



Macroeconomic Unit of the Governing Board of the Indirect Taxation Authority

# ОМА Билтен

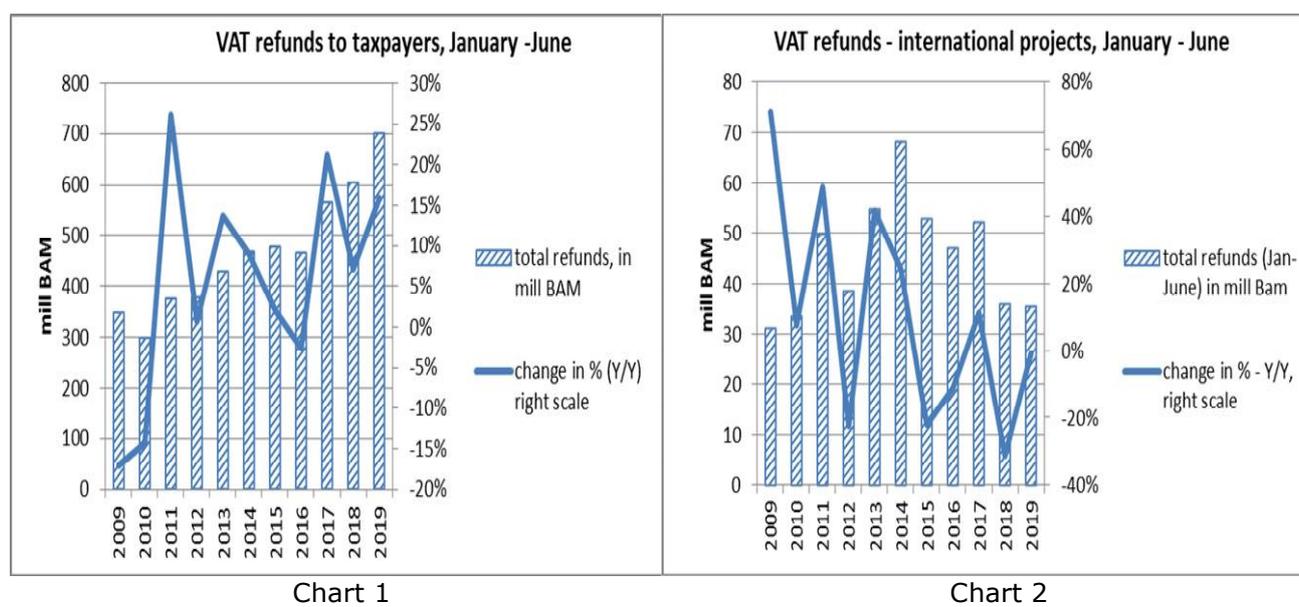


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## With this issue

According to the preliminary cash flow report, at the level of six months of 2019, the gross collection of indirect taxes was higher by 232,1 million BAM, while the refunds were higher by 97,2 mil BAM. Due to the increase in refunds, the cumulative net collection was higher by 134,9 million BAM or 4,6%.



Compared to the first half of 2018, the refunds to taxpayers increased by 95,3 million BAM or 15,8% (Chart 1). On the other hand, after a sudden increase in the payment of refunds to international projects in the first quarter of 2019, there was a slowdown in the second quarter, so in the six months of 2019 the same level of payment was achieved as in the previous year (Chart 2).

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## Analysis of the allocation of revenues from indirect taxes for the period 2006-2018 (trends and structure)

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### 1. Introduction

The process of establishing an indirect taxation system in Bosnia and Herzegovina (B&H) started with the adoption of the Law on Indirect Taxation System in the B&H Parliament (on December 29, 2003) in order to achieve a single economic space and support the fiscal and macroeconomic stability of B&H. After that, the Indirect Taxation Authority of B&H (ITA) was established as a unique body at the level of B&H institutions in charge of collecting all indirect taxes. The term "indirect taxes" includes import and export duties, excises, value-added taxes (VAT) and all other taxes levied on goods and services<sup>1</sup>. From the 1<sup>st</sup> of January 2005, all revenues from indirect taxes are collected on the Single Account (SA) opened at the Central Bank of B&H. The ITA manages with the Single Account and ensures that the balance on the account contains the necessary minimum required for settling liabilities related to collected indirect taxes, and that the allocations according to the budgets of B&H institutions, entities and Brcko District are carried out in accordance with legal regulations. Governing Board of the Indirect Taxation Authority (Board) adopted the Rulebook on calculation of coefficients for allocation to the entities<sup>2</sup> (Rulebook), which prescribes the methodology and procedure for allocation of indirect taxes. In accordance with the Rulebook, the allocation of funds from the Single Account is based on allocation coefficients. It shows participation in final consumption calculated based on the data presented in the VAT returns for certain units (the Federation of B&H, Republic of Srpska and Brcko District).

Revenues from indirect taxes are allocated based on coefficients to the entities and Brcko District and they form the basis of their budgets. Entity laws regulates the further allocation of these revenues, i.e. the Law on Public Revenue in the Federation of B&H<sup>3</sup> and the Law on the Budget System in the Republic of Srpska<sup>4</sup>. B&H is characterized by a complex and asymmetric administrative structure composed of several levels of government, as well as a high degree of fiscal decentralization, and therefore the allocation of revenues from indirect taxes is extremely complex. Namely, B&H consists of two entities: the Federation of B&H with 10 cantons and 79 local government units and the Republic of Srpska with 64 local government units, and the Brcko District with a special status that has a certain degree of fiscal autonomy. The system of financing multiple levels of administration with revenues from indirect taxes consists of their allocation on two levels. The basic users of the first level of allocation are the B&H institutions, entities and Brcko District, while the basic users of the second level of allocation are the cantons, local government units (LGU), "Directorate for Roads of the Federation of B&H" and Public Company "Roads of the Republic of Srpska".

The Governing Board of the ITA decides about the allocation of revenues from indirect taxes by a simple majority of the Board members, including the votes of all three Ministers of Finance.<sup>5</sup> Given that the representative of Brcko District has the status of an observer in the Board, and thus does not participate in the allocation of indirect taxes from the Single Account, the High Representative protected the fiscal autonomy established by the Final Arbitration Award, in June 1, 2007. He imposed a fixed ratio for the Brcko District 3.55% or at least 124 million BAM per annum in absolute terms.

