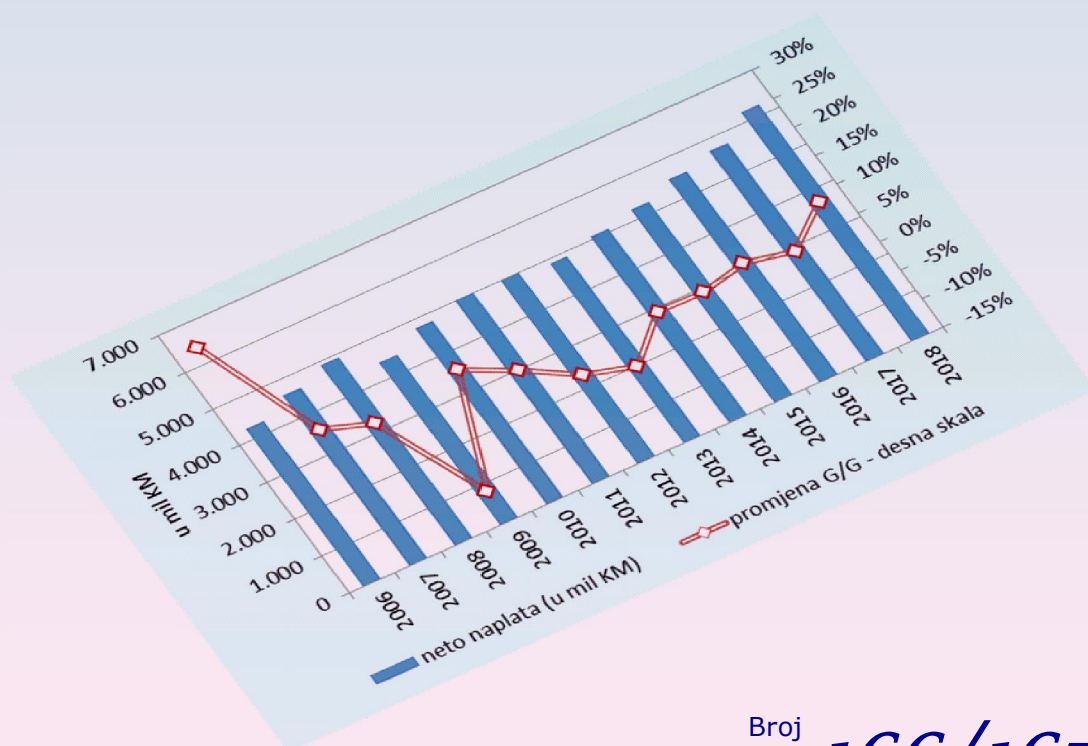




Macroeconomic Unit of the Governing Board of the Indirect Taxation Authority

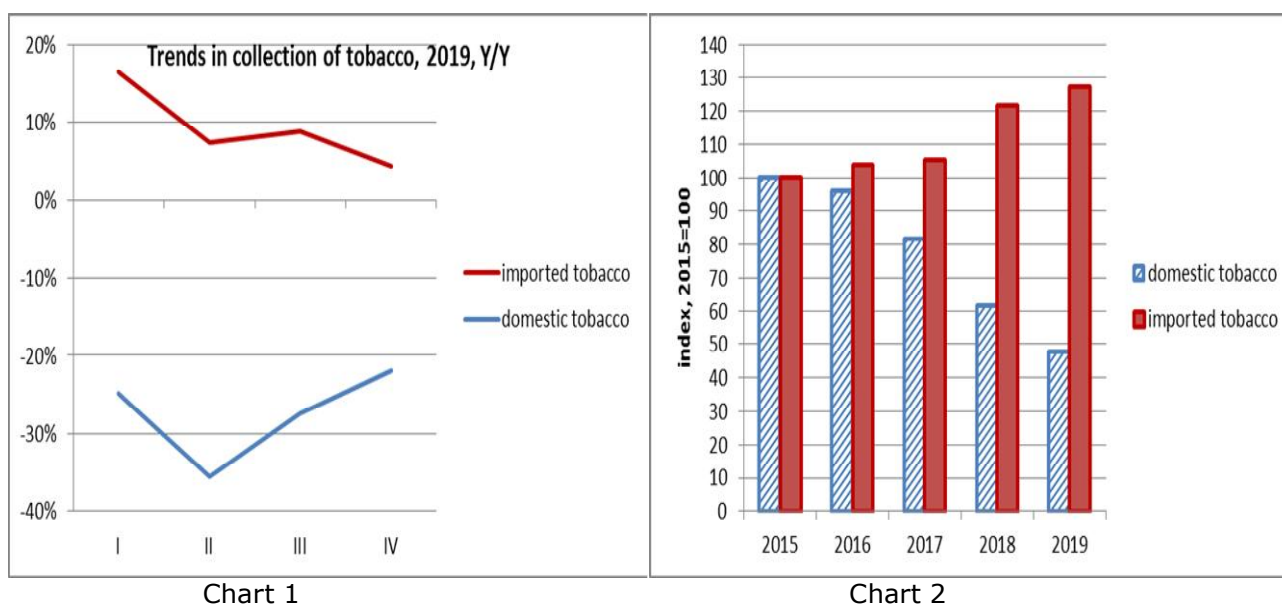
ОМА Билтен



Broj
Број
Number **166/167**

With this issue

According to the preliminary report of the ITA, in April 2019 the net revenue collection from indirect taxes was higher by 65,3 million BAM or by 13,6%. The net effects for the first four months of 2019 amounted to 156,9 million BAM, which is an increase of 8,4% in comparison with the net collection in the same period of 2018. The main generator of revenue growth in the first four months of 2019 is the VAT, whose collection increased by 86,4 million BAM in comparison with 2018, and even higher effects are expected after adjusting of currently unadjusted revenues of approximately 34,2 million BAM. Positive effects were also realized in the collection of excises on oil derivatives and road tax, as well as in the collection of customs revenues. In April, revenues from excises on tobacco products declined by 8,2%, which annulled the increase in the first quarter of 2019.



Improvement in the trend of excise collection of domestic tobacco products (Chart 1) may lead to the conclusion that the situation in collecting domestic excises is improving. However, one should take into account the effect of lower statistical base, i.e. the strong decline in revenues from excises on domestic tobacco products in 2018. In case of using the year 2015 as a statistical base, which is the first whole year after the last change in the taxation policy of tobacco products (applicable from August 1, 2014), nominal comparisons indicate that the collection of excise taxes on domestic tobacco products in the period January-April 2019 was halved in comparison with the same period of 2015, while the collection of excise taxes on imported tobacco products increased by 27% (Chart 2).

Dinka Antić, PhD
Head of Unit

Table of contents:

| | |
|--|---|
| Projections of indirect taxes for the period 2019-2022 | 2 |
|--|---|

Technical design: Sulejman Hasanović, IT expert
Reader/translator: Darija Komlenović, professor

Projections of indirect taxes for the period 2019-2022

Abstract

Relatively short time has passed since the release of the last projections of indirect tax revenues (October 2018). In March 2019, the Directorate for Economic Planning (DEP) published revised projections of macroeconomic indicators, where there were no significant changes in the indicators for 2018. The official data from the national accounts for 2018 were still not available at the time of preparation of DEP's projections, and therefore they estimated, on the basis of available data for the first three quarters of 2018 and short-term statistics for the fourth quarter, that a real GDP growth of 3,3% was achieved in 2018, which is unchanged level relative to their projections from September last year. On the other hand, projections of real GDP growth for 2019 were revised downwards, from 3,5% to 3,1%. DEP explains these corrections by the slowdown in economic growth in the EU in the second half of 2018, and in important trade partners of B&H such as Germany and Italy in the last quarter of 2018, stressing the relevance of these developments to the economy of B&H. According to DEP's projections the trend of economic growth in B&H is expected to continue in the coming years. The projections of real GDP growth for 2020 and 2021 remained unchanged compared to DEP's projections from September 2018.

According to the Projections of the Macroeconomic Analysis Unit (hereinafter referred to as "the Unit") from October 2018, it was expected that 6.142,6 million BAM of indirect tax revenues would be collected in 2018. The projections have been shown to be relatively cautious, as it has been collected 6.220,8 million BAM or 78,2 million BAM more revenues. The projections have been exceeded on VAT and excise tax revenues due to positive trends in net VAT collection in the last quarter of 2018, as well as the changes in the structure of the cigarette market in favor of the importers and consequential change in the excise revenues collection scheme.

The projected amount of net revenue collection from indirect taxes for 2019 is 6.452,9 million BAM, which is 3,7% more than in 2018. The projected revenue growth rate is 1,1 pp higher than in the Unit's forecast from October last year. The largest contribution to the projected absolute revenue growth in 2019 of 232,1 million BAM have the VAT revenues (140,4 million BAM). The following are the revenues from road taxes and excise taxes which were projected to grow 35,7 and 35,4 million BAM respectively. The projected increase in revenues from customs duties amounts 15,7 million BAM. The residual of annual revenue growth refers to other and unadjusted revenues at Single Account (SA) of ITA.

The projected amounts of revenues by type for 2019 make the basis for the projections for the period 2020-2022. The projected growth of indirect tax revenues is 176,6 million BAM, 199,1 million BAM and 223,9 million BAM for 2020, 2021 and 2022 respectively. The VAT revenues are again the largest revenue generator, due to their significant share in indirect tax revenues and stable growth rates in line with private consumption growth projections (DEP).

1. The basics and assumptions of projections of indirect tax revenues

Indirect tax projections are based on the DEP's projections of macroeconomic indicators (March 2019), and take into account trends in indirect tax collection and current government policies in the area of indirect taxation (baseline scenario).

1.1. Projections of macroeconomic indicators, DEP, March 2019

A continuation of the economic growth trend is expected in B&H according to DEP's projections. DEP estimates that the real GDP growth rate in 2019 should be somewhat lower than in the previous year and would amount to 3,1%. Under the assumption of preserving a favorable external environment and the implementation of structural reforms in the country, DEP expect the continuation of economic growth trend in 2020, 2021 and 2022 (Table 1).

