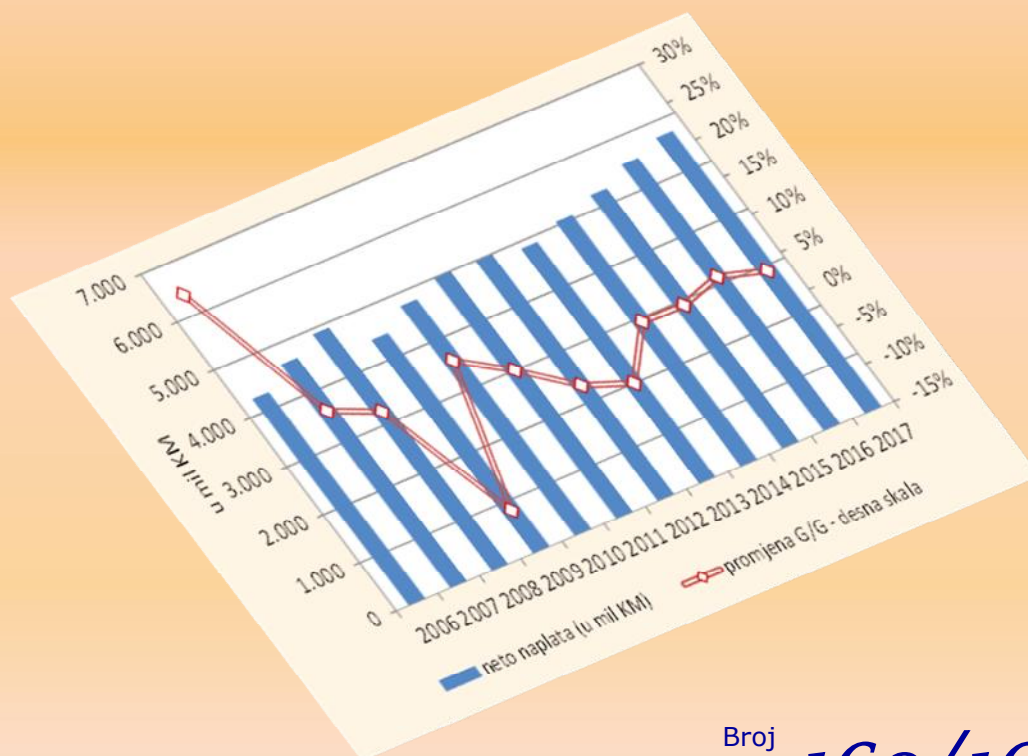




Macroeconomic Unit of the Governing Board of the Indirect Taxation Authority

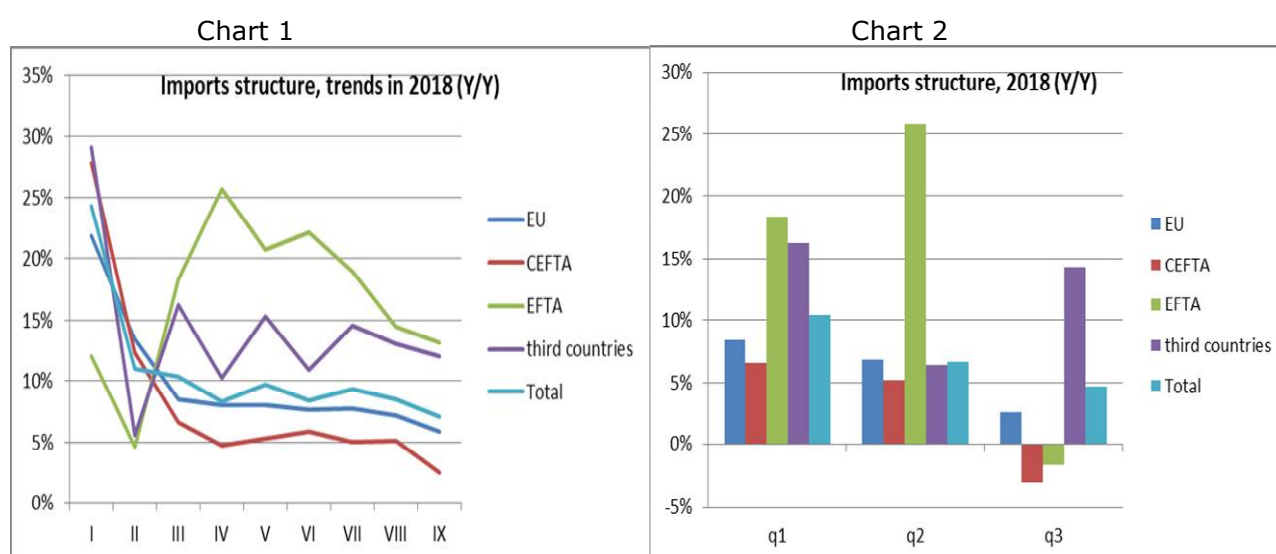
# ОМА Билтен



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Number **160/161**

## With this issue

Revenues charged on imports (VAT, customs, excises, road tax) in gross collection make 2/3 of total indirect tax revenue. Due to the strong correlation of imports and VAT refunds, the dynamics of imports is of great importance for the net collection of indirect taxes, and therefore for the financing of all levels of government in B&H. Projections of the revenues from customs depend on the dynamics of imports from the third countries, as well as of import of goods from the EU which is under the customs regime. Nevertheless, the last phase of liberalization which implied the application of the Adapted Stabilization Agreement with the EU as of 1<sup>st</sup> February 2017, did not, as expected, lead to a fall in revenues from customs duties, but on the contrary, brought an increase of 8,4% in 2017, and of 7% for the first nine months of 2018. Positive trends have also been recorded in the collection of revenues from VAT and in excises on imports (more information available in Bulletin).



Source: Agency for statistics of B&H, own calculations

Despite the positive trends in the collection of import duties, according to the data on imports of goods provided by Agency for Statistics of B&H, a significant slowdown of imports growth has been noted in all major groups - trade partners of B&H in the period from January to September 2018 (Chart 1). On the other hand, quarterly analysis shows a strong growth in imports from the third countries in the third quarter (Chart 2). Since the highest quarterly customs revenue growth in 2018 was recorded in the third quarter of 2018, it is clear that the strong growth in imports from the third countries completely neutralized the slowdown in imports from the EU.

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Head of Unit

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## REVISED INDIRECT TAX REVENUE PROJECTIONS 2018-2021

### I ASSUMPTIONS

Indirect tax revenue projections for the period 2018-2021 imply baseline projections.

The assumptions for drafting the projections are as follows:

- Forecasts of macroeconomic indicators by Directorate of Economic Planning (DEP) for the period 2018-2021 from September 2018;
- Amendments to the Excise Law in force since 1<sup>st</sup> February 2018.<sup>1</sup>
- Continuation of harmonization of excise duties on cigarettes with EU standards and the application of the new taxation policy on fine-cut tobacco<sup>2</sup>;
- Effects of the application of the adapted Stabilization and Association Agreement (SAA) in force since 1 February 2017.<sup>3</sup>;
- Current trends in indirect tax revenue collection.

The policy of excise duty on tobacco in 2018 is determined by the Excise Law and the ITA GB Decision<sup>4</sup>. The policy of excise duty on tobacco in the period 2018-2019 includes continuous annual increase in the specific excise duty on cigarettes of 0,15 KM 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 ITA preliminary cash flow report on the SA, it was collected 677,3 million KM of gross revenues from indirect taxes in September, which is an increase of 35,6 million KM compared to September 2017. Due to increase in refunds, the net effect of indirect tax revenue collection amounted to KM 26,5 million. At the level of nine months of 2018 gross revenues from indirect taxes were higher by 401,3 million KM or by 7,7% compared to the same period of 2017. At the same time, the refunds increased by 92,3 million KM or by 9,9%. Finally, it was collected 309 million KM more net revenues in the nine months than in the same period of 2017, which represents a growth of 7,2%. The quarterly comparison of 2018 collection with the collection from 2017 shows a positive trend, which is expected, since the collection of indirect tax revenues in 2018 also includes the effects of amending the Excise Law applicable from 1 February 2018. However, the quarterly analysis shows a slowdown in the collection of indirect taxes (Chart 1). In the first quarter revenue growth amounted 10,7%, in the second 8,9%, while in the third amounted a modest 2,9%.