<sup>1</sup> Article 1. The Law on the Indirect Taxation System

<sup>2</sup> "Official Gazette of B&H" No. 62/08

<sup>3</sup> "Official Gazette of the Federation of B&H" No. 22/06

<sup>4</sup> "Official Gazette of the Republic of Srpska" No. 121/12, 52/14, 103/15, 15/16

<sup>5</sup> Article 19 of the Law on the Indirect Taxation System

## 2. Application of the Rulebook on calculation of coefficients for allocation to the entities

The Rulebook prescribes the methodology and procedure for the allocation of revenues from indirect taxes that are transferred to the entities, which remain after the allocation of revenues from indirect taxes collected in the Single Account for minimum reserves, payment of refunds of revenues from indirect taxes and financing of B&H institutions.

The amount for financing the Brcko District is allocated from the remaining amount. The amounts necessary for financing external debt is deducted from the amounts to be delivered to the entities due liabilities and shall be directly paid to the Ministry of Finance and Treasury of B&H that maintains the plan of repayment of external debt.

The Rulebook defined following:

- Dynamics of the coefficient calculation is quarterly
- Quarterly coefficients have a temporary character until the final settlement for that fiscal year
- Two temporary settlements are made for one fiscal year
- A final settlement between the entities is carried out after an external audit has been carried out
- It is not possible to make further adjustments in the allocation after the final settlement for a particular fiscal year

The ITA executes temporary settlements and final settlement between the entities within 30 business days from the date of the settlement decision at the expense of entity's current revenues. The allocation beneficiaries may arrange a deadline for the execution of a temporary and final settlement that is shorter than that period. The quality of final consumption data is in the interest of the ITA as well as all users financed from the Single Account so the constant work on improving final consumption data is the goal of all participants in the allocation. Accordingly, the Unit for Final Consumption was established inside of the Board whose tasks are defined by the Rulebook.

### 2.1. Temporary quarterly allocation

Calculation of quarterly allocation coefficients for the calendar quarters is done based on the cumulative of final consumption expressed on the VAT returns in the three-month period covering the period (t-2) in relation to the first month of the quarter to which they are applied. The ITA shall submit to the Board the signed report about final consumption of the allocation users shown on the VAT returns for each month of the previous year and for each month of the current year. It is submitted on the 21<sup>st</sup> day of the month preceding the quarter for which the temporary quarterly coefficients are determined or the first following working day. These data on final consumption includes all adjustments of VAT returns, which are entered into the IT system on the 20<sup>th</sup> day of the month at 12:00 p.m. relating to the VAT returns included in the calculation of final consumption for the monitored period. Quarterly coefficients of temporary allocation are calculated from the final consumption data obtained from VAT returns in the following way:

Table 1. Quarterly coefficients of temporary allocation

Quarter for which coefficients are calculated:	Monthly VAT returns on final consumption:
Quarter Q1 (I-III)	IX, X, XI from previous year
Quarter Q2 (IV-VI)	XII from previous year, I and II of current year
Quarter Q3 (VII-IX)	III, IV and V of current year
Quarter Q4 (X-XII)	VI, VII and VIII of current year

Quarterly coefficients of the temporary allocation are made by putting into the ratio cumulative of final consumption of each entity in the three-month period from the Table 1 (column left) with the cumulative of final consumption of both entities for the same period. The Macroeconomic Analysis Unit established within the Board prepares the proposal of coefficients for temporary quarterly allocation submitting it to the members of the Board. Upon approval of the members of the Board, quarterly coefficients for allocation shall be submitted to the Director of the ITA for execution.

## **2.2. Temporary settlements**

The Rulebook defines two temporary settlements between the allocation users of revenues from indirect taxes:

- the first temporary settlement takes place on 31<sup>st</sup> of July of current year, and refers to the period January - June of current year, and
- the second temporary settlement takes place on 31<sup>st</sup> of January of current year, and refers to the previous fiscal year.

Temporary settlements are made by putting into the ratio the cumulative of final consumption of each allocation user according to VAT returns with the cumulative of final consumption of both entities for the observed period depending on whether the first or second temporary settlement is made and according with the methodology defined by the Rolebook.

## **2.3. Final settlements**

The final settlement is made after the acceptance of the external audit report. When calculating the final settlement proposal, the external audit shall also take into account the information of the Macroeconomic Analysis Unit regarding the fulfillment of the minimum amount for financing the Brcko District. The Governing Board of the ITA adopts the Decision and determines the date of the final settlement. The Decision about final settlement is submitted to the Director of the ITA for the execution. The final settlement coefficient for each allocation user is calculated by comparing the cumulative of total consumption of each allocation user by VAT returns with the cumulative of total final consumption of two entities in the period January - December for the year for which settlement is made. The amount that should have been allocated to the allocation user is calculated using the final settlement coefficient to the total amount from the Single Account, which was distributed to the entities in the period January - December for the year for which settlement was made. VAT returns for a specific month can still be changed subsequently in a period of five years although the time limit for adjusting the allocation from the Single Account for the previous year is limited to one year. Temporary and final settlements adjust the previously allocated amounts to the entities in order to match the calculation of final consumption calculated for that particular period without a time shift.