Table 1. GDP growth rate projections, DEP, March 2019

| Projected GDP growth rates | 2018 | 2019 | 2020 | 2021 | 2022 |
|----------------------------|------|------|------|------|------|
| Nominal growth | 4,7 | 4,3 | 4,5 | 5,2 | 5,3 |
| Real growth | 3,3 | 3,1 | 3,7 | 3,8 | 4,0 |

Projections of indirect tax revenues are closely related to GDP projections and its components. Any deviation of the execution of national accounts parameters from their projected values represents a risk for revenue projections. It is shown below (Charts 1-3) the graphical illustration of GDP components relevant for indirect tax projections, as well as their changes in comparison to DEP's previous projections (September 2018).

Chart 1

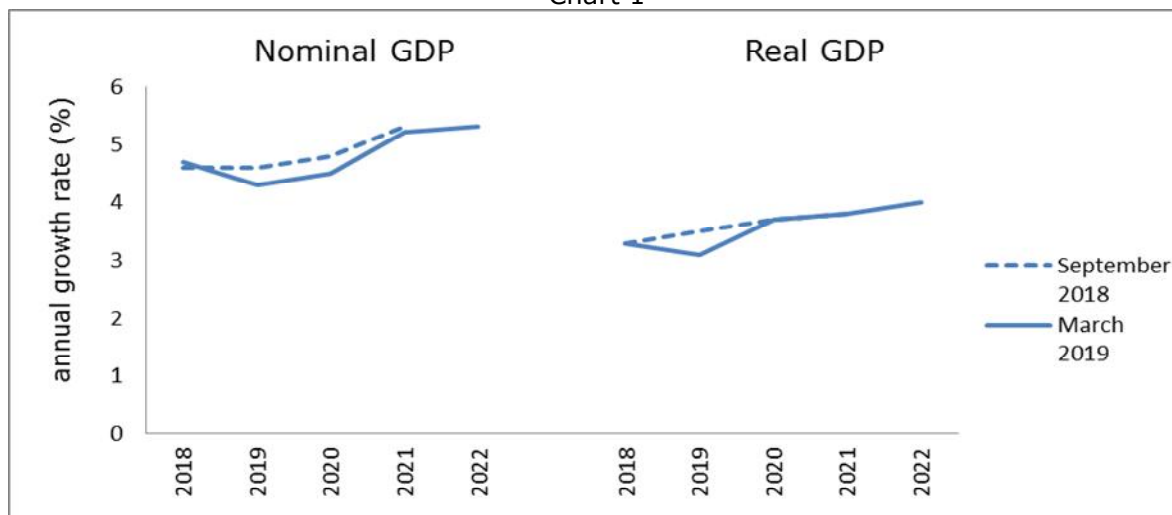


Chart 2

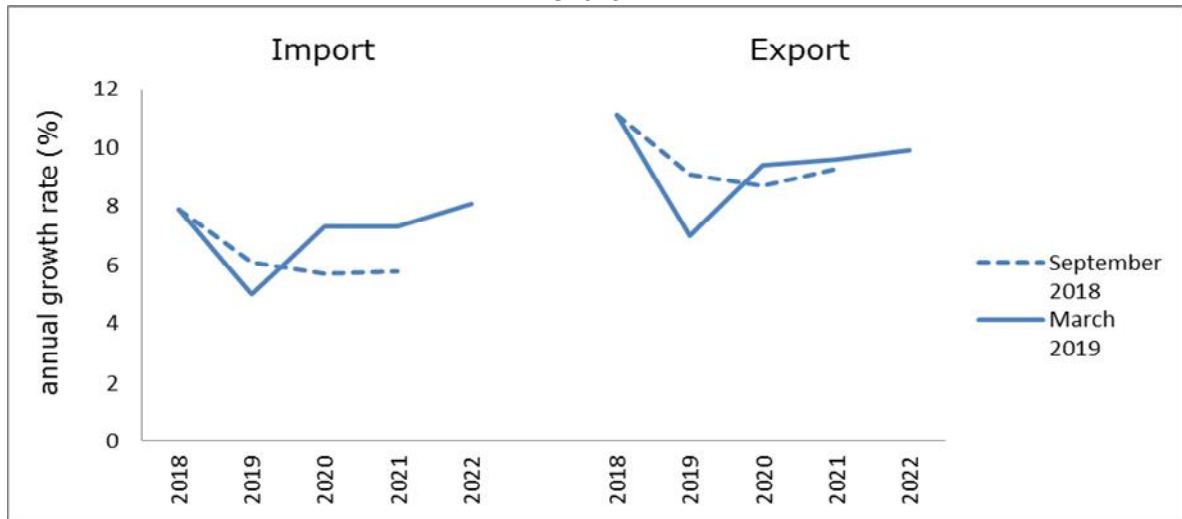
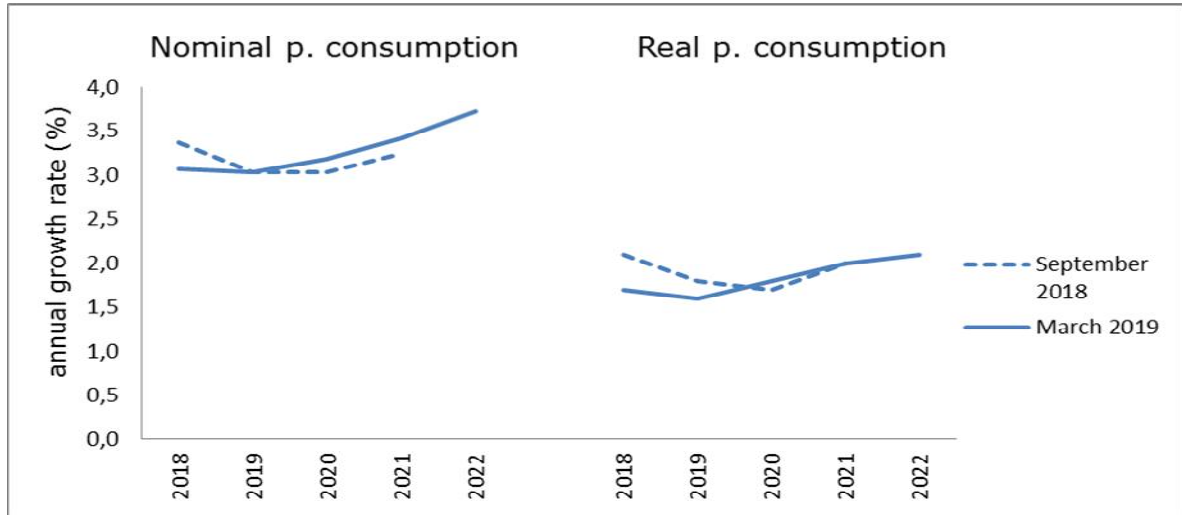


Chart 3



1.2. Current policies in the area of indirect taxation

VAT obligations and payment system are regulated by the Law on Value Added Tax ("Official Gazette of B&H", No. 9/05, 35/05, 100/08 and 33/17).

Excise policy is regulated by the Law on Excises in Bosnia and Herzegovina ("Official Gazette of B&H", No. 49/09, 49/14, 60/14 and 91/17). Projections of indirect tax revenues are based on the assumption of continuation of the harmonization process of excise duties on cigarettes with EU standards and the application of the cut tobacco taxation policy according to the Law from 2014.¹ The policy of excises on tobacco in 2019 has been regulated by the Law on Excises and Decision² of the Governing Board of ITA. It is expected for the legally prescribed ceiling of the total excise tax on cigarettes of 176 BAM / 1000 cigarettes to be reached for all price categories of cigarettes in 2019, which would end the process of harmonization with EU standards in the field of cigarette taxation.³

The Law⁴ on Customs Policy in Bosnia and Herzegovina regulates the basic elements of customs policy and general rules and procedures that apply to goods brought into and out of the customs territory of Bosnia and Herzegovina.

The phases of liberalization of foreign trade in B&H are shown in Chart 4.⁵

Chart 4. Phases of liberalization of foreign trade in B&H

| | CEFTA | EU, SAA | | | customs records | | | EFTA | | EU, adapted SAA | |
|------|--------------|----------------|------|------|------------------------|------|------|-------------|------|------------------------|------|
| 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |

¹ The new policy is in effect since 1st August 2014 (Amendments to the Law on Excises in B&H "Official Gazette of B&H" No. 49/14)

² Decision on Determining of the Specific and Minimum Excise Duty for Cigarettes and Amount of the Excise Duty on Smoking Tobacco for 2019 („Official Gazette of B&H" No 75/18).

³ There are currently in the parliamentary procedure the amendments to the Law on Excises which have been adopted by the Governing Board of the ITA in 2018, which imply the introduction of a three-year moratorium on the increase of the specific excise duty on cigarettes starting from 2019. In the meantime, the Decision on Determination of the Specific and Minimum Excise Duty for Cigarettes and Amount of the Excise Duty on Smoking Tobacco for 2019 according to the applicable Law has been adopted. Given the expectations regarding reaching the EU's standard of taxation in 2019, the possible adoption of amendments to the Excise Act would not have real effects on revenue collection in the period 2020-2022.

⁴ The new Law on Customs Policy ("Official Gazette of B&H" No. 58/15) will apply from August 2019, and until that date the old Law on Customs Policy ("Official Gazette of B&H" No. 57/04, 51/06, 93/08, 54/10 and 76/11) will continue to apply. The exception is Article 207 of the new Law which has been applied as of 25th April 2018.

⁵ More on liberalization of B&H foreign trade in Antic, D. " Liberalization of Foreign Trade in B&H (2007-2017): Implications and Comparative Analysis", OMA Bulletin 152/153, March / April 2018.