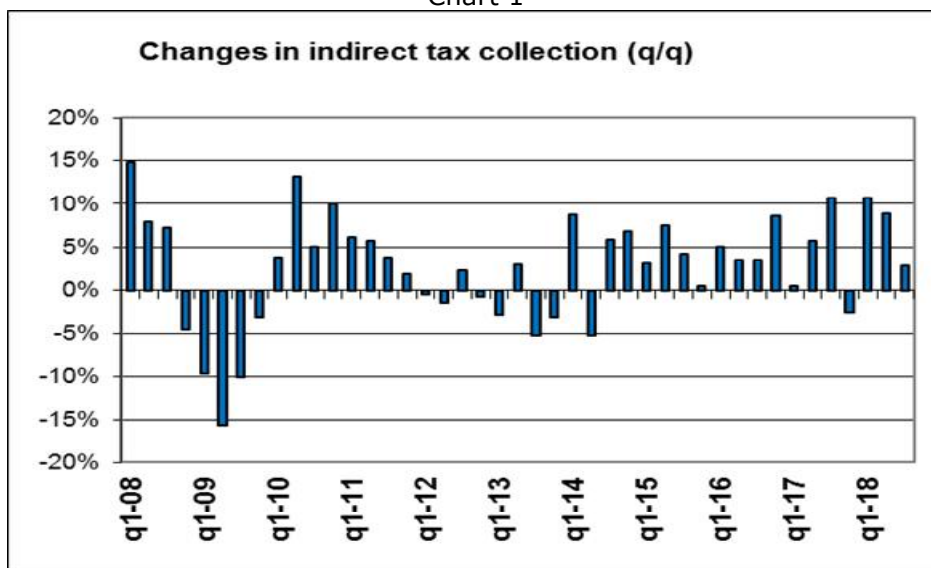
<sup>1</sup> Official Gazette of B&H, No. 91/2017

<sup>2</sup> 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)

<sup>3</sup> Given the formal start of implementation and problems in the initial phase of implementation, the adaptation of SAA was reflected in the revenues from customs only in the first quarter of 2018.

<sup>4</sup> Decision on Determination of the Specific and Minimum Excise Duty for Cigarettes and Amount of the Excise Duty for Smoking Tobacco in 2018 (Official Gazette of B&H, No. 84/2017).

Chart 1



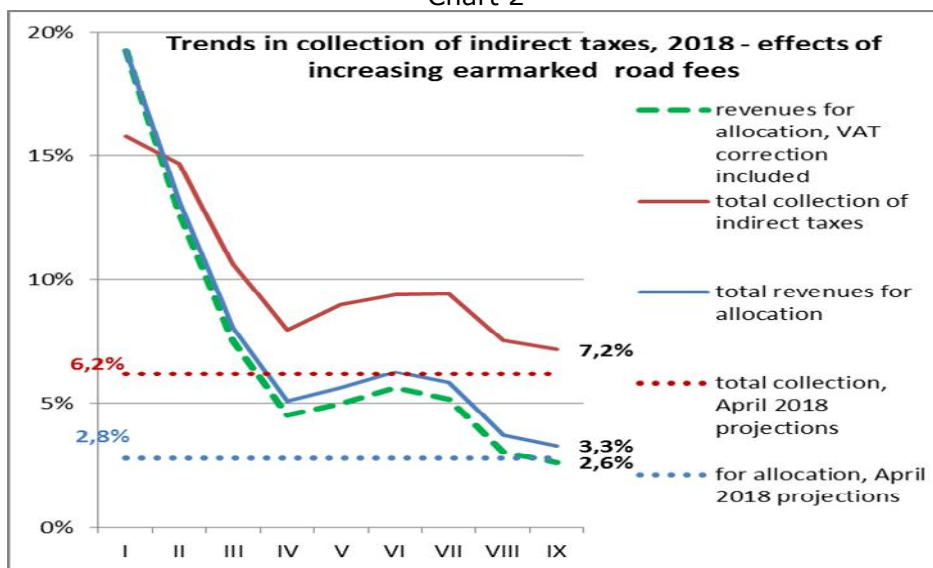
In order to ensure the comparability of the collection of indirect tax revenues in 2018 with the collection in 2017, for the purpose of the analysis, it is necessary to completely exclude the collection of earmarked road tax, given that almost all the effects of the amendment of the Excise Law (effective from 1 February 2018) refer to the earmarked road tax.<sup>5</sup> The amount of revenue after exclusion of the earmarked road tax represents revenue transfers to the budgets of the institutions of B&H, the Entities and the District ("funds for distribution").

After exclusion of the earmarked road tax collection from the amount of total indirect taxes collected in 2017 and 2018, the growth of funds for distribution in the period January - September 2018 compared with the same period of 2017 amounted 3,3%, which is 0,5 percentage points more compared to the Unit projections of annual growth rate from April 2018 (Chart 2).

Since the effects of the Excise Law changes include the amount of VAT charged on the additional earmarked road tax, after excluding this effect the growth rate of the funds for distribution amounted 2,6%. Consequently, it can be concluded that the amendments to the Excise Law brought 4,6 percentage points of the increase in indirect tax revenue.

<sup>5</sup> Amendments to the Excise Law also include an increase in excise tax on heating oil. A structural analysis of the taxed oil derivative for six months showed that the growth of excise taxes on the imported heating oil was completely annulled by the fall of excises charged on heating oil produced in B&H.

Chart 2



## 2.2. Collection by type of revenues

The analysis by types of revenue was made on the basis of the structure of revenues that includes adjusted<sup>6</sup> cash revenues from indirect taxes collected in the period January - September 2018, as well as revenues collected by offsetting liabilities by indirect tax claims. This analytical approach was necessary due to the frequent compensation of the liabilities for excise taxes on oil derivatives and for road taxes by the VAT claims (tax credits) during 2018. Given that these are significant amounts, the use of only cash flow would unjustifiably reduce the collection of excises while, on the other hand, the VAT collection would have been unjustifiably increased for the amount of offset revenues. After correction of the offset amount, the largest nominal effects were realized in the collection of the road tax (177,9 million KM), then in VAT collection (117,7 million KM) and in customs (13,7 million KM). On the other hand, the drop in excise revenues amounted 9,5 million to KM.

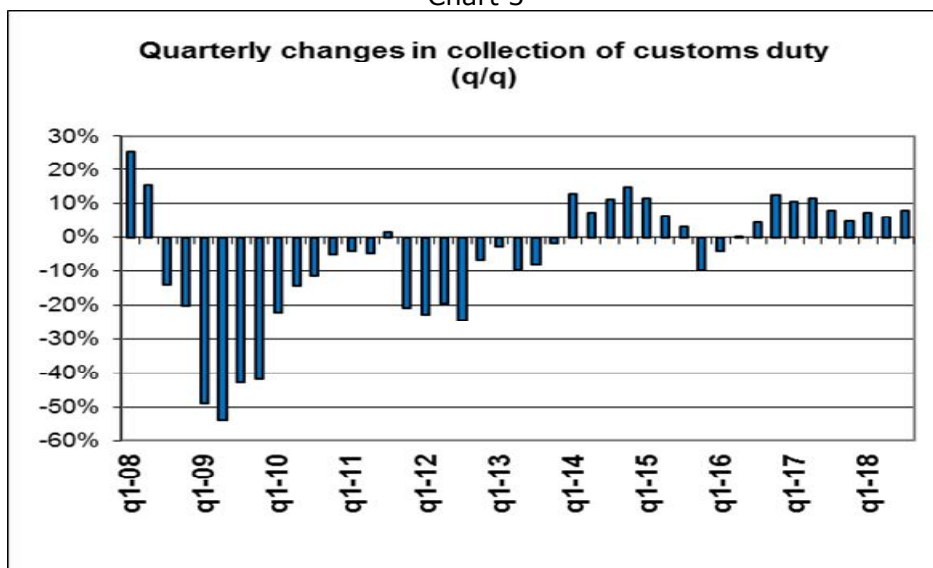
### Customs

Positive trends in collecting revenue from customs have lasted nine months in continuity, starting from July 2016, which is a surprise given the assessment of fiscal losses due to the application of the adapted SAA with the EU. The first quarter of 2018 brought a growth of 7,2%, the second 5,9%, and the third 7,8%. Continued increase in customs revenues is the result of the growth of imports from the EU in the part of goods that remained under the customs regime, as well as of imports from Asian countries, and the recovery of imports from Russia.<sup>7</sup>

<sup>6</sup> The analysis does not include 29,4 million KM of unadjusted revenue.

<sup>7</sup> According to the Agency for Statistics of B&H, in the period January-August 2018 imports from Asian countries increased by 10,7%, wherein the imports from China grew at a rate of 13,4%. There were also recorded strong growth rates of imports from Russia (28,7%) and from the EU (6,7%). Source: [www.bhas.ba](http://www.bhas.ba).