## **2.4. The effects of methodology defined by the Rulebook**

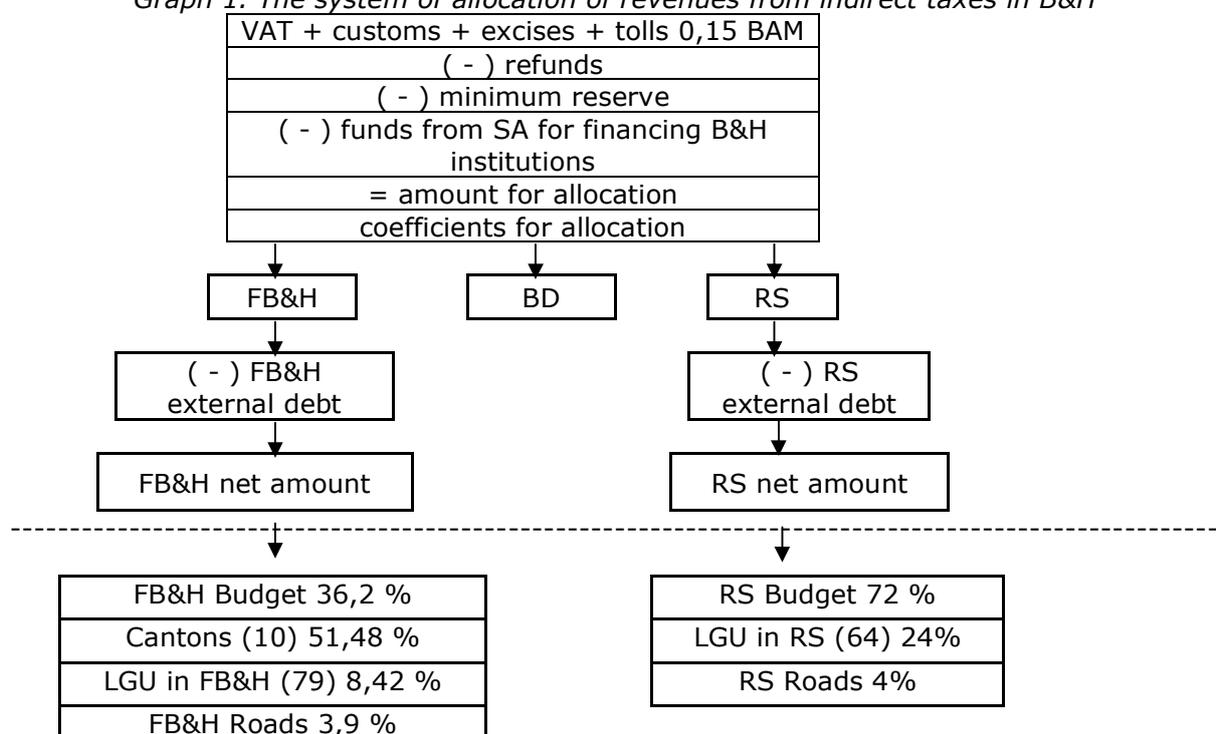
The system of allocation of revenues from indirect taxes is characterized by a certain degree of automatism in determining temporary quarterly coefficients. If the Governing Board of the ITA does not approve the coefficients proposed by the Macroeconomic Analysis Unit until the fifth day of the current calendar quarter for which allocation coefficients should be adopted, the ITA will apply the quarterly coefficients of allocation. These coefficients were the basis for the allocation in the previous calendar quarter i.e. the last adopted allocation coefficients. If the Governing Board of the ITA during the current calendar quarter adopts temporary quarterly coefficients, the ITA will apply them and make a recalculation from the first day of the quarter until the date of the coefficient adoption by the Board, thus the blocking of the Single Account is disabled. That ensures lower levels of governments filling their budgets with revenues from indirect taxes. Quartile

allocation coefficients have many advantages of the economic, fiscal and political nature, because they bring a high degree of stability and predictability. They also bring lower oscillation in filling the budget. Monthly coefficients calculated based on monthly VAT returns would bring greater oscillations and lower stability.

### 3. The system of allocation of revenues from indirect taxes

The system of allocation of revenues from indirect taxes in B&H is shown in Chart 1 from which it is seen that the priority in allocation has taxpayers' refunds. After the allocated amount for refunds, the total amount collected in the Single Account (VAT, customs duties, excises, tolls of 0.15 BAM) is reduced by the amount of the minimum reserves needed for the continuous and unrestricted operations of the ITA. Holding reserves in the Single Account is of strategic importance to the B&H fiscal and economic system. Insufficient reserves cause delays in the economy due to blocking payment of returns, poor and uncompetitive image of the economy, and increase of expenses due to interest payments for each day of delay in payment of refunds and other expense that can be avoided. On the other hand, excessive reserves also lead to borrowing of lower levels of government due to the deficit in the inflow from the Single Account. The amount of the minimum reserves is determined in accordance with the Rulebook on Collection, Compilation, Allocation of revenues from indirect taxes and Reporting<sup>6</sup>. The next step in the allocation is transfer of the corresponding part of amount to the budget of B&H institutions. This amount is calculated as the amount of the B&H institutions budget for the current year, multiplied by the coefficient obtained when 1 is divided by the number of working days of the ITA in the current year. The remaining amount after the deduction of reserves and the amount belonging to the budget of B&H institutions is a part for the allocation to the entities.

Graph 1. The system of allocation of revenues from indirect taxes in B&H<sup>7</sup>



<sup>6</sup> "Official Gazette of B&H", No. 05/05

<sup>7</sup> Izvor: Antić, D., 2013. "Multi-level fiscal system in Bosnia and Herzegovina: evolution and coping with economic crisis". Financial Theory and Practice, 37 (3), 279-310. <http://www.fintp.hr/upload/files/ftp/2013/3/antic.pdf>

### **3.1. Allocation of revenues from indirect taxes in the Federation of B&H**

The Law on public revenue in the Federation of B&H<sup>8</sup> defines the allocation of revenues from indirect taxes paid to the budget of the Federation of B&H from the Single Account. According to the Law, after allocation of part of funds for financing the external debt of the Federation of B&H indirect taxes are divided in the following way:

- i) Budget of the Federation of B&H 36.2%
- ii) Budgets of the cantons 51.48%
- iii) Budgets of the local government units 8.42%
- iv) "Directorate for Roads of the Federation of B&H" 3.9%

If we analyze the allocation of revenues from indirect taxes more detailed, it is important to emphasize that individual participation in the allocation of the cantons in the Federation of B&H is done in accordance with the formula based on the following criteria:

- i) 57% based on the population of the cantons
- ii) 6% based on the cantonal surface area
- iii) 24% based on the number of pupils in elementary education and
- iv) 13% based on the number of students in secondary education<sup>9</sup>.