1.3. Indirect tax collection trends

Collected revenues from indirect taxes show a long-term growth trend. Exceptions were "the crisis year" 2009 when a sharp drop in revenue of 9,9% was achieved, as well as stagnation and a slight fall in revenues in 2012 and 2013 respectively. The growth of collected revenues on SA of ITA was recorded in all other years (Chart 5). It was collected 4,1 billion BAM of net revenues from indirect taxes on the SA of ITA in 2006, and in 2018 the net revenues increased by more than 50% (6,2 billion BAM) in comparison with 2006. It should be noted that these amounts do not include the lagging payments of indirect taxes on entity accounts, which were more significant in the initial years after the introduction of VAT.

The share of indirect taxes on the SA of ITA in GDP varied over the years. After falling this share from 18,8% in 2008 to 17,1% in the crisis year 2009, it has been ranging from 17,3% to 18,6% since 2010. It is estimated that in 2018 it amounted 18,3% (GDP estimates by the DEP). The share of indirect taxes on the SA of ITA in total consumption also varied, and since 2014 it has seen a continuous growth trend. It is estimated that in 2018 (consumption estimates by the DEP) it amounted 19,5%

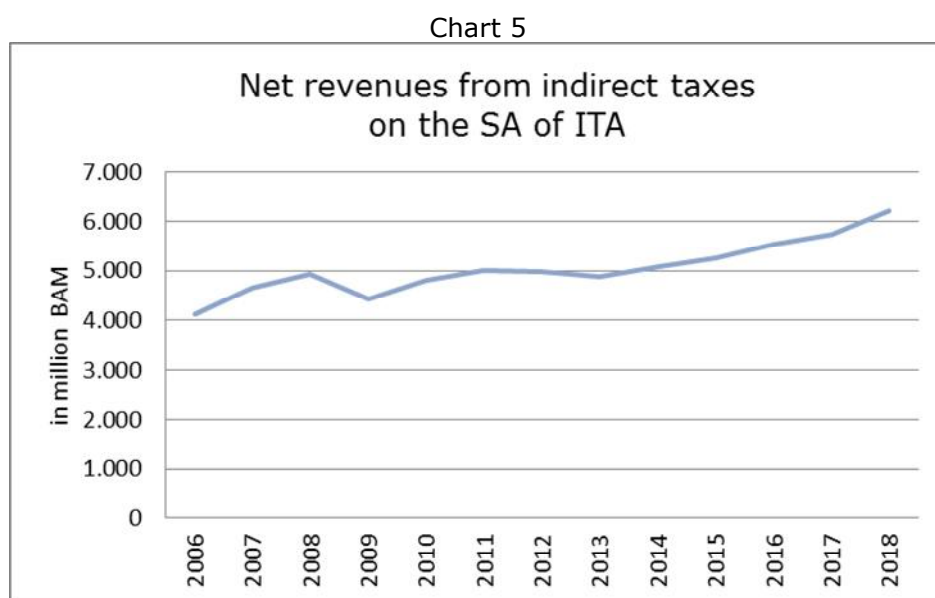


Table 2. Share of indirect tax revenues on the ITA SA in GDP and in total consumption

| | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|-------|------|------|------|------|------|------|------|------|------|------|------|------|------|
| % GDP | 19,5 | 19,8 | 18,8 | 17,1 | 18,4 | 18,6 | 18,1 | 17,3 | 17,9 | 17,7 | 17,8 | 17,6 | 18,3 |
| % C | 18,4 | 19,2 | 17,9 | 16,5 | 17,6 | 17,7 | 17,4 | 16,9 | 17,3 | 17,7 | 18,3 | 18,4 | 19,5 |

Source: Calculation based on data from ITA, BHAS and DEP projections for 2018

1.3.1. Collection in 2018

An overview of the nominal collection shows that the record amount of indirect tax revenues since the establishment of the ITA was collected in 2018 (6.220,8 million BAM) and the rate of growth reached even 8,6%. This was expected bearing in mind the amendments to the Law on Excises. In order to ensure, for the purpose of analysis, the comparability of collection of indirect tax revenues in 2018 with the collection in 2017 it is necessary to completely exclude the collection of the earmarked road tax, given that almost all the effects of the amendments to the Law on Excises (applicable of 1st of February 2018) refer to the earmarked road tax. The amount of revenues after the exclusion of earmarked taxes represents revenue transfers according to the budget of institutions of B&H, Entities and the District ("distribution funds"). After the exclusion of the earmarked road tax collection from the total amount of indirect tax collected in 2017 and 2018, the growth of distribution funds in 2018 amounts to 4,7% (Chart 2). Since the effects of amendments to the Law on Excises also include the amount of VAT charged on an additional earmarked road tax, excluding this effect the growth rate of distribution funds amounts 4%. Therefore, it can be concluded that the amendments to the Law on Excises brought 4,6 percentage points of increase in revenues from indirect taxes.

1.3.2. Collection in the first quarter of 2019

Total revenues

According to the preliminary cash flow report on ITA SA, it was collected 628,3 million BAM gross revenues of indirect taxes in March 2019, which is an increase of 9,2% compared to March 2018. However, due to increased VAT refund payments, the net collection was higher by 41,8 million BAM or 9%. At the level of the first quarter of 2019, gross collection amounted to 1,823 billion BAM, while refund payments were 30,2 million BAM higher than in the first quarter of 2018. Ultimately, the net collection of indirect tax revenues was higher by 91,7 million BAM than the collection in the first quarter of 2018. In the last five quarters the trend of positive growth has continued with a high growth rate of indirect tax revenues of 6,6% (Chart 6).

Chart 6

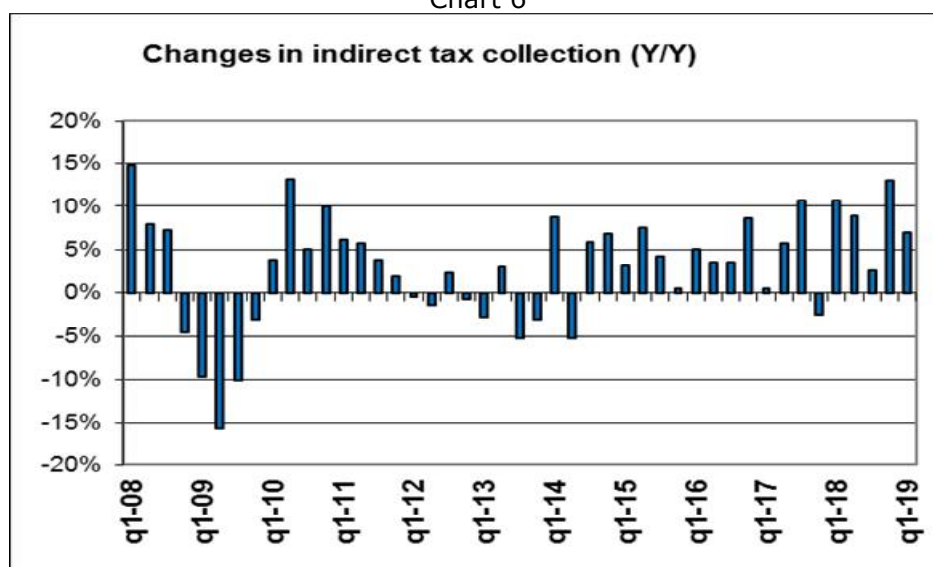
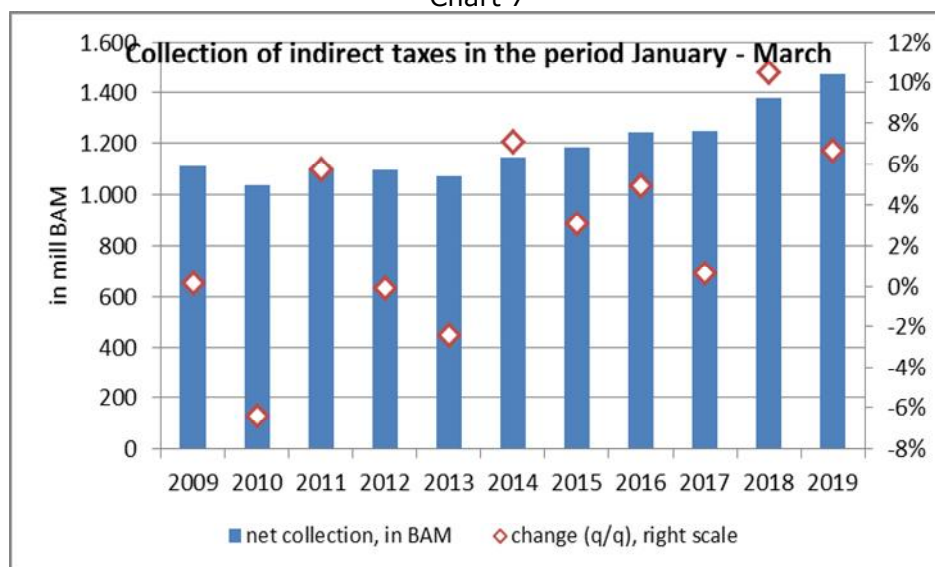


Chart 7



Comparison of the nominal collection of indirect tax revenues in the first quarter of 2019 with the first quarter of 2018 points to the conclusion that, despite high refund payments, the net collection of indirect tax revenues in the nominal amount was the most successful since the establishment of the ITA (Chart 7).

The growth rate in the first quarter of 2019 is expectedly lower, since the collection of revenues in 2018 included the effects of increase in the rate of earmarked road tax from the price of oil derivatives, in accordance with the amendments to the Law on Excise Duties. Since the amendments to the Law have been applied since 1st February 2018 the collection of revenues in January 2019 also contains the effects of increased road tax rate. The mentioned effects contributed with 1,4 percentage points in the structure of the growth of revenues from indirect taxes of 6,6% in the first quarter of 2019.