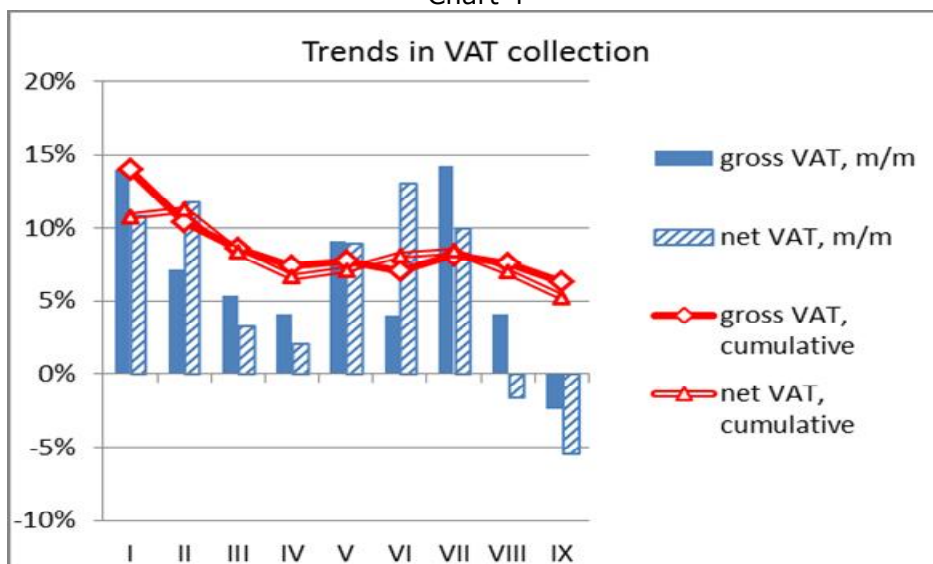
Chart 3



## VAT

The collection of net VAT revenues in the period January-September 2018 is characterized by high growth rates. In the first quarter, the high growth rates of net VAT partly resulted from delay in refund payments due to the introduction of new VAT software. High growth rates were also influenced by the increase in the earmarked road tax rate, as well as by offsetting the excise and road tax liabilities by VAT credits. The growth slowed down in the third quarter due to rising refund payments, especially in August and September, when the VAT net collection fell by -1,6% and -5,5% respectively. The lower net VAT collection in the third quarter led to a slowdown in the cumulative growth rate of net VAT, which remained at 5,2%.

Chart 4

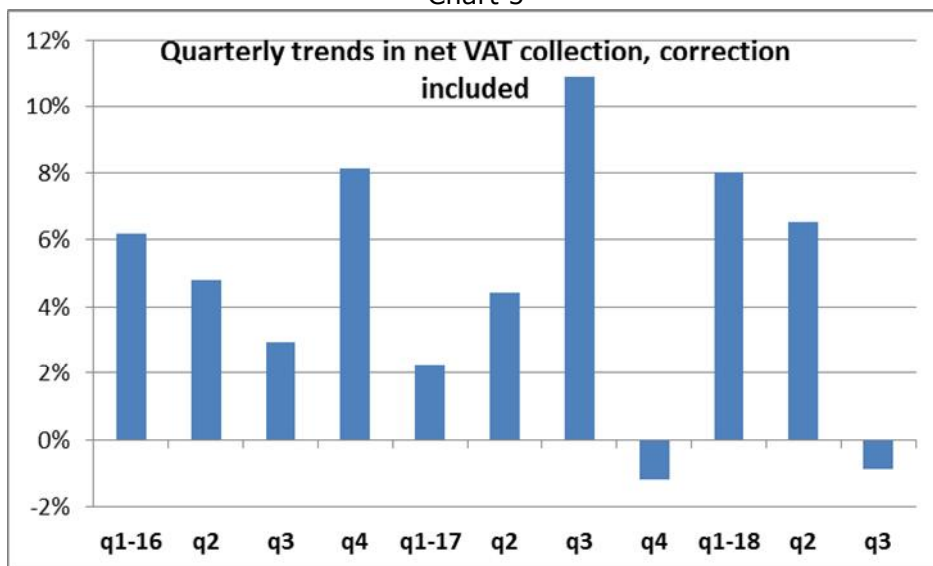


Quarterly comparison after correction of the collection for the offset of excises on oil derivatives liabilities by VAT credits shows a negative growth in the third quarter (Chart 5). In the first quarter net VAT growth was 8%, in the second 6,5%, while in the third quarter of 2018 there was



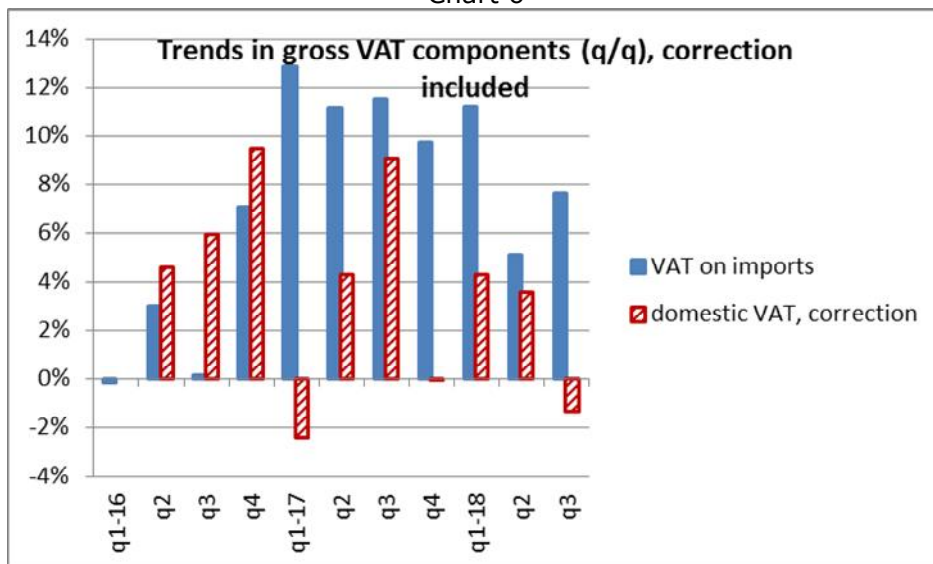
a decrease of 0,8%. The adjustment of unadjusted revenues is expected to annul the third quarter net VAT deficit and to bring a slight growth of the cumulative rate.

Chart 5



The analysis of the gross VAT components points to positive movements in VAT on imports, while domestic VAT, after correction, shows a downward trend. In the period January-September 2018 VAT on imports grew at a rate of 7,8%, while domestic VAT grew at a rate of 2%.

Chart 6



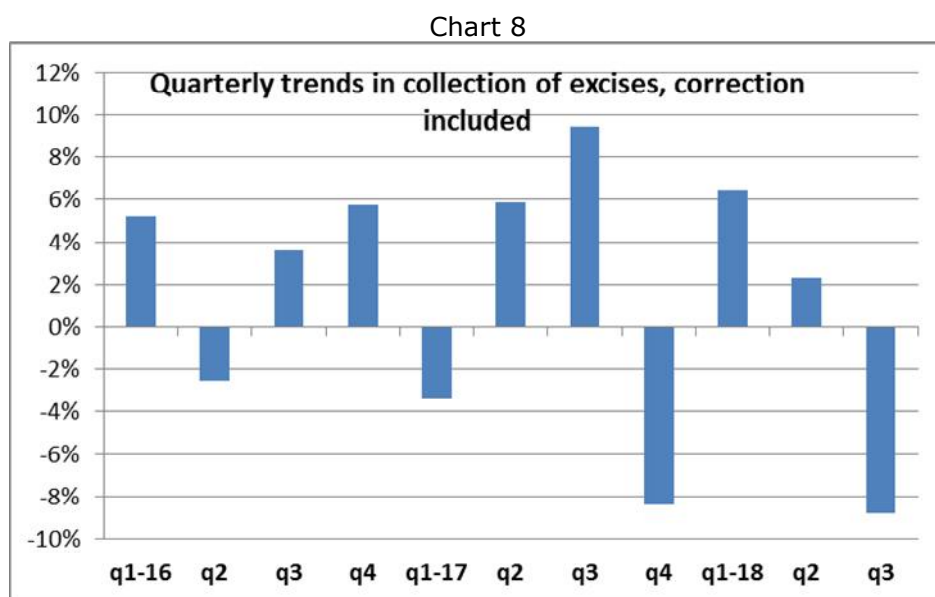
Quarterly analysis shows constant high growth rates of VAT on imports of 11,2% in the first quarter, 5,1% in the second and 7,6% in the third quarter of 2018 (Chart 6). On the other hand, after the growth of domestic VAT in the first and second quarters of 4,3% and 3,6% in the third quarter there was a fall of 1,3%. The adjustment of unadjusted revenues is expected to annul the deficit in domestic VAT from the third quarter.