Furthermore, the individual participation of local government units in the allocation of the revenues from the Single Account in the Federation of B&H is based on the following:

- i) 68% based on the population in the LGU
- ii) 5% based on the surface area of the LGU
- iii) 20% based on the number of pupils in primary education
- iv) 7% based on the level of development of the LGU, defined through the development index.

### **3.2. Allocation of revenues from indirect taxes in the Republic of Srpska**

The Law on the Budget System of the Republic of Srpska<sup>10</sup> defines the allocation of revenues from indirect taxes paid to the budget of the Republic of Srpska from the Single Account. According to the Law, after allocation of part of funds for financing the external debt of the Republic of Srpska indirect taxes are divided in the following way:

- i) Budget of the Republic of Srpska 72%
- ii) Budgets of the local government units 24%
- iii) Public Company "Roads of the Republic of Srpska" 4%

If we analyze the allocation of revenues from indirect taxes more detailed, it is important to emphasize that individual participation in the allocation of local government units in the Republic of Srpska is done in accordance with the formula based on the following criteria:

- i) 75% based on the population in the LGU
- ii) 15% based on surface area of the LGU
- iii) 10% based on the number of students in secondary schools on the LGU territory

<sup>8</sup> Article 6. Law on Public Revenue in the Federation of B&H, "Official Gazette of the Federation of B&H" No. 22/06, 43/08, 22/09, 35/14, 94/15

<sup>9</sup> Article 9. Law on Public Revenue in the Federation of B&H, "Official Gazette of the Federation of B&H" No. 22/06, 43/08, 22/09, 35/14, 94/15

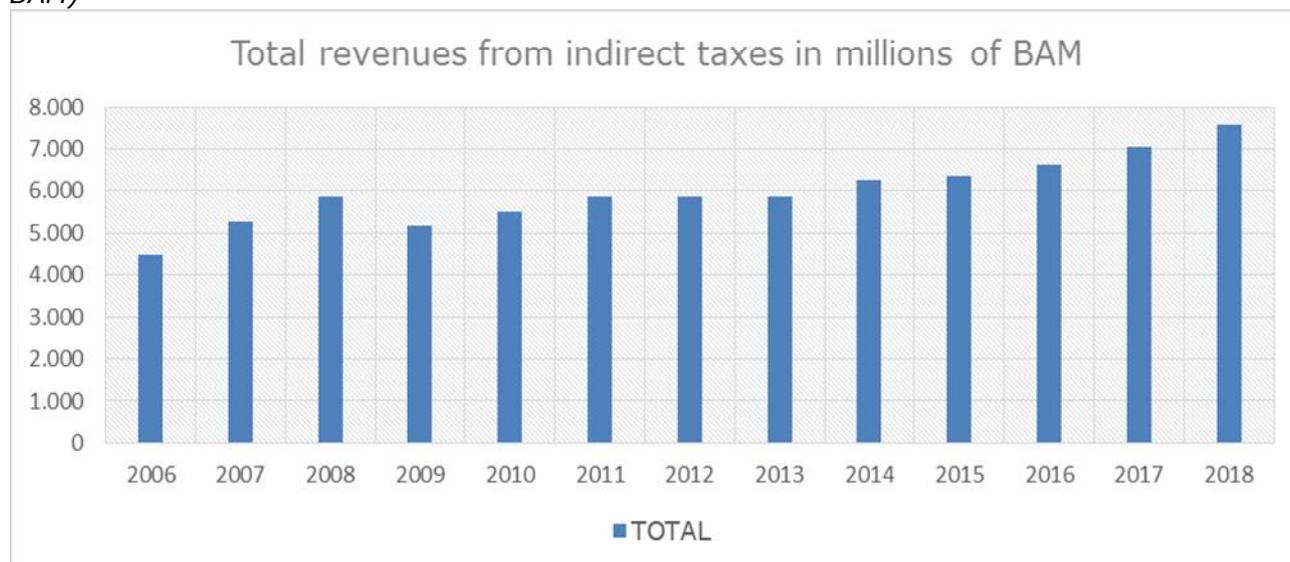
<sup>10</sup> Article 9 of the Law on the Budget System of the Republic of Srpska, "Official Gazette of the Republic of Srpska " No. 121/12, 52/14, 103/15, 15/16

#### 4. Allocation of revenues from indirect taxes in the period 2006-2018

Revenues from indirect taxes constitutes the most important share in public revenues in B&H. Dynamics of filling the Single Account, i.e. collection, and therefore the allocation of these funds is crucial for all budgets. The revenues allocated to the entities, the cantons and the local government units are largely dependent on their collections. It is very important to make an analysis of the collections before we make an analysis of the allocations.

Graph 2. shows the movement of gross collection of revenues from indirect taxes in the period 2006-2018 and we can see that the largest collection was achieved in 2018. The amount of the allocation depends on the amount of the payment. In the period 2006-2008 the collection of revenues recorded a three-year growth, after which a significant decline in revenues occurred in 2009 as a result of the global economic and financial crisis. It significantly influenced the B&H economy. It reduced all key economic indicators in the country in combination with long-term structural problems and low competitiveness of the domestic economy. The fall in foreign trade was accompanied by a decline in total industrial production and in investment, which ultimately resulted in a fall in gross domestic product. The fall in revenues in 2009 was caused by a fall in revenues in the main categories, primarily due to the decline in VAT revenues, which were reduced due to the movement of foreign trade, i.e. due to the high negative growth rate of imports. The fall in customs revenues was caused by the entry into force of the Stabilization and Association Agreement with the EU<sup>11</sup> and total imports in 2009 were reduced due to the slowdown in economic activity in B&H and the world under the impact of global economic and financial crisis.