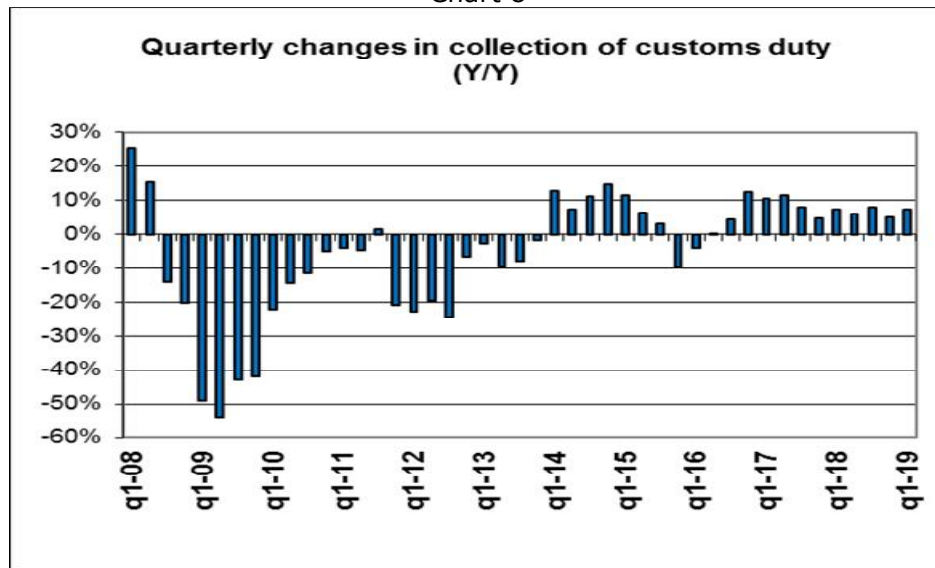
Analysis by type of revenues⁶

Customs

A positive trend in the collection of customs revenues from the second half of 2019 continued in the first quarter of 2019, with a slight increase. The collection of customs duties was determined by the movement of imports from the EU in the part of goods that remained under the customs regime, and imports from the third countries. In January, customs revenues fell by 2,5% compared to the same month of 2018, while in February and March there was a growth of 12,7% and 9,5%, respectively, which boosted the quarterly growth rate to 7,2%. An overview of quarterly trends in collection of customs revenues shows that, despite strong turbulences, a positive trend has been maintained that has been in place for twelve quarters consecutively (Chart 8).

⁶ It should be noted that it was collected 20,9 million BAM of revenues in the first quarter which could not be taken into account in the analysis of revenue collection, since they remained unadjusted in the IT system of the ITA.

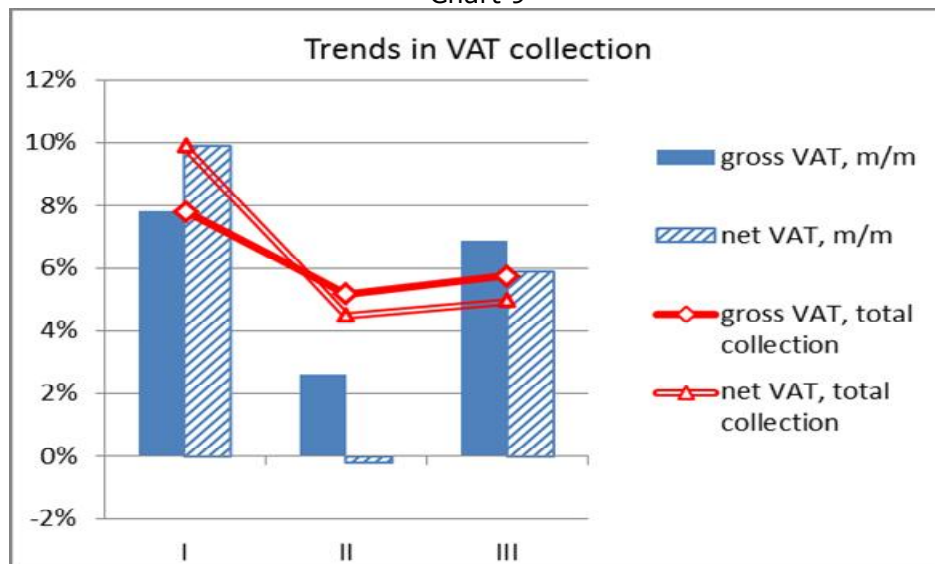
Chart 8



VAT

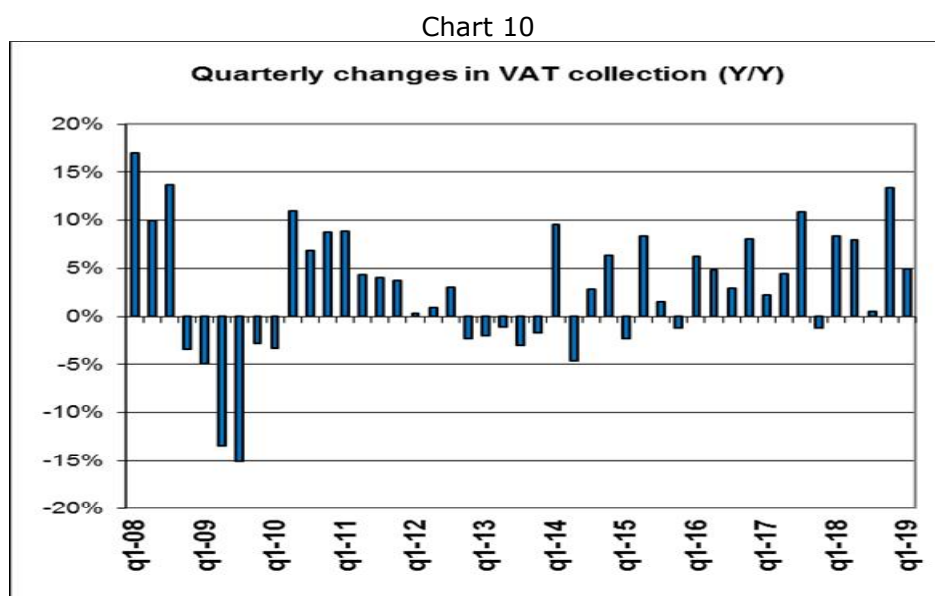
The trend of positive VAT growth from 2018 has continued in the first quarter of 2019, but with a modest growth rates. This has been expected, given that the high VAT growth rate in 2018 was influenced, among other things, by two factors whose impact had been manifested in 2018: an increase in road tax rate and net cash reporting on revenue collection, which did not include the offset of liabilities for excise duties and road tax by VAT claims (tax credits).⁷ Monthly collection of VAT in the first quarter has strongly oscillated due to oscillations of gross collection and VAT refunds. However, the growth of the cumulative net VAT of 5% at the quarterly level is still above the projection of consumption.

Chart 9

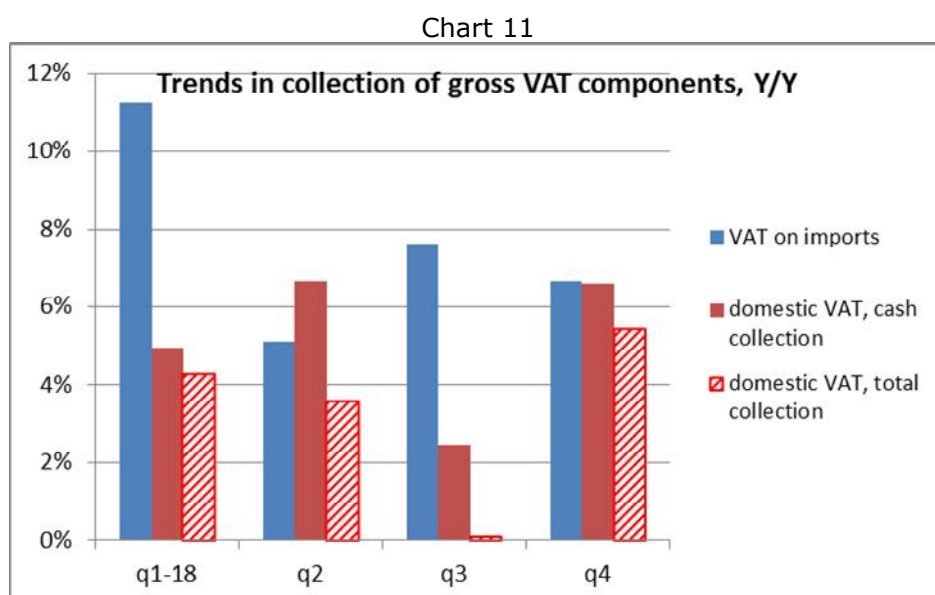


⁷ The consequence of net cash reporting is the overestimation of VAT collection and the underestimation of collection of revenues from excise duties.

It can be noticed from the review of quarterly trends in the collection of net VAT that the positive trends in VAT collection have lasted for three years continuously, with the exception of the fall in the fourth quarter of 2018, which was largely the consequence of prolonging the payment of refunds from one quarter to another (Chart 10). Considering the amount of temporarily unadjusted revenues of 20,9 million BAM in the preliminary ITA report, there can be expected even higher VAT growth rate in the first quarter of 2019.



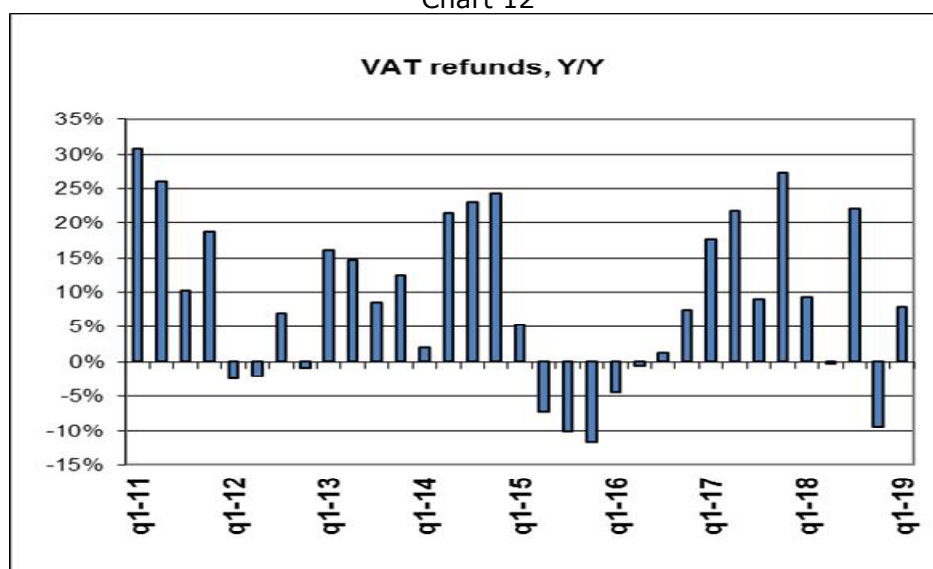
The growth of gross VAT in the first quarter of 2019 is the result of a strong increase in domestic VAT of 8,4% and a modest increase in VAT on imports of 4% (Chart 11).