VAT refund payments in September 2018 were 11,8% higher than in the same month of 2017, which increased the cumulative growth rate of refunds to 9,5%. At the level of nine months of 2018, it was paid to taxpayers 116 million KM more than in the same period in 2017, while refunds for international organizations decreased by 24,4 million KM in comparison with the nine months of 2017. Quarterly analysis of VAT refund shows a moderate growth of 9,3% in the first quarter, a slight decrease of 0,3% in the second quarter, and a strong growth of 20,2% in the third quarter (Chart 7).

### *Excises and road tax*

The collection of excise revenues<sup>8</sup> in the period January-September shows a sharp drop in comparison to the initial high growth of 20% in January, which was partly generated by increased procurement of oil derivatives prior to the increase in retail prices after entering into force the amendments to the Excise Law. Excise revenues recovered in the middle of the year, and then fell in the last three months. Negative trends in monthly collection have led the cumulative collection in a negative growth zone, with a fall of 0,8% for nine months.

Quarterly trends in total collection of excises show a sharp downward trend. Positive collection was realized only in the first quarter, when a growth of 6,4% was recorded. There was deterioration already in the second quarter, when the amount of collected excise revenues exceeded the collection from the same quarter of 2017 by only 2,3%. The deterioration in the collection of excises escalated in the third quarter, when decrease of 8,8% was recorded (Chart 8).

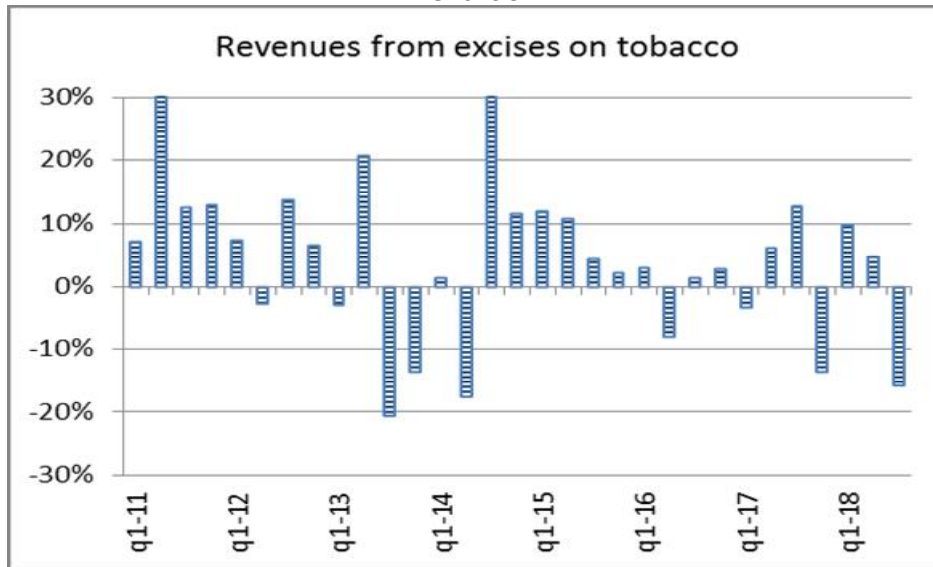


The collection of total excise revenue is determined by the collection of excises on tobacco products, since they have the highest share in collected excises. In the first quarter of 2018, there was an increase of 9,6% in excises compared to the same quarter of 2017 (Chart 9).

<sup>8</sup> The analysis of the collection of total excises, excises on oil derivatives and road taxes was made after correcting upwards for the amount of revenue collected through offsetting by VAT credits.

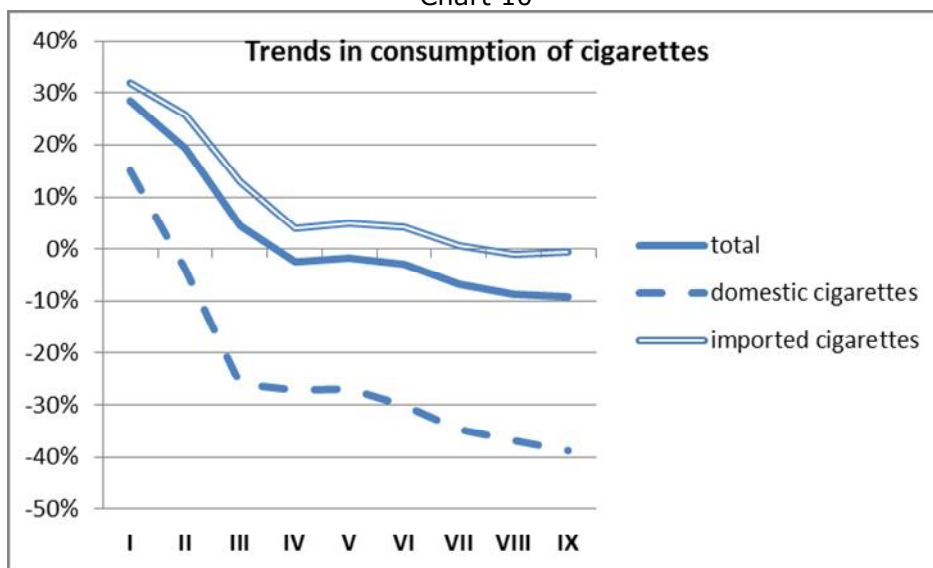


Chart 9



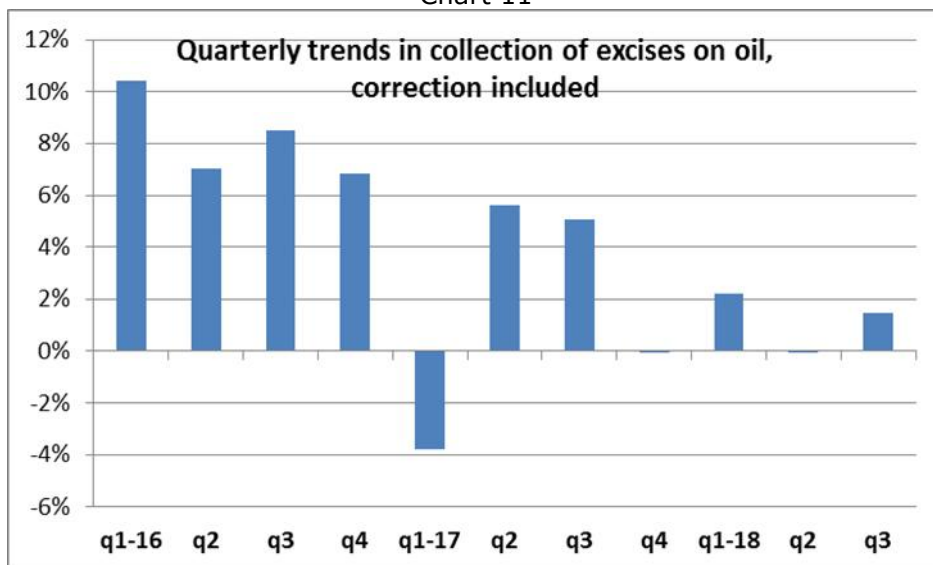
The reason is the delay in the increase in retail cigarette prices, which was common in previous years after the increase in excise on cigarettes at the beginning of the year. Postponement of the shifting the additional tax burden to retail prices has led to the growth of cigarette sales, and thus the increase in revenues. However, the period in which the tobacco companies have borne the additional tax burden at the expense of their profits lasted shorter than in 2017. The fall in consumption measured by the number of issued excise stamps for domestic cigarettes has escalated already in March, and has been deteriorating continuously throughout the year. It is evident that the domestic tobacco industry lost even 38,8% of sales in the period of nine months of 2018 (Chart 10). On the other hand, positive trends in the consumption of imported cigarettes from the first months continued in the second quarter, although with lower growth rates, thereby compensating for losses on excises on domestic cigarettes. However, the importers significantly reduced the withdrawal of excise stamps in the third quarter so, at the nine-month level, the sale, expressed in number of issued excise stamps, was by 0,6% lower than in the same period of 2017. These trends resulted in a 15,8% drop in excise revenues in the third quarter.

Chart 10



In the structure of the collected revenues from excise tax on oil derivatives 6,2% was collected by offsetting liabilities and VAT credits and the rest by cash payments.