Chart 2. Gross collection of revenues from indirect taxes in the period 2006-2018 (in millions of BAM)



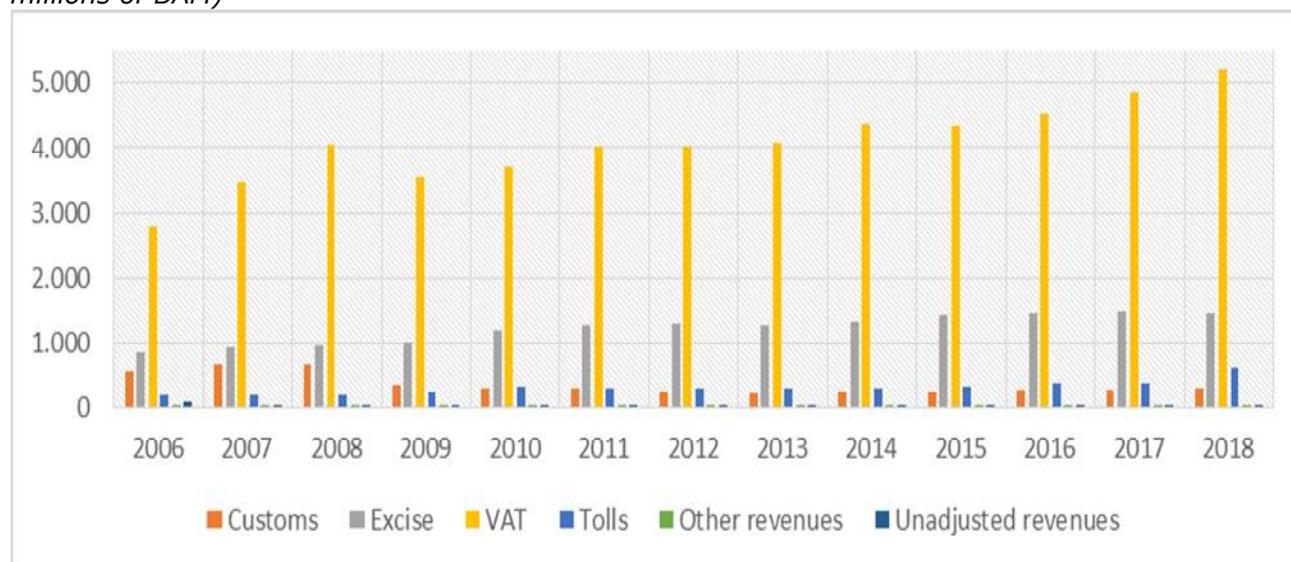
Source: Data of the Indirect Taxation Authority of B&H

Chart 3. shows the movement of gross collection of revenues from indirect taxes over the years by type of revenue individually. The most significant revenues were generated from VAT, after which significant amount was realized from excise duties. If we analyze toll revenues and revenues from import and export duties, i.e. customs revenues, we can conclude that customs revenues were higher than toll revenues in the period 2006-2011. The reason for the decline in customs revenues

<sup>11</sup> Stabilization and Association Agreement with the EU (the gradual abolition of customs duties and the reduction of other non-fiscal charges on imports)

over the years is reflected in the process of liberalization of foreign trade, which implies free trade between individual countries. It was done in phases through the signing of bilateral and multilateral agreements between individual countries. The first phase of liberalization began in 2007. After that, it is visible that collection of customs revenues starts to decline. The collection of excise revenues is continuously increasing, which is reflected in the increase of excises on certain products defined by the amendments to the Law<sup>12</sup>.

*Graph 3. Gross collection of revenues from indirect taxes in the period 2006-2018 by type (in millions of BAM)*



Source: Data of the Indirect Taxation Authority of B&H

## 5. Allocation of revenues from indirect taxes for the period 2006-2018

### 5.1. Allocation of revenues to users

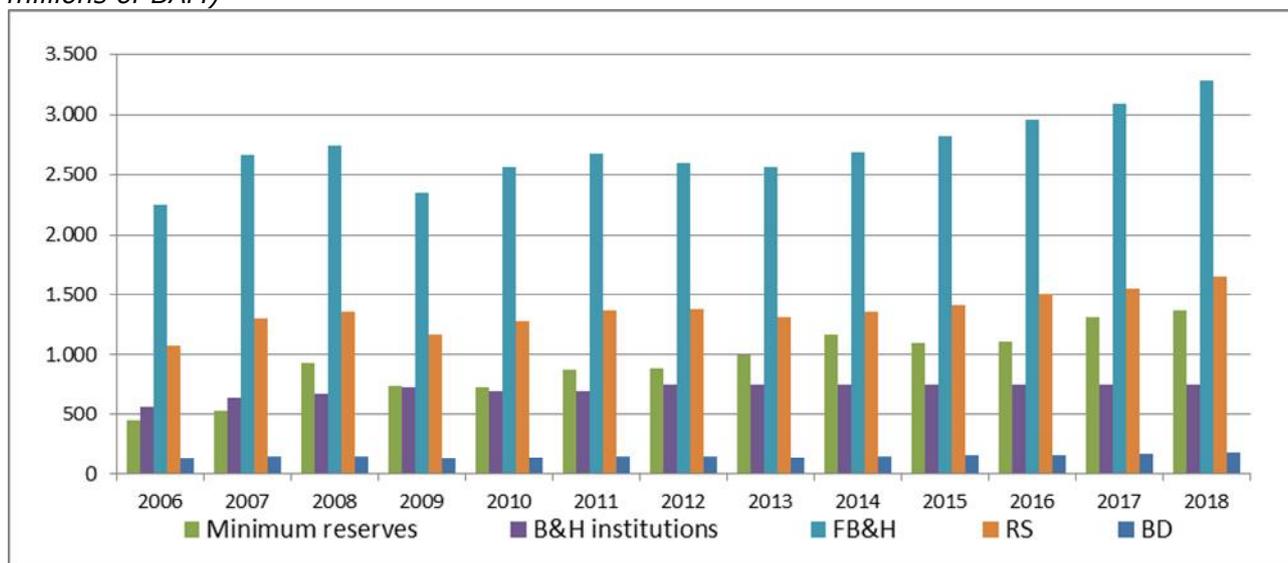
#### 5.1.1. Allocation of gross revenues

Graph 4. shows the allocation of gross revenues from indirect taxes for the period 2006-2018 in millions of BAM. The collection of earmarked tolls is excluded from the amount of gross revenues. From the data, we can conclude that the allocated gross amount in 2018 is by 62.59% higher than in 2006. The amount for the allocation of revenues from indirect taxes is the highest in 2018. The highest growth in 2018 in absolute amount compared to 2006 had the share of the Republic of Srpska, which increased by 54.0%. The total allocated revenues have a tendency of growth in line with the collection in the three-year period 2006-2008. Under the influence of the global economic and financial crisis a sharp decline in the allocation of revenues in 2009 is evident. After that, the allocation is constantly increasing. The amount for allocation of revenues from indirect taxes to the B&H institutions since 2012 is fixed and it is 750 million BAM. It is defined by the Agreement on the Adoption of the Document Global Framework of Fiscal Balance and Policies in Bosnia and Herzegovina<sup>13</sup>.