It should be noted that the collection of domestic VAT in 2018 was overestimated due to net cash reporting on offsetting the liabilities for excise duties and road tax by VAT credits. The problem of recording of the tax offset in 2018 is also expressed in 2019, but in terms of using the statistical basis for comparison. Due to the excessive increase in domestic VAT in 2018, the growth rates in 2019 were underestimated. In order to get the real rate of growth of domestic VAT, it is necessary to exclude from domestic VAT the amount of VAT credits used for payment of duties for excise and road tax in 2018. After this correction, the growth rate of domestic VAT in the first quarter of 2019 amounts 9,2% (Chart 11, "Domestic VAT, total collection").

Comparison of VAT refunds in the first quarter of 2019 with 2018 shows an increase in refunds for the taxpayers of 8,7% or by +26,1 million BAM, while refunds for the international projects increased by 4,6 million BAM in comparison with the same period of 2018. An overview of quarterly trends in payments of VAT refunds shows large fluctuations in 2018. After a significant decline in refunds in the fourth quarter of 2018, they increased by 8% in the first quarter of 2019 (Chart 12). In addition, the average share of refunds in gross VAT in the first quarter of 2019 was 1,4 percentage points higher than the average rate in 2018, while, compared to the previous years, it represents the maximum share so far.

Chart 12



Excises and road taxes

After the fall in excise revenues in the last two months of 2018, an increase of 3,2% was achieved in January 2019. However, there was a decline in the collection already in February, which reduced the cumulative revenues to the level of 2018. A strong growth of 13,2% was achieved in March, which increased the cumulative to 3,9%. Quarterly overview shows strong quarterly oscillations in the collection of excise duties, which resulted from the oscillations in the collection of excise taxes on tobacco and oil derivatives in the last three years (Chart 13).

Chart 13

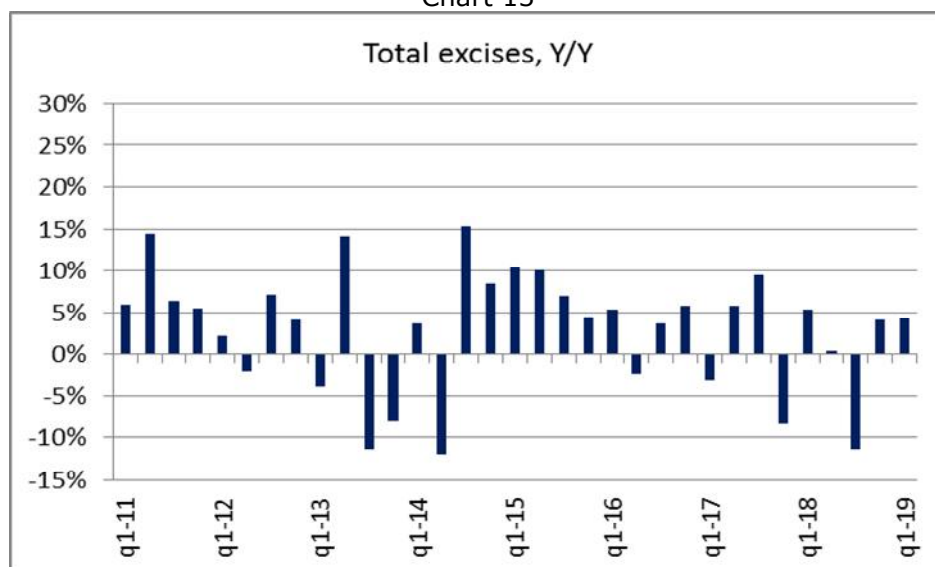
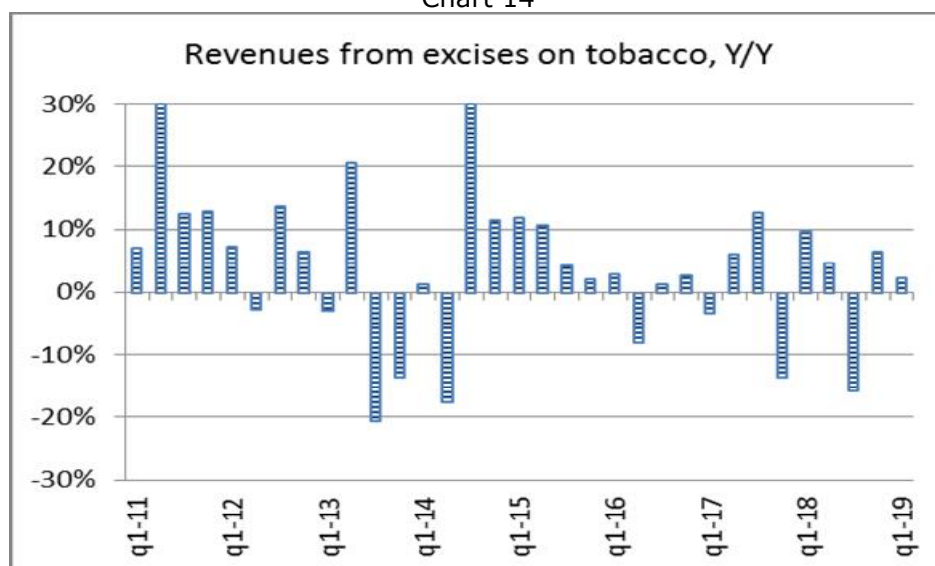


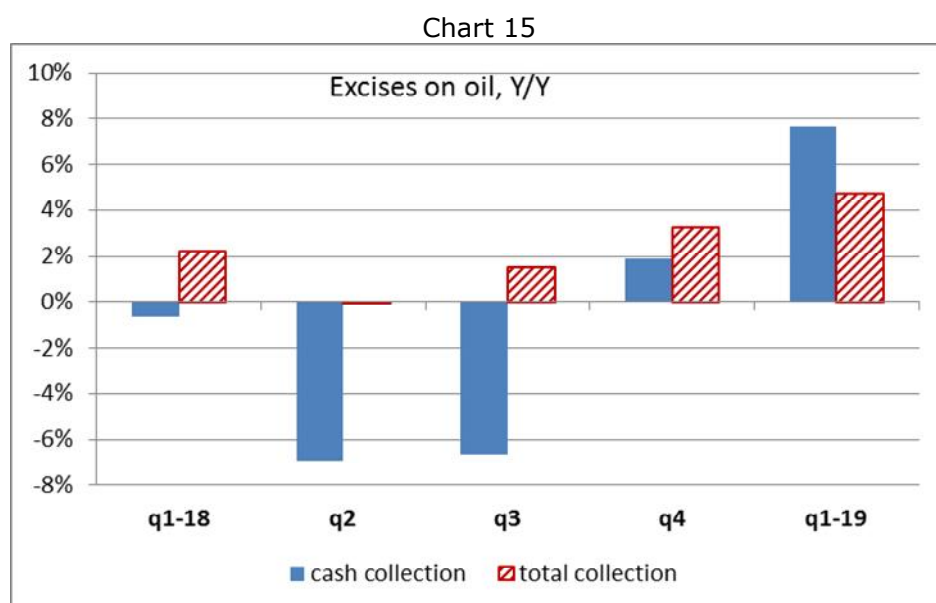
Chart 14



There was an increase in revenues from excise taxes on tobacco products in March 2019, both on imports and on domestic products. However, bearing in mind that the domestic production of tobacco products in 2018 was halved, the increase in the collection in March only aroused hope that the remaining production, which consists of only two brands of cigarettes, will not be shut down. There was a rise in the retail prices of cigarettes and tobacco due to the increase of specific excise on cigarettes and cut tobacco as of 1 January 2019. In such circumstances, the growth in the collection of excise taxes on imported tobacco products indicates a "crawling" takeover of the market of tobacco products in B&H by large world companies, by gradual substitution of the domestic cigarettes with the cigarettes from imports. In addition, it should be borne in mind that the rise in retail prices of cigarettes on average is significantly below the level which would

compensate for the overall growth of the tax burden on cigarettes. The mentioned price and market strategy of the few large tobacco companies in the B&H market resulted in 2,3% increase in revenues from excises on tobacco products in the first quarter of 2019 (Chart 14). If we look at the past business policies, the takeover of a part of the additional tax burden on the expense of the company's profits usually lasted only a few months, and no more than two quarters, so that the increase in retail prices of cigarettes can soon be expected, followed by the occurrence of negative effects on consumption and collection of excise duties.

According to the cash flow report, excise tax revenues on oil derivatives in the first quarter of 2019 increased by 7,7% compared to the same quarter of 2018 (Chart 15). However, bearing in mind that during 2018 there was a frequent occurrence of the offsetting the liabilities for excise duties on oil derivatives by VAT credits, in order to get real picture of excise duty collection dynamics, it is necessary to include collection of excises by compensations in the base for comparison. After correcting the base, the growth of excise revenues on oil derivatives in the first quarter of 2019 amounted 4,7% (Chart 15, "Total collection").



The corrected trends point to the conclusion that the increase in tax burden on oil derivatives did not negatively affect the consumption of derivatives in B&H. On the contrary, significant growth rates of consumption and consequently of excise revenues have been achieved even in times of turbulences of oil prices on the world market. In addition, the overhaul of the Refinery that has lasted for several months led to the substitution of domestic oil derivatives with the imported ones, resulting in a shift in the structure of the derivatives market to the benefit of imported derivatives.⁸

Increase in the rate of road tax as of 1st February 2018 brought the enormous revenue growth from the road tax in 2018 (Chart 16).

