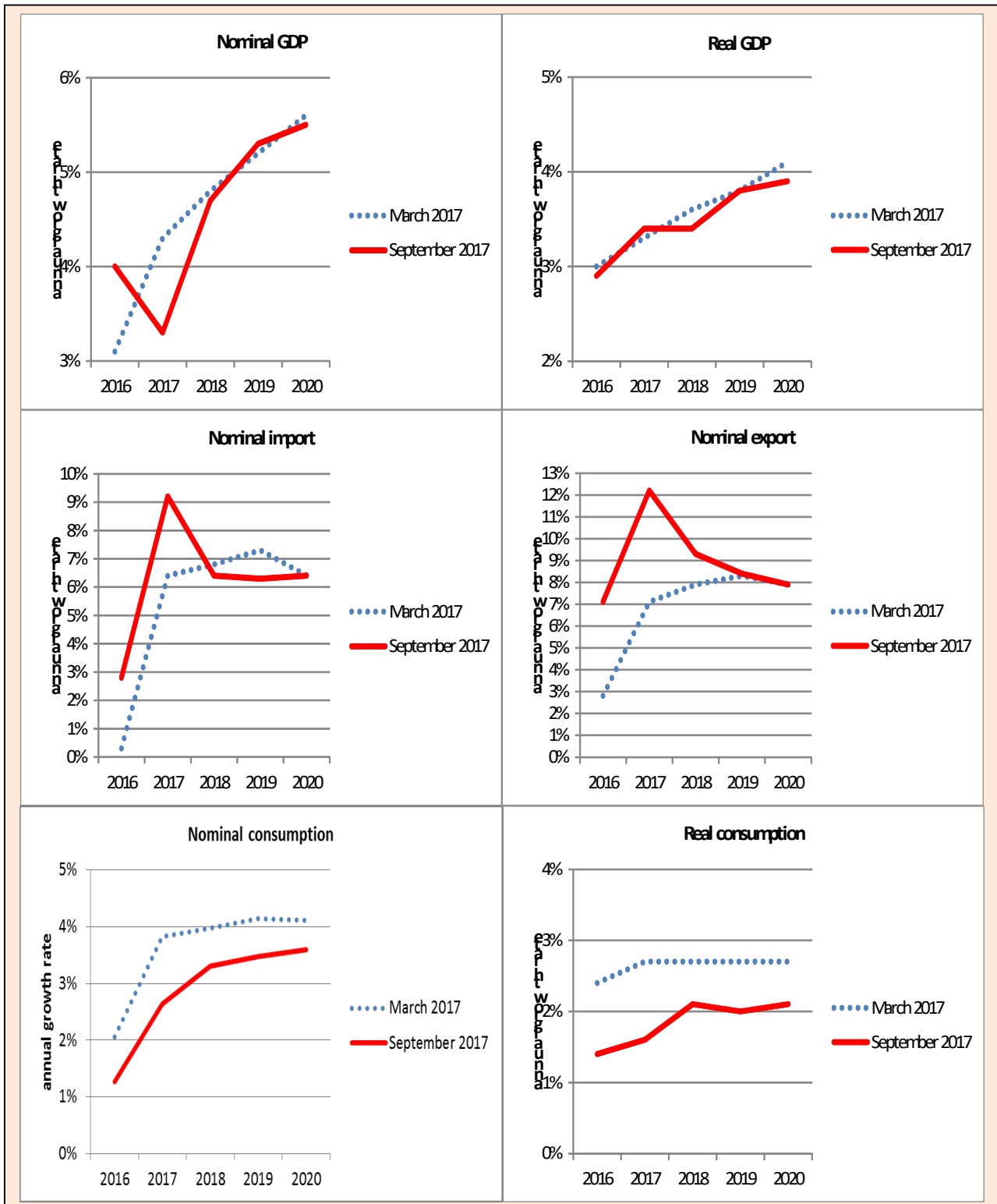
4.1. Projections for 2017

Due to current collection trends and changes in macroeconomic projections (DEP), the indirect tax revenue projections for 2017 were corrected by +185,7 million BAM (Table 3).

VAT

Revenues from VAT increased by 55,4 million BAM. It should be borne in mind that the April projections of VAT on imports were made with a special degree of caution, given the negative trends in the first quarter of 2017. An important factor of VAT growth was imports which increased twice as fast as the March projections (DEP), and the current growth rate exceeds the September projections for imports (DEP). Given that the import VAT is the dominant component of gross VAT, the greater deviations in collection compared to projections reflect on the overall VAT collection as well. In this respect, the correction of VAT on imports was upgraded in line with current trends. Additional revenue growth from VAT is the result of an unexpected surplus in collection of revenue from customs duties and excises/road fees. Given that customs duties and excises/road fees are included in the VAT base, a significant amount of VAT revenues is collected representing up to 40% of the difference between the revised VAT projection and the April projection. Corrections were lowered for VAT refunds due to the postponement of VAT refund payments that changed the normal payment dynamics.