<sup>12</sup> The Law on Excise Duties ("Official Gazette of B&H" No. 49/09 49/14 60/14 91/17) and the Decision on determining the specific and minimum excise)

<sup>13</sup> [https://www.mft.gov.ba/srb/images/stories/budzet/gfo/2018/Sporazum%20GO\\_srp\\_pdf.pdf](https://www.mft.gov.ba/srb/images/stories/budzet/gfo/2018/Sporazum%20GO_srp_pdf.pdf)

Graph 4. Allocation of gross revenues from indirect taxes to users in the period 2006-2018 (in millions of BAM)



Source: Data of the Indirect Taxation Authority of B&H

Table 2 shows the allocation of gross revenues from indirect taxes for the period 2006-2018 in percentages. From the presented data, we can see the changes in the structure of the allocation. Percentage growth in the allocation of revenues from indirect taxes in 2018 compared to the initial period, i.e. compared to 2006, refers to the minimum reserves (9 p.p.), while the Federation of B&H recorded the largest decline in 2018 compared to the initial period (-5.2 p.p.), in comparison with other participants in the allocation. Observing the average of the coefficients for 2018 compared to 2006, there is a slight decrease in the share of allocation to the entities, Brcko District and B&H institutions, and consequently an increase in the share of allocation in favor of minimum reserves.

Table 2. Allocation of gross revenues from indirect taxes to users in the period 2006-2018 (in % and differences in p.p.)

u %	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	p.p. (2018-2006)
Minimum reserves	10.0	10.0	15.9	14.5	13.5	15.3	15.4	17.3	19.1	17.6	17.1	19.2	19.0	9.0
B&H institutions	12.7	12.1	11.5	14.3	12.7	12.0	13.0	13.0	12.3	12.0	11.6	10.9	10.4	-2.3
FB&H	50.6	50.5	46.8	45.9	47.5	46.4	45.2	44.5	43.9	45.2	45.6	44.9	45.4	-5.2
RS	24.0	24.7	23.2	22.8	23.7	23.7	23.9	22.7	22.2	22.7	23.3	22.6	22.8	-1.3
BD	2.7	2.7	2.6	2.5	2.6	2.6	2.5	2.5	2.4	2.5	2.5	2.5	2.5	-0.2
<b>Total</b>	<b>100</b>	<b>0</b>												

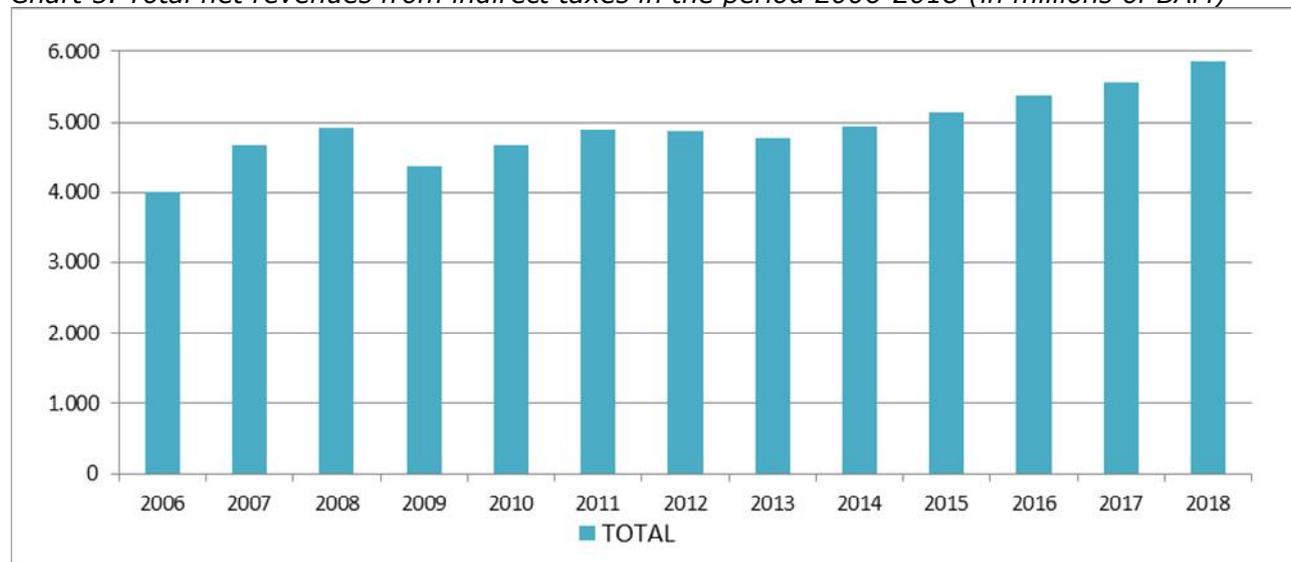
Source: Data of the Indirect Taxation Authority of B&H

### 5.1.2. Allocation of net revenues

Graph 5. shows the total net revenues from indirect taxes for the period 2006-2018 in millions of BAM. Looking at the dynamics of net revenues trends, a growth trend with occasional exceptions in 2009 and 2013 can be observed. From the presented data, we can conclude that the amount of

net revenues in the 2018 is 46.33% higher than in the beginning period, i.e. 2006, and that it is the highest in 2018, which is closely related to the trend of collection.