⁸ The share of domestic excise tax revenues on oil derivatives in total excise taxes dropped from a maximum of 44%, as recorded in 2010, to only 13% in the first quarter of 2019.

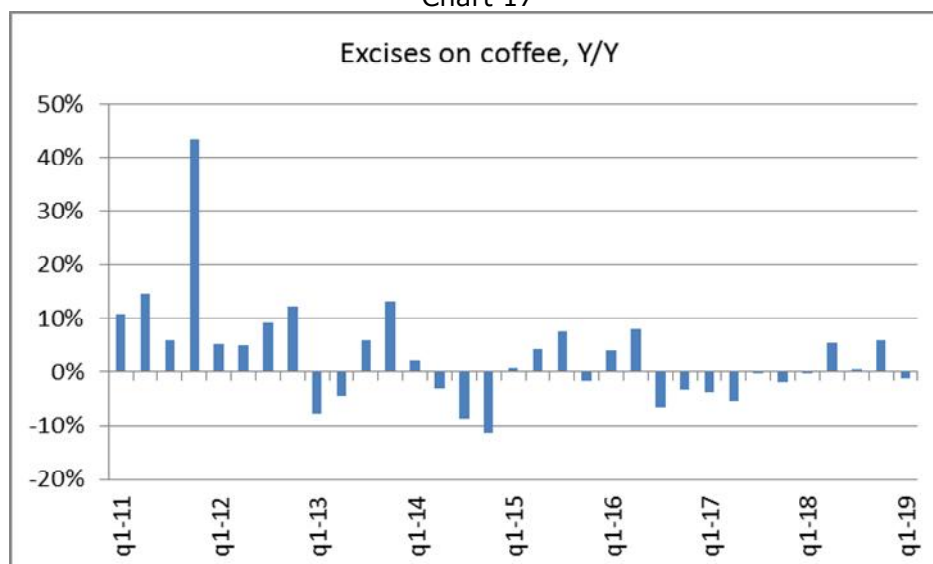
Chart 16



The growth of 21,8% was achieved in the first quarter of 2019. Since the effects of the increase in road tax appeared only in January 2019, the growth rate in the first quarter is considerably higher than the rate of increase in revenues from excises on oil derivatives. In the rest of 2019 it is expected the stabilization of the growth rate of the road tax revenues in line with consumption growth.

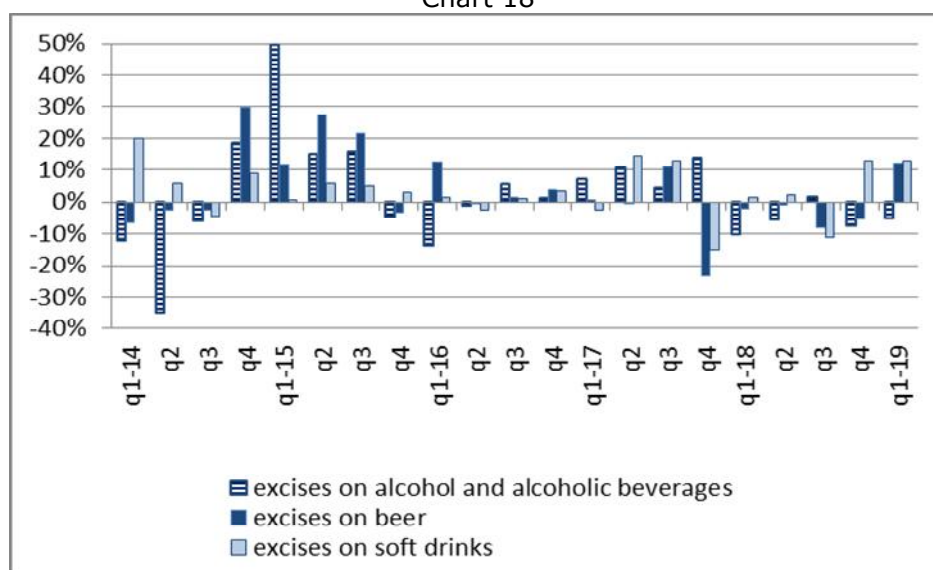
The collection of excises on coffee has shown strong quarterly oscillations (Chart 17), which, however, brought an increase of 3% in 2018. In the first two months of 2019 a cumulative increase of 2,9% was achieved. However, excise revenues fell by 7,5% in March, which annulled a positive growth and brought a decline of 1,2% in the end.

Chart 17



In the first quarter of 2019, revenues from excises on non-alcoholic beverages increased by 12,9%, continuing positive trends from the fourth quarter of 2018 (Chart 18). On the other hand, the negative trends in the collection of excises on alcohol and alcoholic beverages from 2018 have been continued. Excise collection decreased by 5,1% compared to the same quarter of 2018. After five consecutive quarters of negative growth in the collection of excises on beer, there was a high increase of 12,2% in the first quarter of 2019. The main reason of a high growth in the first quarter is the collection of old debt based on domestic excise duties on beer. After excluding the effect of collecting old debts from the collection in 2019, there is a 10,2% drop in total collection of excises on beer. Therein the collection of domestic excises on beer was lower by 4,4%, while the collection of excises on imported beer was 3,5% higher. However, this was insufficient to offset negative trends in the collection of domestic excise.

Chart 18



2. Projections of revenues from indirect taxes for the period 2019-2022

Revenue projections for the period 2019-2022 are available in Table 3. In order to ensure the comparability of projected and collected revenues from indirect taxes, projections of indirect tax revenues are presented on a cash basis in accordance with ITA reporting on collection by type of revenue.

In Table 4, revenue projections are presented in % of GDP. The declining trend of indirect taxes in GDP is explained by the projected decline in the share of consumption in GDP (DEP).⁹ The projected share of indirect taxes in total consumption in the forthcoming period is stable and amounts 19,7% in 2019 (growth of 0,2 p.p. compared to 2018, see Table 2), 19,6% in 2020 and 2021, and 19,5% in 2022.

⁹ According to DEP projections from March 2019, the share of total consumption in GDP will fall from 93,8% in 2018 to 87,8% in 2022.

Table 3: Projections of revenues from indirect taxes in million BAM (2019-2022)

| Type of revenue (net) | In million BAM | | | | | | Projected growth rate | | | |
|-------------------------------|----------------|----------------|----------------|----------------|----------------|--|-----------------------|-------------|-------------|-------------|
| | Execution | Projection | | | | | 2019 | 2020 | 2021 | 2022 |
| | 2018 | 2019 | 2020 | 2021 | 2022 | | | | | |
| VAT | 3.839,0 | 3.979,5 | 4.106,3 | 4.246,5 | 4.405,0 | | 3,7% | 3,2% | 3,4% | 3,7% |
| Excises | 1.444,7 | 1.480,1 | 1.495,6 | 1.517,1 | 1.539,6 | | 2,5% | 1,0% | 1,4% | 1,5% |
| Customs | 286,6 | 302,3 | 324,4 | 348,1 | 376,3 | | 5,5% | 7,3% | 7,3% | 8,1% |
| Road tax | 620,7 | 656,4 | 668,3 | 681,6 | 695,9 | | 5,8% | 1,8% | 2,0% | 2,1% |
| Other | 29,7 | 34,6 | 35,0 | 35,4 | 35,8 | | 16,4% | 1,1% | 1,2% | 1,2% |
| TOTAL | 6.220,8 | 6.452,9 | 6.629,6 | 6.828,7 | 7.052,6 | | 3,7% | 2,7% | 3,0% | 3,3% |
| Earmarked road tax *) | -385,9 | -410,3 | -417,7 | -426,0 | -435,0 | | 6,3% | 1,8% | 2,0% | 2,1% |
| FUNDS FOR DISTRIBUTION | 5.834,9 | 6.042,7 | 6.211,9 | 6.402,7 | 6.617,7 | | 3,6% | 2,8% | 3,1% | 3,4% |

Notes:

*) The earmarked road tax amounted to 0,10 BAM /l of oil derivatives until 1st February 2018, and from 1st February to 0,25 BAM /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 Revenue¹⁰ does not fully correspond to the amount of the collected earmarked road tax shown in Table 3 (385,9 million BAM) due to the application of the new model of distribution of collected road tax as of 1st 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 BAM/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 BAM/l of derivatives to the Entities and the Brcko District according to the new model started only in March 2018.

¹⁰ Official Gazette of B&H, No 91/17

Table 4: Projections of revenues from indirect taxes in % of GDP (2019-2022)

| Type of revenue (net) | % GDP | | | | |
|-------------------------------|---------------|--------------|--------------|--------------|--------------|
| | Execution **) | Projection | | | |
| | 2018 | 2019 | 2020 | 2021 | 2022 |
| VAT | 11,3% | 11,2% | 11,1% | 10,9% | 10,7% |
| Excises | 4,2% | 4,2% | 4,0% | 3,9% | 3,7% |
| Customs | 0,8% | 0,9% | 0,9% | 0,9% | 0,9% |
| Road tax | 1,8% | 1,8% | 1,8% | 1,7% | 1,7% |
| Other | 0,1% | 0,1% | 0,1% | 0,1% | 0,1% |
| TOTAL | 18,3% | 18,2% | 17,9% | 17,5% | 17,2% |
| Earmarked road tax *) | -1,1% | -1,2% | -1,1% | -1,1% | -1,1% |
| FUNDS FOR DISTRIBUTION | 17,1% | 17,0% | 16,7% | 16,4% | 16,1% |

Notes:

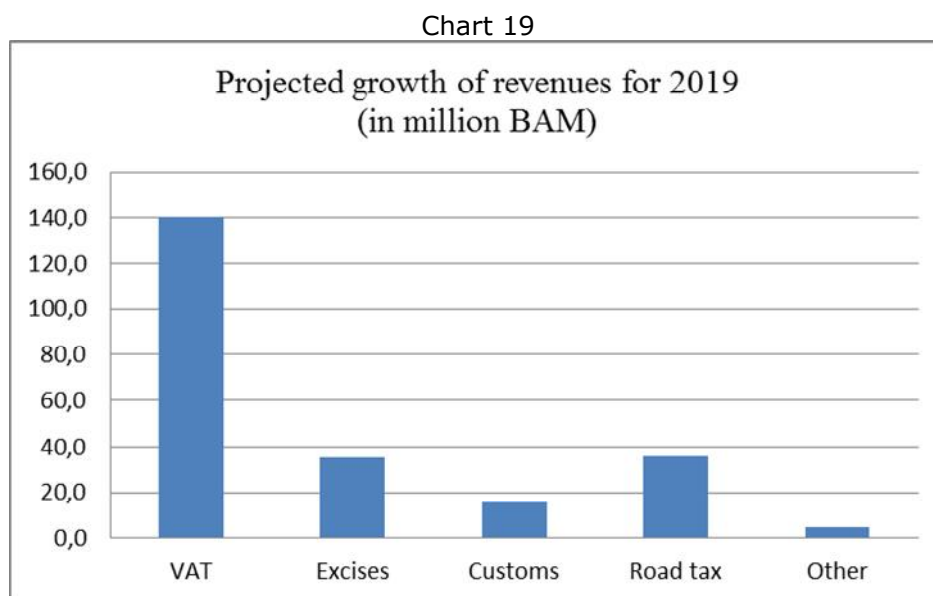
*) The earmarked road tax amounted to 0,10 BAM /l of oil derivatives until 1st February 2018, and from 1st February to 0,25 BAM /l of oil derivatives

***) Given that no official data from national accounts was available for 2018, but the GDP projections by DEP (March 2019) were taken, the data in the column "Execution for 2018" can also be considered as projections.

2.1. Projections for 2019

The projected amount of net revenues of indirect tax revenues for 2019 is 6.452,9 million BAM, which is 3,7% more than in 2018. The projected revenue growth in absolute terms amounts to 232,1 million BAM.

Chart 19 shows the share of certain types of revenues in the projected absolute growth of total revenues (in million BAM).



VAT

VAT revenues have the biggest contribution (140,4 million BAM) to the projected absolute growth of revenues in 2019. The main reasons why the projected growth rate of annual collection (3,7%) is even 1.3 p.p. below the executed growth rate of net VAT in the first quarter of 2019 are the following:

1. Projections of annual macroeconomic indicators (DEP), primarily the growth of private consumption, which is below revenue growth in the first quarter of 2019.
2. The used assumption of the absence of offsetting the liabilities for excise duties and road tax by VAT credits in 2019. Given that only a small part of the offsetting in 2018 was realized in the first quarter (3,0 million BAM), in the forthcoming period (IV-XII 2019) a lower VAT revenue growth could be expected than in the first quarter because of a higher base for comparison in the previous year on this basis. The usage of this assumption was reflected in the projections of excise revenues on oil derivatives and road tax in the same amount but in the opposite direction (+).

Excises

The projected amount of total excise revenues in 2019 amounts to 1.480,1 million BAM, which is 35,4 million BAM or 2,5% more than the collection in 2018.

Revenues from excises on oil derivatives

The largest part of the increase in excises in 2019 is due to the projected increase in excise tax on oil derivatives, which is significant due to the used assumption of the absence of offsetting the liabilities for excise duties and road tax by VAT credits in 2019. The projected high growth of excise tax on oil derivatives is also supported by favorable trends of collection of these revenues in the first quarter of 2019 (see section 1.3.2 Collection in the first quarter of 2019, Chart 15)

Revenues from excises on tobacco

Current trends in collection of excises on tobacco products in the first quarter of 2019 indicate deterioration in trends. This was expected regarding the latest increase in specific excise tax as of 1st January 2019, which caused the increase in retail prices of tobacco products. The price increase creates the additional incentives for the substitution of legal tobacco products with illegal or hand rolled cigarettes, resulting in further compression of the legal market value of tobacco products and the decrease in legal consumption of cigarettes, measured by the number of issued excise stamps. In such circumstances, with the intensified measures to combat black market, in the best case it may be expected the level of excise revenues collection as in 2018. The overall situation will be relaxed by the fact that, according to estimates, the total excise tax contained in the retail prices of all cigarettes should reach the legal threshold of 176 BAM / 1000 cigarettes in 2019. By complying with this legal ceiling, which at the same time represents the standard of cigarette taxation in the EU, there will no longer be a mandatory increase in the specific excise tax on cigarettes at the beginning of 2020. After ten years of continuous increasing in cigarette prices, the consumers of cigarettes will not be under pressure of creating the short-term cigarette stocks at the end of the year, which should be to a lesser extent reflected on the tobacco business policies in terms of changing import dynamics, as well as on the scheme of collection of excises in 2019, which in the case of imports are paid *ex ante*.

Road tax

The projected amount of the road tax in 2019 is 656,4 million BAM, which is 5,8% more than the collection in 2018. The projected increase of the road tax of 35,7 million BAM in 2019 is based on:

1. the effects of the growth of the specific road tax rate in January 2019 as compared to January 2018 (the amendments to the Law on Excises were applied as of 1st February 2018),
2. the projections of real growth rates of macroeconomic indicators (DEP),
3. assumption about the absence of offsetting the liabilities for road tax by VAT credits in 2019.

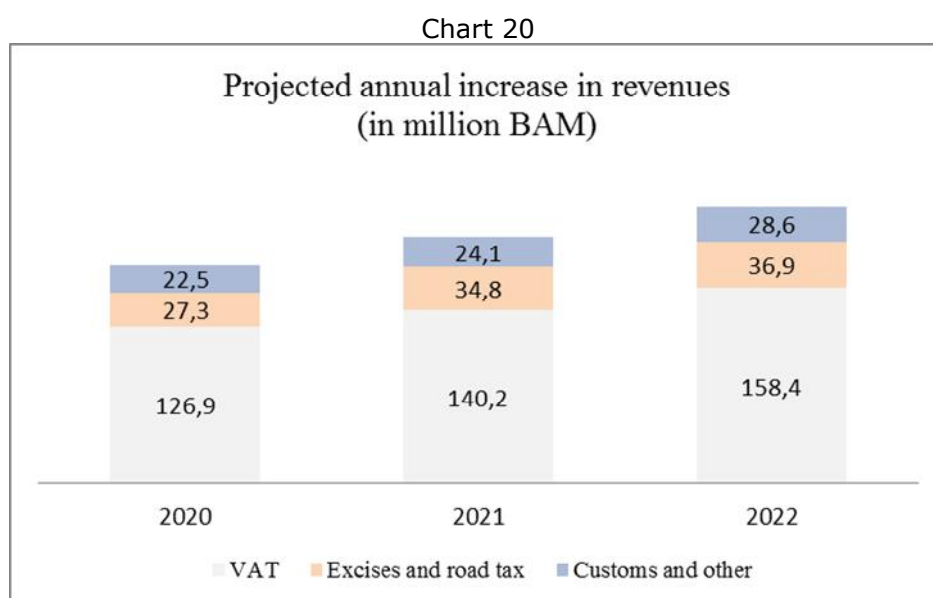
Customs

The projection of customs revenues for 2019 amounts to 302,3 million BAM and is based on current collection trends and projections of imports growth.

2.2. Projections for the period 2020-2022

The projected revenue growth rates for 2020, 2021 and 2022 are 2,7%, 3,0% and 3,3% respectively. Revenue projection in this period is based on projected relevant macroeconomic indicators, historical seasonal collection scheme and projections of individual revenue categories for 2019. As in the case of 2019, projections are made on a cash basis. It is assumed that there will be no offsetting the liabilities for road tax by VAT credits in 2019. If they eventually appear, this can be reflected in the deviations of collection from projections by type of revenue, rather than the total collection of indirect taxes.

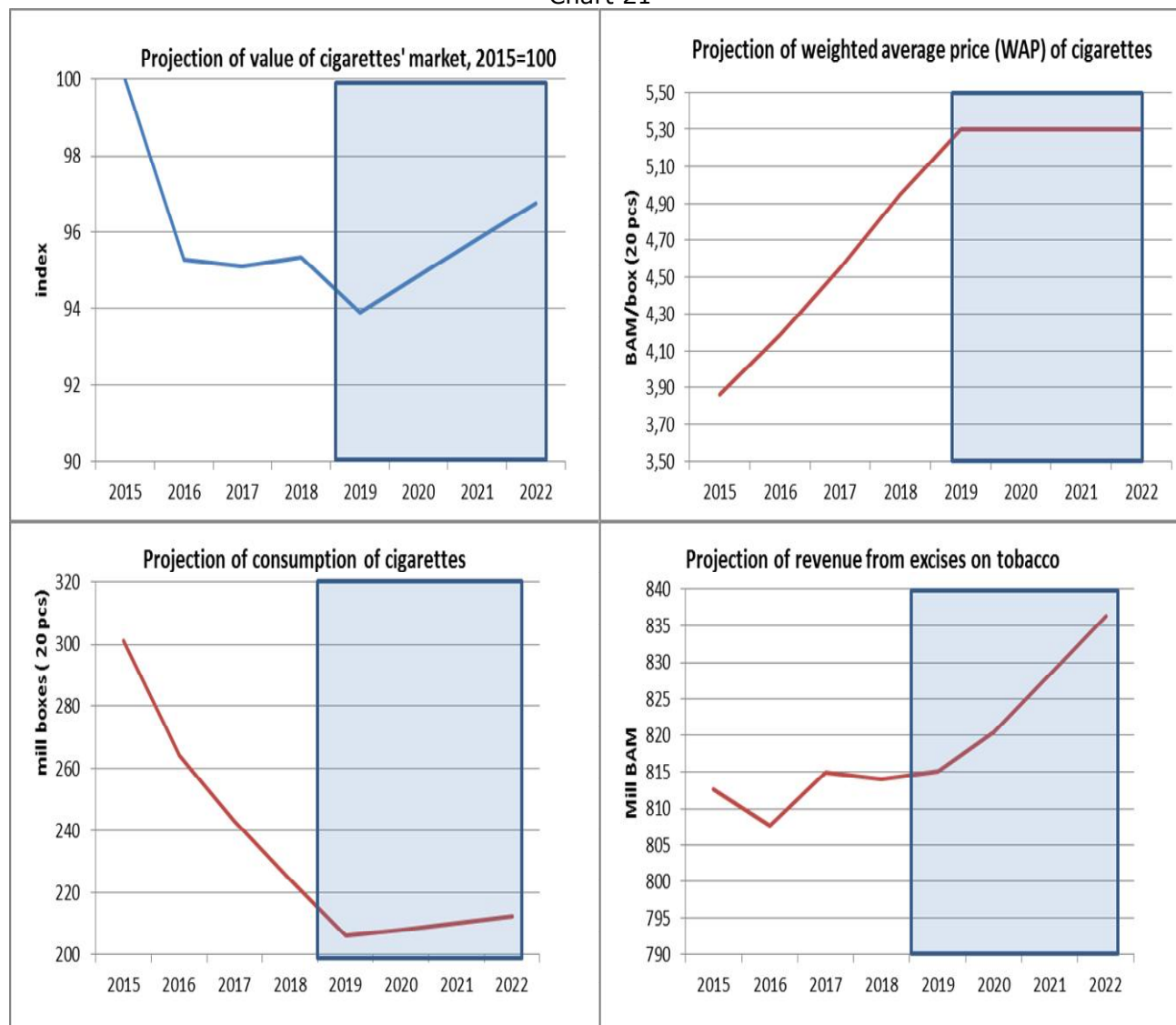
Chart 20 shows the projected annual growth of revenue by type.