Chart 14



Source: Projections of Directorate of Economic Planning (March and September 2017)

Customs Duties

Revenues from customs duties were upgraded by up to 42,1 million BAM. The first reason is more positive current trends in collecting revenues from customs duties on goods from third countries and goods originating in the EU that remained under the regime of customs in 2017 in relation to imports projections. The second factor for correcting customs duties is the assessment of customs revenue losses due to the application of the adapted SAA that has not been achieved.

Excise Duties and Road Fees

The largest correction in the projections for 2017 was made on excise duties revenue in the amount of 70,6 million BAM, with the largest share in corrections having excise duties on tobacco products.

During the April projections of excise duties on tobacco products the starting point was negative trends in 2016 and in the first quarter of 2017, the current elasticity of cigarette consumption in the conditions of continuous growth in retail prices due to increased tax burden, increased substitution of cigarettes by cut tobacco from legal and illegal production and tax evasion because of the strengthening of the black market. However, the effect of the expansion of cigarette and cut tobacco demand in border, transit and tourist traffic has neutralized all negative input assumptions of the April projections.

During the April projections of excise duties on oil derivative the starting point was negative current trends in the first quarter caused by the rise in oil prices in the world market and the poor forecasts of oil price movements by relevant international energy agencies. The fall in oil prices in the world market caused the growth in the consumption of oil derivatives in B&H which was further increased by the external demand of oil derivatives by non-residents due to the price competitiveness of oil derivatives in B&H compared to the region. From the same reasons, correction was upgraded for road fee revenues in the amount of 17,5 million BAM.

4.2. Projections for the period 2018-2020

Projections for 2016., 2017. and 2018. are revised upwards by 223 million BAM, 227,4 million BAM and 246 million BAM, respectively. Correction of projected amounts of revenues for the given period is partly a result of correcting the projected amounts for 2017, which are the basis for their development. The smallest corrections are made on VAT revenues as revised macroeconomic projections from September 2017 (DEP), mostly regarding consumption and imports, are more pessimistic than in March 2017 (Chart 14). Significant adjustments are made to customs revenues whose April projections were reduced for the estimated effects of the application of the adapted SAA. Finally, the biggest corrections of projections were made in revenues from excise duties and road fees, which are the result of correcting projections for 2017 and the latest forecasts by international energy agencies on oil price movements in the world market that are more favorable than the spring forecasts. The high difference in the projections of excise duty revenues in 2020 is a consequence of the assumption that the process of harmonization of excise duties on cigarettes in B&H with minimum EU standards will be completed in 2019, which should bring the stabilization of the cigarette market in B&H and the growth in excise duty revenues in line with the increase in consumption and income.

V RISKS FOR PROJECTIONS

Given the basic set of projections of indirect taxes and overall economic conditions in B&H and in the world, the realization of the projected level of indirect tax revenues in the period 2017-2020 is subject to the following risks

- Projections of indirect tax revenues are closely related to the projections of macroeconomic indicators of DEP. Any deviation of these parameters from the projected value represents the risk for revenue projection;
- The weak economic recovery of the main export partners of B&H (EU, CEFTA countries) increases the level of risk for achievement of macroeconomic projections, and thus projections of indirect tax revenues as a whole;
- Strengthening of the black market of tobacco products, caused by the faster growth of the tax burden on cigarettes in B&H compared to the countries in environment, can jeopardize the execution of projections of revenues from excise duties on cigarettes;
- Decrease in regional tax competitiveness due to the deterioration of indirect tax policies in B&H (growth of the specific excise duty on tobacco products, possible increase in oil derivative excise duty and/or increase in VAT rate, lower excise rates in the environment) leads to a reduction in external demand (border, transit, tourist) for oil derivatives, cigarettes and cut tobacco as well as for other consumer goods and accompanying services (catering, hotel, tourist,...) which could jeopardize the collection of revenues from indirect taxes;
- The appearance of external shocks, in view of rising oil prices and derivatives in the world market beyond current expectations, will hit the market of derivatives in B&H and will negatively affect the derivative consumption and thus the execution of projections for revenues from excise duties on derivatives and road fees from the price of oil derivatives.