Chart 11

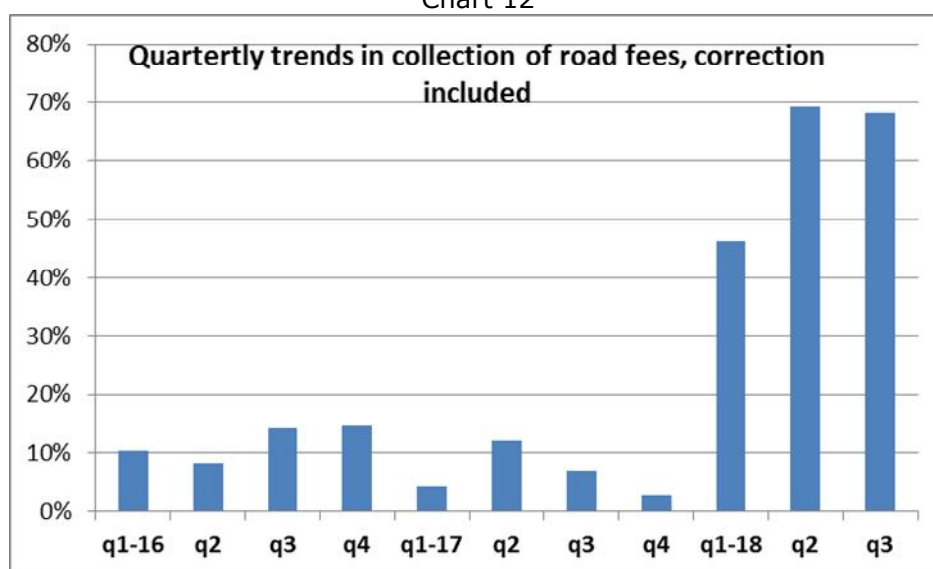


In the period January - September 2018, excise revenues on oil derivatives increased by 1,5%. In the first quarter revenues increased by 2,2%, in the second quarter they were at the level of the same quarter of 2017, and in the third quarter they grew by 1,5% (Chart 11). It was expected that the cumulative negative effects of the increase in tax rates on oil derivatives after the recent amendments to the Excise Law and the rise in oil prices on the world market would lead to decline in the consumption of derivatives in B&H, and thus in the collection of excise revenues. The analysis of the derivative structure for the first six months showed an increase in the quantities of imported diesel and a fall in gasoline consumption. There was also recorded an enormous increase in kerosene quantities of 58%, and a strong decrease in the quantities of heating oil of 30%. These trends can be explained by the tax attractiveness of the kerosene on which road tax is not levied, as well as by additional taxation of heating oil after 1 February 2018 and by enhanced

controls of the usage of heating oil by the ITA and entity inspections. It should be borne in mind that data on the structure of oil derivatives do not have to be fully in line with the consumption, since they don't represent sold quantities of oil derivatives, but the imported.

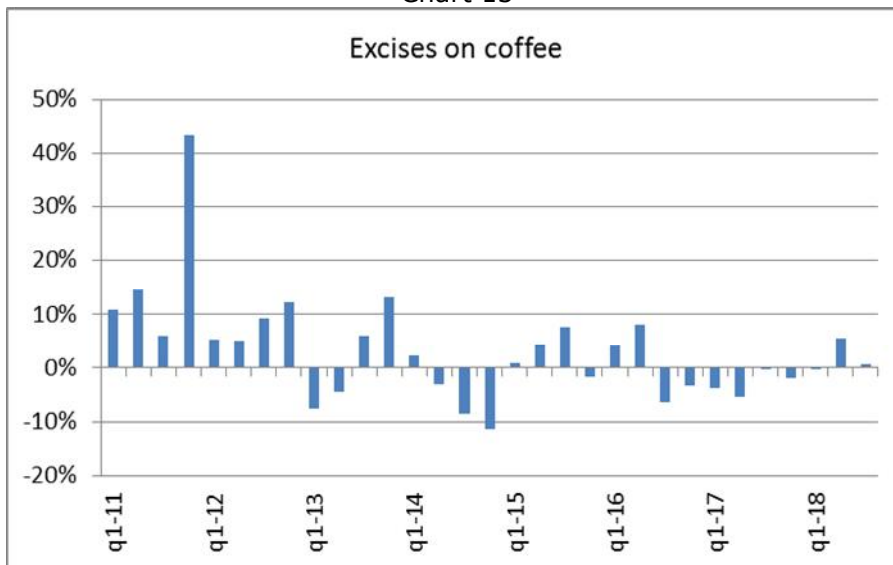
The strong growth in road tax revenue in 2018 was expected due to the increase in the rate of earmarked road tax as of 1 February 2018. The cumulative growth rate of road tax revenue in the period January-September amounted 62,7%. Given that additional earmarked road tax has been collected since February, and on domestic derivatives based on excise tax return since March, the growth rate of revenues from road taxes in the first quarter amounted 46,4%, while very high growth rates of 69,4% and 68,2% were achieved in the second and the third quarter (Chart 12). The growth rates levels above the increase in tax burden can be explained by the increase in quantities of imported diesel as well as by introduction of road tax on liquid petroleum gas as of 1 February 2018.

Chart 12



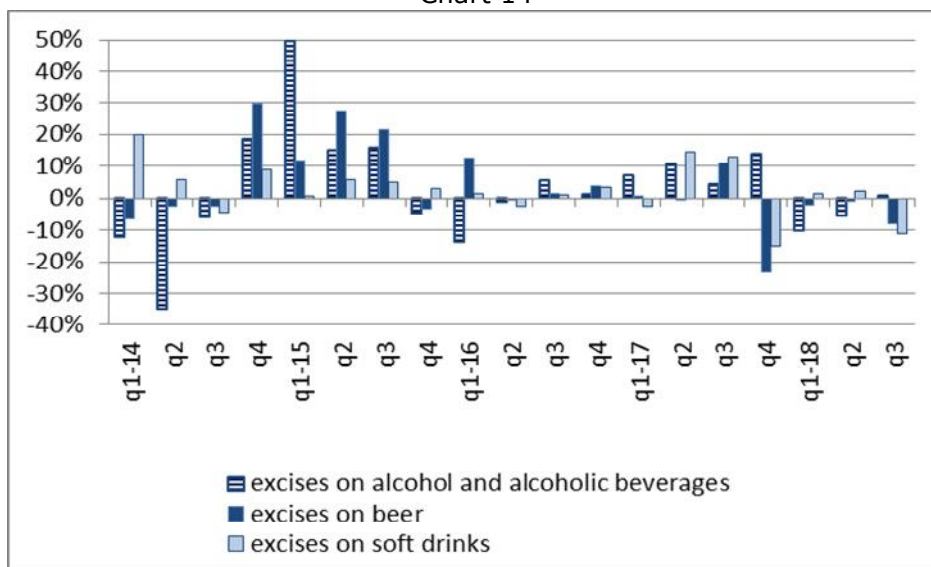
The collection of excises on coffee in the period January-September of 2018 was higher by 2% compared to the collection in the same period of 2017. The quarterly analysis shows that in the first quarter a minimum decrease of 0,3% was achieved, while in the second and third quarters a growth of 5,6% and 0,6%, respectively, which represents a positive trend after seven consecutive quarters with a fall in revenues (Chart 13).

Chart 13



Positive trends in the collection of excise taxes on alcohol and alcoholic beverages continued in September, which alleviated former negative trends, while, on the other hand, trends in the collection of excises on beer and non-alcoholic beverages have worsened. Excises on imported beers, however, remained in the positive growth zone of 2,6%, while the cumulative drop in excises on domestic beer amounted 15,5% (Chart 14). Quarterly analysis shows a significant deterioration in the collection of excises on beer and non-alcoholic beverages in the third quarter, while, on the other hand, the excises on alcohol and alcoholic beverages, after a negative growth in the first part of the year, moved to a positive growth zone in the third quarter (Chart 14).

Chart 14



**III REVISED INDIRECT TAX REVENUES PROJECTION (2018-2021)**

Table1: Revised projections (2018-2021)

Type of revenue (net)	in million KM						Projected growth rate			
	Execution	Projection					2018	2019	2020	2021
	2017	2018	2019	2020	2021					
VAT	3.576,1	3.758,8	3.872,7	3.990,4	4.120,0		5,1%	3,0%	3,0%	3,2%
Excise duties	1.464,8	1.436,8	1.439,3	1.469,1	1.502,1		-1,9%	0,2%	2,1%	2,2%
Customs duties	269,1	287,0	304,5	321,8	340,5		6,6%	6,1%	5,7%	5,8%
Road fees	382,5	620,2	647,6	656,7	667,2		62,1%	4,4%	1,4%	1,6%
Other	33,4	39,7	40,1	40,5	40,9		18,9%	1,0%	1,0%	1,0%
<b>TOTAL</b>	<b>5.726,0</b>	<b>6.142,6</b>	<b>6.304,3</b>	<b>6.478,6</b>	<b>6.670,7</b>		<b>7,3%</b>	<b>2,6%</b>	<b>2,8%</b>	<b>3,0%</b>
Earmarked road tax *)	-152,8	-383,8 **)	-404,8	-410,4	-417,0		151,2%	5,5%	1,4%	1,6%
<b>FUNDS FOR DISTRIBUTION</b>	<b>5.573,2</b>	<b>5.758,8</b>	<b>5.899,5</b>	<b>6.068,1</b>	<b>6.253,7</b>		<b>3,3%</b>	<b>2,4%</b>	<b>2,9%</b>	<b>3,1%</b>

## Notes:

\*) The earmarked road tax amounted to 0,10 KM /l of oil derivatives until 1<sup>st</sup> February 2018, and from 1<sup>st</sup> February to 0,25 KM /l of oil derivatives

\*\*\*) The amount of earmarked road tax to be distributed to users in 2018 under the provisions of the Law on Changes and Amendments to the Law on Payments into the Single Account and Distribution of Revenue<sup>9</sup> does not fully correspond to the amount of the projected earmarked road tax shown in Table 1 (383,8 million KM) due to the application of the new model of distribution of collected road tax as of 1<sup>st</sup> February 2018, according to which the distribution is not performed on a daily basis, but subsequently, at the end of the month for the previous month on the basis of the preliminary / final report of the ITA on collected revenues by type. The distribution of earmarked road tax of 0,10 KM/l of derivatives according to the old model of daily distribution ended on 31 January 2018, and the distribution of an earmarked road tax of 0,25 KM/l of derivatives to the Entities and the Brcko District according to the new model started only in March 2018.