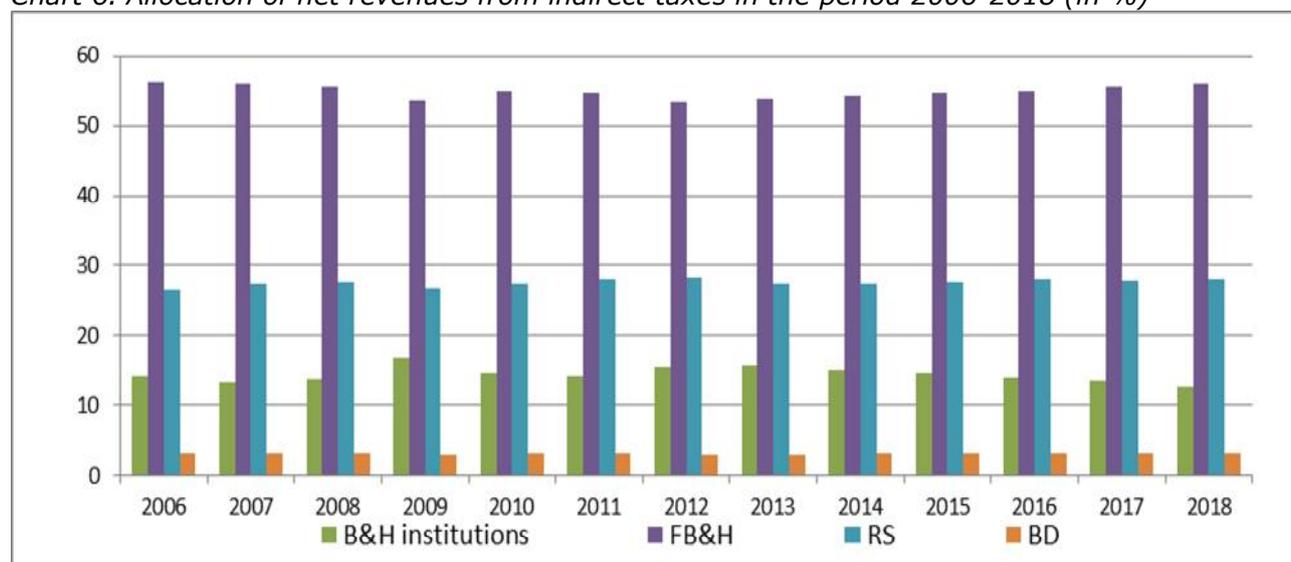
Chart 5. Total net revenues from indirect taxes in the period 2006-2018 (in millions of BAM)



Source: Data of the Indirect Taxation Authority of B&H

Graph 6. shows the allocation of net revenues from indirect taxes to users in the period 2006-2018 in percentages. That includes B&H institutions, the entities and Brcko District. From the data, it can be seen that the amount of allocation to the entities had a fluctuating trend, with the largest amount being allocated in 2018. The Federation of B&H has the largest share in the allocation, after which a significant amount has been allocated to the Republic of Srpska, then to B&H institutions, and Brcko District.

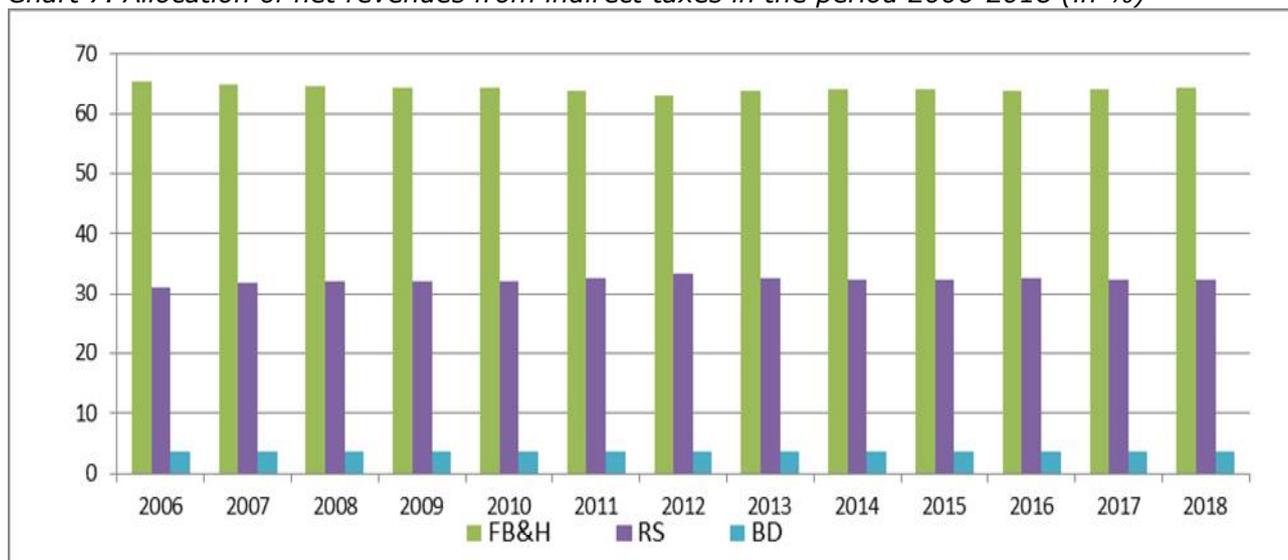
Chart 6. Allocation of net revenues from indirect taxes in the period 2006-2018 (in %)



Source: Data of the Indirect Taxation Authority of B&H

Graph 7. shows the allocation of net revenues from indirect taxes to the entities and Brcko District in the period 2006-2018 in percentages. From the data, it is visible that the allocation coefficient for the entities is fluctuating, while the allocation coefficient for the Brcko District is fixed at 3.55%. In the observed period, the Federation of B&H achieved the highest allocation coefficient in 2006, and the smallest in 2012, which leads to reversed movement for the Republic of Srpska. If we look at the allocation of net revenues from indirect taxes in 2018 compared to 2006 as the starting or base year, we can see a decrease in the coefficient in the Federation of B&H by 1.14 p.p. in favor of the Republic of Srpska.