Road tax revenues do not contribute significantly to the projected absolute revenue growth in the period 2020-2022 due to the exhaustion of the effects of tax rate increase. Projections of excises (with the exception of part of excise duty on tobacco that is charged *ad valorem*) and road taxes

are based on the projections of real growth rates of appropriate macroeconomic indicators, which is another reason, in addition to falling share of consumption in GDP, of the decrease of projected revenues in GDP (see Table 4).

Chart 21



Starting from the assumption that the harmonization process of excise duties on cigarettes with EU standards will be completed in 2019, the stabilization on the tobacco products market and then recovery can be expected in the next three years (Chart 21). The realization of these forecasts depends on the growth of income, which could have caused that smokers, who had switched over to cut tobacco earlier because of the high prices of cigarettes, return again to the cigarette consumption. In such circumstances it is realistic to expect first stagnation, and then decline of the cut tobacco market. However, the value of cigarette market will not reach the level of 2015 by the end of the planned period. Given the real necessity of the market stabilization, it is also expected the stability of average prices. It is possible that due to the positioning on the market there will be a change in the prices of some brands, especially given the total uncertainties about the future of the domestic cigarette production. The rapid reduction in the production of domestic

cigarettes during 2018 had the effect of changing the cigarette structure, i.e. the substitution of domestic cigarettes with the brands from imports, which ultimately led to an increase in the average weighted cigarette price in B&H above expected. Changing the structure of the cigarette market in favor of importers also brought a change in the collection scheme of excise revenues¹¹ and, ultimately, higher collection of excises in 2018 than expected. The rise in the value of cigarette market and the stagnation of retail prices could result in poor growth in cigarette consumption after a decade of sharp decline. In these circumstances, it is possible to expect an increase in excise revenues of 0,7% in 2020, and of 1% in 2021 and 2022 (Chart 20). An important factor in the realization of the projected growth of excise revenue collection is the effectiveness of measures to combat the black market.

3. Differences compared to previous projections

3.1. Differences in projections for 2018

According to projections of the Unit from October 2018, there had been expected the growth rate of indirect tax revenues of 7,3%. The execution was exceeded by 1,3 percentage points or by 78,2 million BAM (0,23% of projected GDP). If we observe the October projections by type of revenue, we see that they have been exceeded on the revenues from VAT and excise taxes on tobacco (Table 5).

Table 5. The differences between the revenues collected in 2018 from the October 2018 projections

| | excises | | | | | | | |
|----------------|---------|-------|---------|-------|---------|----------|--------|-------|
| | VAT | oil | tobacco | other | customs | road tax | other | total |
| in million BAM | 80,2 | 0,2 | 7,2 | 0,5 | -0,4 | 0,5 | -10,0 | 78,2 |
| in % of GDP*) | 0,24% | 0,00% | 0,02% | 0,00% | 0,00% | 0,00% | -0,03% | 0,23% |

*) Projection of GDP, DEP, March 2019

The VAT revenues are higher due to positive trends in net collection in the last quarter of 2018. Lower execution of refunds from October's expectations, primarily on the basis of international projects, positively reflected on the net collection. Excise tax revenues were exceeded due to the substitution of part of the domestic consumption of cigarettes by cigarettes from imports, and the consequent time shift of part of collected revenues in 2018 (see footnote 11). All other categories of revenues (customs, road tax, and other excise categories) have been executed at the level of the projected amount (the difference between projected and executed revenues ranges between 0 and 1 million BAM). The exception are "other revenues", which amounted 10 million BAM less than in October projections, and the difference refers to unadjusted revenues on Single Account whose level depends solely on administrative factors.¹² The smaller amount of unadjusted revenue from their cumulative level in the first three quarters has had a positive impact on the executed amounts of other categories of revenue, primarily VAT revenues.

If, on the other hand, we observe the Unit's projections from the October 2017 on which the 2018 budgets have been based on, we see that they have been exceeded by 218,1 million BAM or by + 0,64% of the projected GDP. It should be borne in mind that the total executed revenues in 2018 cannot be compared with the projections from 2017, due to effects of the amendments to the Law

¹¹ Excises on domestic cigarettes are paid on a monthly basis ten days after the expiration of the month, and excises on imported cigarettes when taking over excise stamps which is the month - month and a half before the moment of import / consumption.

¹² Unadjusted revenues include revenues for which relation cannot be made between analytics of payment (Single Account) and analytical records of taxpayers in modules of the ITA IT system.

on Excises in 2018 which at that time have not been incorporated into projections because of the then unknowns regarding the adoption of amendments to the Law on Excises. If we compare the distribution funds in 2018 (which do not include those effects) with the projections from October 2017, we will see that they were executed at the level that was planned at that time (the difference was only -12,7 million BAM or -0,04% of projected GDP).

3.2. Differences in projections for the period 2019-2021

The differences between the projections of indirect taxes for the period 2019-2021 compared to the projections from October 2018 result from changes in the trends of the collection of certain types of revenues and changes in the projections of macroeconomic indicators (see Charts 1-3 in section 1.1. Projections of macroeconomic indicators).

The assumption of offsetting the liabilities for excise duties and road tax by VAT claims¹³ has been altered in comparison with the projections of the Unit from October 2018. In the April 2019 projections of the Unit, this assumption was abandoned given the Refinery's overhaul over several months, and the consequent fall in the consumption of domestic derivatives and their substitution for imports. It is logical that reducing the obligations for domestic excise taxes on oil derivatives in 2019 should lead to a reduction in the need to use VAT credits in order to meet their obligations. It should be mentioned again that the use of any assumption on the amount of the offset obligation does not affect the total projected revenue, but only a certain type recorded on a cash basis.

The differences between the projections by type of revenue in comparison with the projections from October 2018 are shown in Table 6. The differences are expressed in million BAM and in % of projected GDP (DEP, March 2019).

Table 6: Differences of projection for the period 2019-2021 compared with the projections from October 2018.

| | In million BAM | | | in % of GDP *) | | |
|--------------|----------------|--------------|--------------|----------------|--------------|--------------|
| | 2019 | 2020 | 2021 | 2019 | 2020 | 2021 |
| VAT | 106,8 | 115,9 | 126,5 | 0,30% | 0,31% | 0,32% |
| Excises | 40,8 | 26,5 | 15,0 | 0,11% | 0,07% | 0,04% |
| Customs | -2,1 | 2,6 | 7,6 | -0,01% | 0,01% | 0,02% |
| Road tax | 8,8 | 11,5 | 14,4 | 0,02% | 0,03% | 0,04% |
| Other | -5,6 | -5,6 | -5,6 | -0,02% | -0,02% | -0,01% |
| TOTAL | 148,7 | 151,0 | 158,0 | 0,42% | 0,41% | 0,40% |

*) Projection of GDP, DEP, March 2019

VAT

It can be concluded from Table 6 that the biggest differences are on VAT revenues. Differences on this type of revenue are driven by:

- changes in the statistical base, i.e. higher VAT revenue collection in 2018 than the projected amount in October (see Table 5);

¹³ In the projections from October 2018, the following is stated: „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.”

- positive collection trends in the first quarter of 2019, above the projected growth rate of consumption for 2019 (see section 1.3.2 Collection in the first quarter of 2019);
- changes in projected growth rates of private consumption (see Chart 3)
- change in the assumption from the Unit's October 2018 projections about offsetting the liabilities for excise duties and road tax by VAT claims.

Excises and road tax

The differences in excise projections compared to the October projections are based on:

- changes in the statistical base, i.e. higher collection of revenues from excises on tobacco in 2018 than the projected amount in October (see Table 5);
- changes in projected rates of macroeconomic indicators (see Charts 1-3)
- slower growth of the value of cigarette market in comparison with the consumption growth;
- change in the assumption from the Unit's October 2018 projections about offsetting the liabilities for excise duties and road tax by VAT claims.

Customs

The differences in customs projection in comparison with the October projections are based on:

- Positive trends in collection in the first quarter of 2019, above the projected growth rate for imports for 2019 (see section 1.3.2 Collection in the first quarter of 2019);
- changes in projected import rates (see Chart 2)

4. Risks

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 2019-2022 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.
- The weakening of regional tax competitiveness, due to the deterioration of indirect tax policies in B&H in terms of the growth of specific excise on tobacco products, will lead to a reduction in external demand (border, transit, tourism);
- 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.