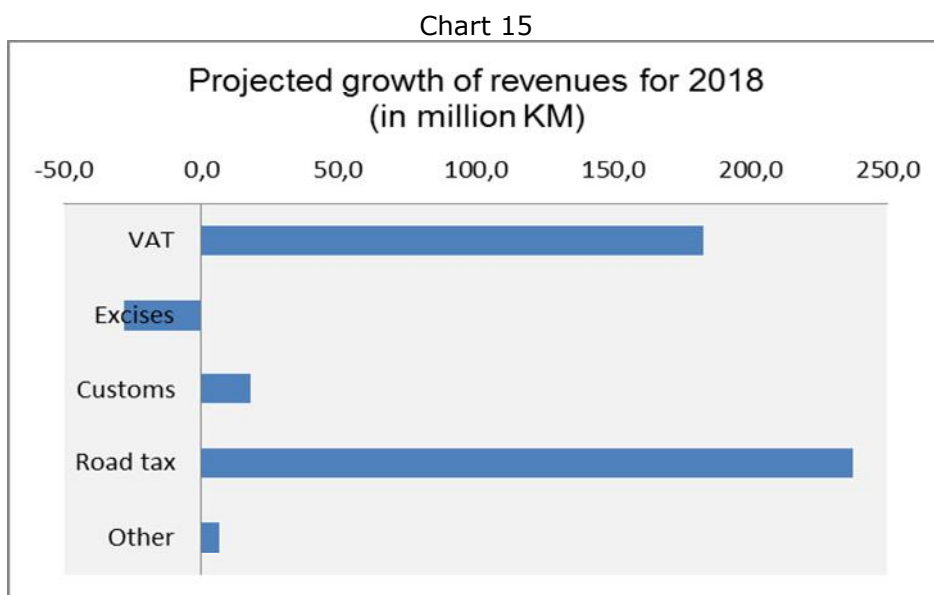
<sup>9</sup> Official Gazette of B&H, No 91/17

### 3.1. Projections for 2018

In order to ensure the comparability of projected and collected revenues from indirect taxes, **projections of indirect tax revenues are made on a cash basis** in accordance with ITA reports on collection by type of revenue.<sup>10</sup>

Based on the revenue collection trends, the annual macroeconomic projections and the estimates of the effects of amendments to the Excise Law and effects of the application the adapted SAA, the projected net collection of indirect tax revenues for 2018 amounts to 6.142,6 million KM which is 7,3% more than in 2017.

Chart 15 shows shares of various types of revenues in the projected absolute growth of total revenues (in million KM). The largest contributor to the projected revenue growth of 416,6 million KM are road tax revenues (237,7 million KM), ie earmarked road taxes due to the application of higher rates as of 1<sup>st</sup> February 2018. The next are VAT revenues, which are expected to increase by 182,7 million KM. Customs and other revenues do not have a significant share in the planned revenue growth, while excises have negative effects (-28,0 million KM).



#### Customs

The projection of customs revenues for 2018 amounts to 287,0 million KM, and is based on the current collection trends and projections of growth rate of import.

#### VAT

Projection of VAT revenues for 2018 amounts to 3.758,8 million KM, which is 5,1% more than the collection in previous year. The projected annual growth rate of the collection is for as much as 3,1 pp lower than the growth rate of net VAT in the first half of the year, due to negative collection trends in August and September. Strong VAT growth rates at the very beginning of the year were largely caused by one-off effects.<sup>11</sup>

<sup>10</sup> Until the month of August the cumulative amounts of offsetting the liabilities for excise taxes on oil derivative and liabilities for road tax by VAT credits amounted 2,4 million KM and 4,5 million KM respectively.

<sup>11</sup> See more in the part 2.2. Collection by types of revenues, section VAT



### *Excises and road tax*

Projection of total excise revenues in 2018 amounts to 1,436.8 million KM. After longtime positive trends in excise revenues (the exception is fall in 2013), their fall of 1,9% was planned for 2018. A revenue drop is planned for all excise categories except for the excise taxes on coffee, which have an insignificant weighting factor in total excise revenue.

#### *Revenues from excise taxes on tobacco*

Projections of excise revenues on tobacco products follows current and historical trends, bearing in mind that their movement depends on the business policies of 3-4 major tobacco companies. In the fourth quarter deteriorated trends are expected, due to the Decision which has been made on the new tax increase on cigarettes and smoking tobacco applying from 1 January 2019. Withdrawal of excise stamps during 2018 has shown a serious changes and new restructuring in the tobacco products market in terms of sharp decline in the shares of domestic brands and significant increase in shares of foreign brands. However, due to the slowdown in taxed consumption growth and the growing black market, the increase in the share of foreign brands is not big enough to compensate for losses on domestic brands, and therefore a decline in revenues of 1% is expected in 2018.

#### *Revenues from excise taxes on oil derivatives*

High growth of excises on oil derivatives at the beginning of the year is the result of increased demand for oil derivatives prior to the start of application of higher tax rates on oil derivatives as of February 1, 2018. Although the increase in the fiscal burden on oil derivatives and oil price growth in the world market has been expected to lead to a fall in the consumption of derivatives in B&H, data for 6 months showed a slight increase in total quantities of derivatives.<sup>12</sup> Given that the projections are made on a cash basis, in spite of the projected stagnation of the base for excises on oil derivatives on the annual level (compared to 2017), it is projected the fall in collection in 2018 for this category of excise (-3,3%) due to the frequent practice of offsetting the liabilities for excises on oil derivatives by VAT claims in 2018. Cumulative of the offset amount of liabilities up to August 2008 was 23,4 million KM,<sup>13</sup> and due to the unknowns regarding the method of settling the liabilities for excises on domestic oil and oil derivatives, no significant amounts of the offset were planned until the end of the year. Eventual errors in the estimates of the amounts of offset liabilities by the end of year may reflect to discrepancies between collection and projections by type of revenue, but not on the total collection of indirect taxes.

#### *Other excise categories*

Other excise categories (soft drinks, coffee, alcohol and beer) are projected in accordance with the current collection trends and projections of the DEP. Given their low share in the excise revenues, their movement has no significant impact on the dynamics of total revenues from excise duties.

#### *Road tax*

Projection of road tax for 2018 includes the effects of amending the Law on Excise Duties as of 1<sup>st</sup> February 2018 and amounts to 620,2 million KM, which is even 62,1% more than the road tax collection in 2017. The increase in revenue refers only to the earmarked road tax for the

<sup>12</sup> Dynamics of the quantities of derivatives by categories is available in section: 2.2. Collection by type of revenues; part: Excises and road tax

<sup>13</sup> At the time of preparing the projections, there were available the final data on revenue collection by types until August 2018 and the preliminary report for September. Information on offset amount of liabilities for excises and road taxes by VAT claims are available only in the final reports.

construction of highways and the construction and reconstruction of other roads (increase 231,0 million KM), while increase of only 6,7 million KM was planned for the road tax which is charged at a rate of 0,15 KM/l and is subject to regular distribution from the ITA Single Account.

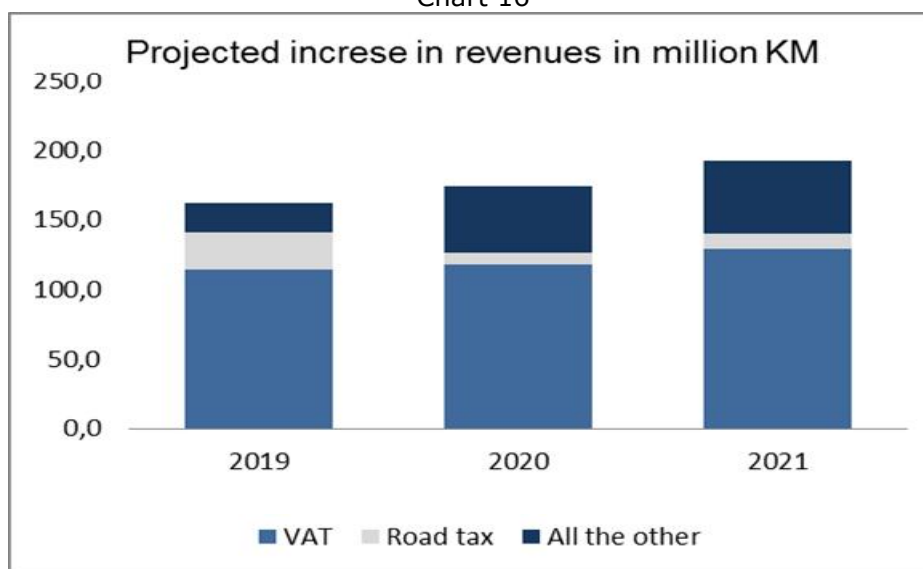
As in the case of excises on oil, the projection is made on a cash basis and is not corrected for the offset amount of liabilities for road tax by VAT claims. Based on the available data by August 2018, the offsetting case has been recorded only in the month of April (a road tax of 0,15 KM / l, in the amount of 4,5 million KM), and the revenue projection of the road tax is based on the assumption that it will not be repeated until the end 2018. As in the case of excises on oil, any errors in the estimates of the amounts of offset liabilities by the end of year may reflect to discrepancies between collection and projections by type of revenue, but not on the total collection of indirect taxes.

### 3.2. Projections for 2019-2021

Projected growth rates of revenues for 2019, 2020, and 2021 are 2,6%, 2,8% and 3,0% respectively. The projections of revenues in the mentioned period are based on the projected relevant macroeconomic indicators, the historical seasonal collection pattern, projections of certain categories of revenues for 2018, as well as on the effects of changes in excise policies on oil derivatives and road tax. As in the case of 2018, the projections are made on a cash basis. Projected amounts of offsetting the liabilities for excises and for road tax by VAT claims in the period 2019-2021 are proportional to projected amounts in 2018, and possible errors in estimates may reflect to the discrepancies between collection and projections by type of revenue, but not on the total collection of indirect taxes.

The largest generator of the surplus of indirect taxes revenues in the mentioned period is VAT, given its significant share in revenues and planned stable growth rates. In all three years, VAT revenues generate over two thirds of the absolute annual projected revenue increase (Chart 16).

Chart 16

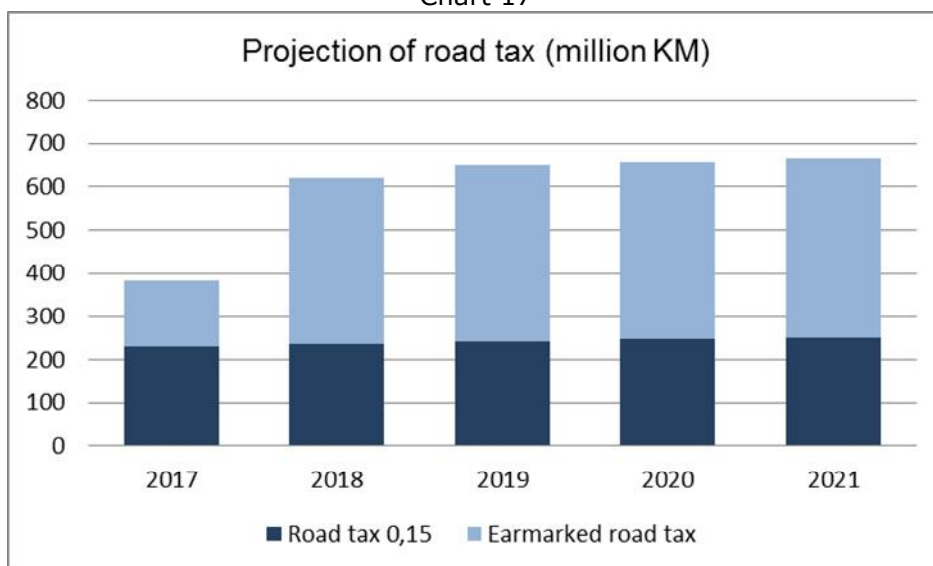


Projections of revenues from excises on tobacco products for 2019 are based on the increase of specific excise to the level of 1,65 KM / package. If the new additional tax burden (excise + VAT) completely transferred to the retail prices, the total amount of excise taxes contained in the retail prices of all cigarette brands should be higher than the legally prescribed ceiling of 176 KM / 1000 pcs (or 3,52 KM / package). This would end the process of harmonization of the tax burden of

cigarettes with a valid EU standard (90 EUR / 1000 pcs) in 2019. A new increase in excise taxes in 2019 will further aggravate the cigarette market, strengthen the black market and erode revenues. An important factor in the growth of the black market of tobacco products, and therefore the collection of excise revenues, will be the taxation policy of tobacco products in the surrounding countries. Completion of the harmonization process in 2020 and 2021 should lead to stabilization of the market and increase of excise revenues in accordance with the projections of growth in consumption and income. Starting from the mentioned assumptions, a drop in excise revenues of 1% is expected in 2019, and growth rates of 2,6% and 2,8% in 2020 and 2021, respectively.

Road tax revenues do not contribute significantly to the planned absolute revenue growth in the period 2019-2021, due to the exhaustion of the effects of increase in tax rates. A somewhat higher growth is planned only in 2019 (27,4 million KM), since the higher rate of earmarked road tax has not been applied from the very beginning of 2018 (Chart 17).

Chart 17



## IV DIFFERENCES COMPARED TO APRIL PROJECTIONS

### 4.1. Projections for 2018

Projections for 2018 are revised for +62,2 million KM. Revisions upwards were made on revenues from VAT (+30,8 mil. KM) and on road tax (46,3 million KM), and downwards on excise revenues (-13,7 million KM) and customs (-1,2 million KM).

When comparing, it should be taken into account that the April projections did not consider the correction on revenues by type, due to offsetting the liabilities for excises and for road tax by VAT claims, since this practice had begun in March 2018.<sup>14</sup>

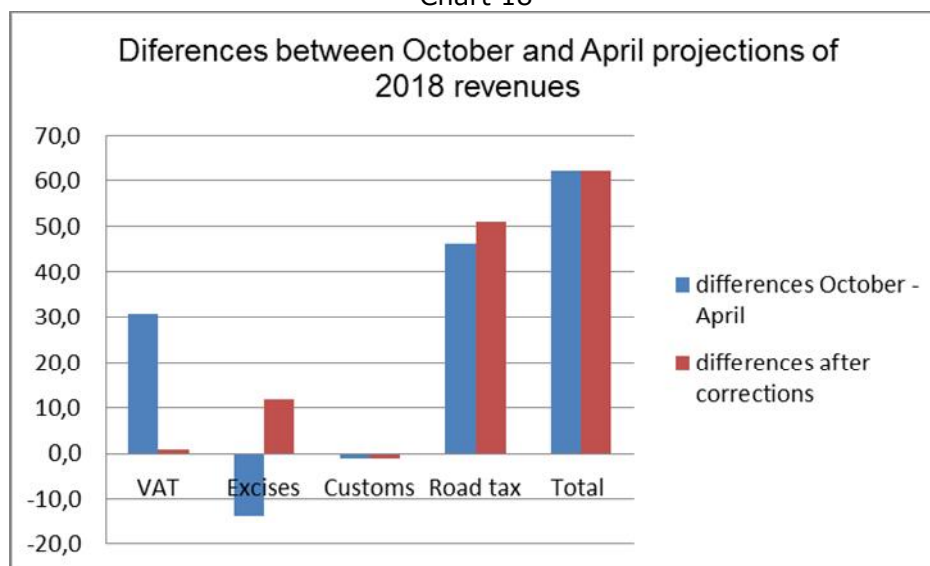
Comparison of projections from October and April 2018 after correction of the offset amounts of liabilities shows a different picture of differences by type of revenues. In this case, VAT revenues were revised only for +0,8 million KM and revenues from road tax for +50,8 million KM. Revenues from excises on tobacco are revised downwards due to worse trends in consumption in the third

<sup>14</sup> At the time of preparing the April projections, a preliminary report for March was available, which did not contain the information on the offset amounts of liabilities (information is available only in final reports).

quarter than expected. After correction, it can be concluded that the total revenues from excises are also revised upwards (+11,7 million KM).<sup>15</sup>

It can be concluded that the main reason for the revision of the projections for the year 2018 is that, according to data from the first half of 2018, there was no expected fall in the consumption of derivatives in B&H in 2018. The assumption of a fall in derivative consumption was used in April 2018 while preparing projections of excises on oil and road tax, due to the increase of fiscal burden on oil derivatives and oil price growth on the world market.

Chart 18



#### 4.2. Projections for the period 2019-2021

Projections for 2019, 2020 and 2021 are revised upwards by +39,3 million KM, +24,2 million KM and +16,5 million KM respectively. Revision by type of revenue is available in Table 2. As there was no significant changes in the estimates of the macroeconomic indicators growth for this period by DEP (see projections of real GDP, real consumption and imports in Charts 19, 20 and 21), it can be concluded that the revision of the projections of indirect taxes during this period was largely due to the revision of the base i.e. revenues in 2018. Only in the case of VAT revenues, the revision has not been proportional to the change of base in 2018 due to a significant correction downwards of the estimates of private consumption dynamics by the DEP (Chart 21).

<sup>15</sup> Gross excise tax revenues were revised by +19,2 million KM, and excises on tobacco by -6.2 million KM. The difference (up to +11,7 million KM) refers to other revenues from excises and excise tax refunds.

Table 2: Differences between projections from October and April 2018

Type of revenue (net)	2018	2019	2020	2021
VAT	30,8	11,6	2,6	-1,0
Excises	-13,7	-17,4	-22,6	-26,4
Customs	-1,2	-0,4	-0,7	-1,1
Road tax	46,3	45,5	44,9	45,0
Other	0	0	0	0
<b>TOTAL</b>	<b>62,2</b>	<b>39,3</b>	<b>24,2</b>	<b>16,5</b>

Chart 19

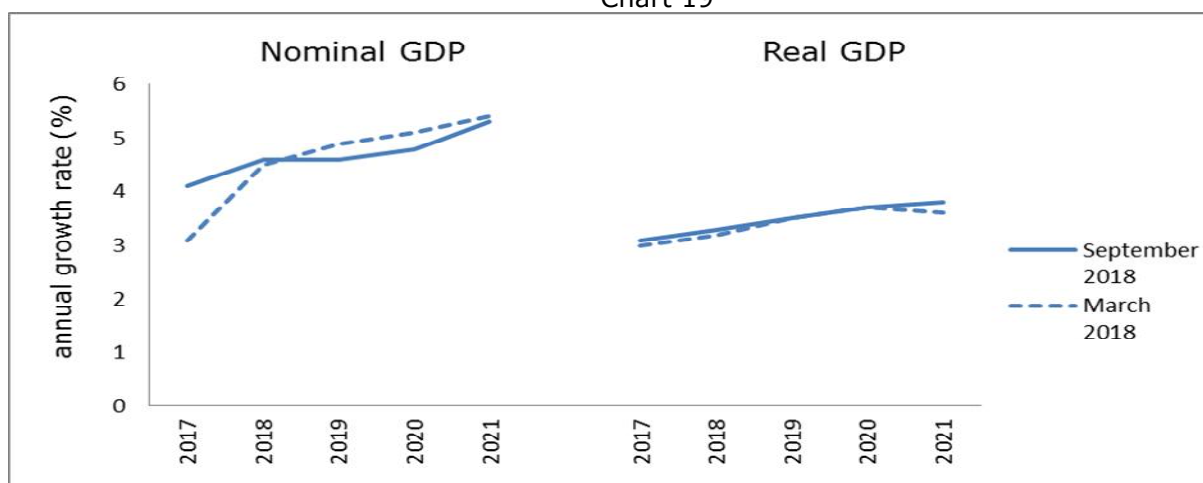


Chart 20

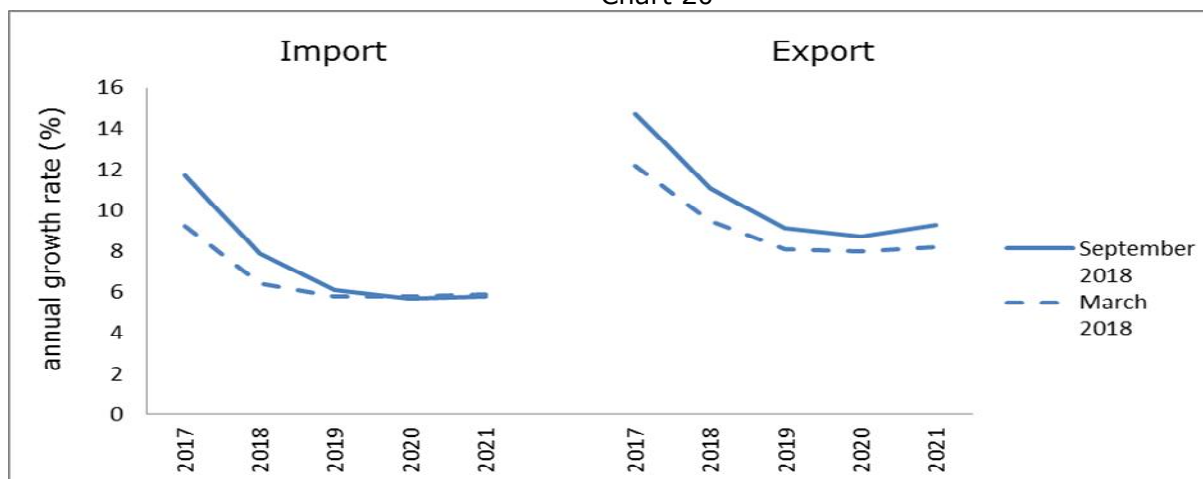
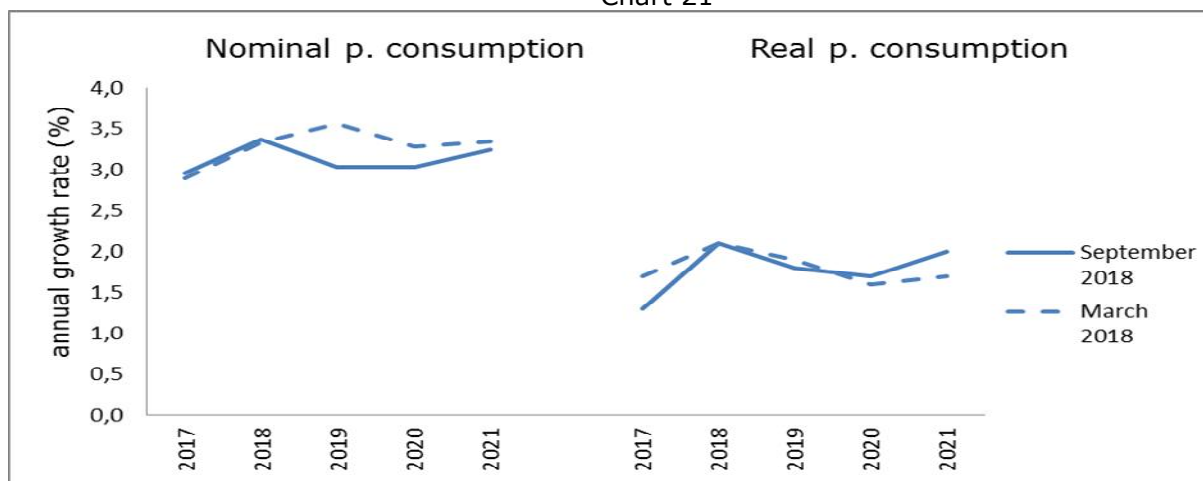


Chart 21



As noted in Section 3.2., the projected amounts of offsetting the liabilities for excises and for road tax by VAT claims in the period 2019-2021 are proportional to projected amounts in 2018. In case of correction of the projections on this basis, it would be concluded that the revenues from VAT in the period 2019-2021 were corrected downwards, while the revenues from excises on oil and the road tax were corrected upwards.

We conclude that, for the period 2019-2021, the main reasons for the revision of projections of indirect tax revenues from April 2018 are as follows:

1. revision of the base for excise tax on oil and road tax in 2018, due to the dynamics of fuel consumption in 2018 which showed to be contrary to expectations from April;
2. Reduction of the projected growth rate of private consumption in the period 2019-2021 which is negatively reflected in the VAT projections.

## 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 2018-2021 is subject to the following risks:

- Projections of indirect tax revenues are closely related to the projections of macroeconomic indicators of DEP, so 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.
- The massive outflow of the population can cause a reduction in the taxable consumption of unemployed citizens leaving B&H which has been financed by incomes from the gray economy or by remittances from abroad, as well as the consumption of labor-intensive



persons leaving B&H, whose income, due to family relocations, will mostly be spent outside B&H.

- 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 of revenues from excise duties on derivatives and road taxes from the price of oil derivatives.