Chart 7. Allocation of net revenues from indirect taxes in the period 2006-2018 (in %)



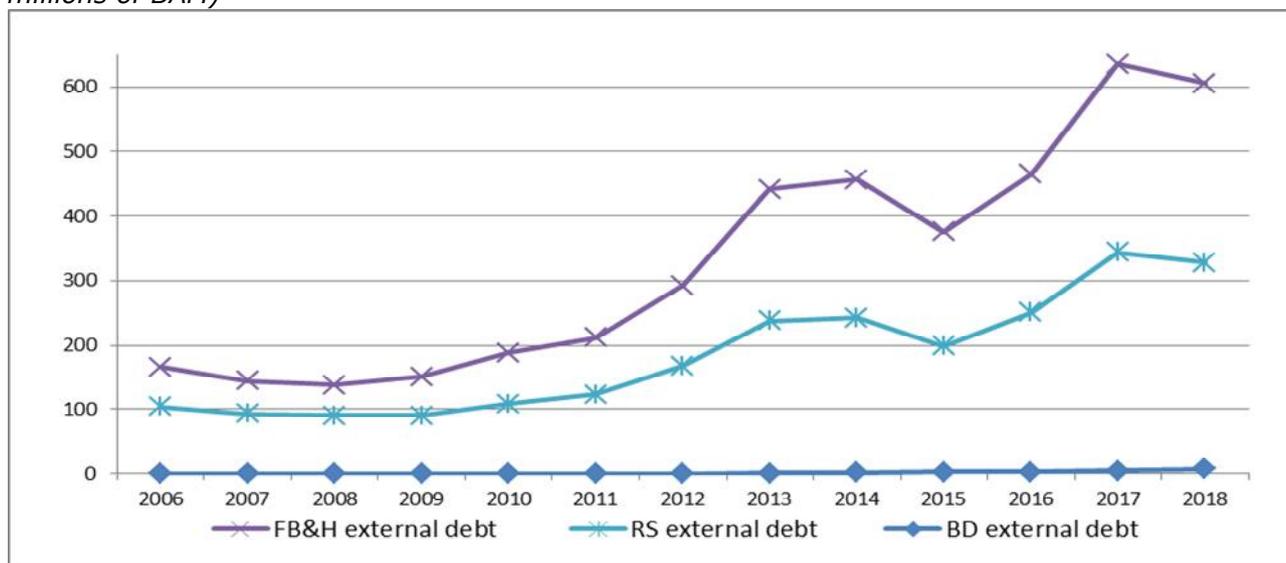
Source: Data of the Indirect Taxation Authority of B&H

## 5.2. External Debt

After allocating part of the funds for the minimum reserves and for the financing of B&H institutions, foreign debt has priority during the allocation of revenues from indirect taxes. According to the dynamics of maturity, it is deducted from the funds intended for allocation to the entities and Brcko District. The increase in the allocation of revenues from indirect taxes for the financing of external debt in the period 2006-2018 indicates the increased indebtedness of the country with foreign creditors, and thus the increased dependence of B&H, i.e. entities and Brcko District on foreign creditors. Liabilities related to the financing of external debt increased in proportion to the increase in external debt in both entities and Brcko District.

Graph 8. shows that the allocation of revenues for financing external debt in the observed period has a tendency of growth in the entities and in the Brcko District. Although we have previously shown significant growth in the collection and allocation of revenues from indirect taxes, simultaneously with the growth of revenues, the external debt of the country is also growing. In accordance with the established system and the allocation method, the growing liabilities of external debt financing "swallowed" a large part of the funds that ultimately are allocated to the entities and lower levels of administration.

Chart 8. Financing of external debt of the entities and Brcko District for the period 2006-2018. (in millions of BAM)



Source: Data of the Indirect Taxation Authority of B&H

Table 3. shows the structure of the external debt of the entities and Brcko District in percentages. Thus, observing the movement of the structure of external debt for 2018 compared to 2006, there is an increase in the allocation of funds in the Federation of B&H and slight increase in the Brcko District, and consequently a decrease in the allocation of funds in the Republic of Srpska.

Table 3. Financing of external debt of the entities and Brcko District for the period 2006-2018 (in %)

u %	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
FB&H external debt	61.64	61.10	60.67	62.58	63.39	63.13	63.43	64.94	65.18	65.01	64.71	64.54	64.34
RS external debt	38.35	38.86	39.28	37.36	36.57	36.84	36.54	34.94	34.60	34.49	34.93	34.99	34.90
BD external debt	0.00	0.04	0.06	0.05	0.04	0.04	0.03	0.12	0.21	0.50	0.36	0.46	0.76
<b>Total</b>	<b>100</b>												

Source: Data of the Indirect Taxation Authority of B&H

### 5.3. The allocation of revenues from highway tolls

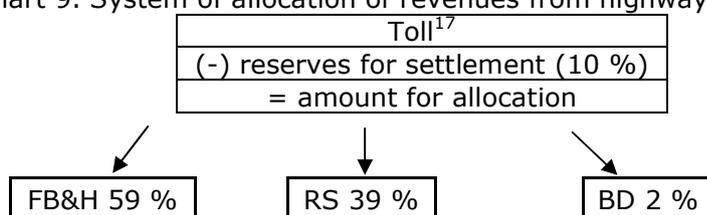
According to Article 2 of the Law on Excise Taxes in B&H<sup>14</sup>, the ITA has opened a separate sub-account within the Single Account for the collection of revenues from highway tolls. The allocation of these revenues is carried out according to the methodology prescribed by the Governing Board of the ITA by a special act. The Governing Board of the ITA adopts a Decision on the temporary allocation of revenues from highway tolls, which determines the temporary allocation<sup>15</sup>. According to the methodology, 10% of the total collected revenues remains in the sub-account of the Single Account and serves to settle the revenues after determining the final allocation methodology. The remaining 90% of revenues are shared between the entities and Brcko District according to the percentages shown in Chart 9.

<sup>14</sup> "Official Gazette of B&H", No. 49/09

<sup>15</sup> "Official Gazette of B&H", No. 102/09,

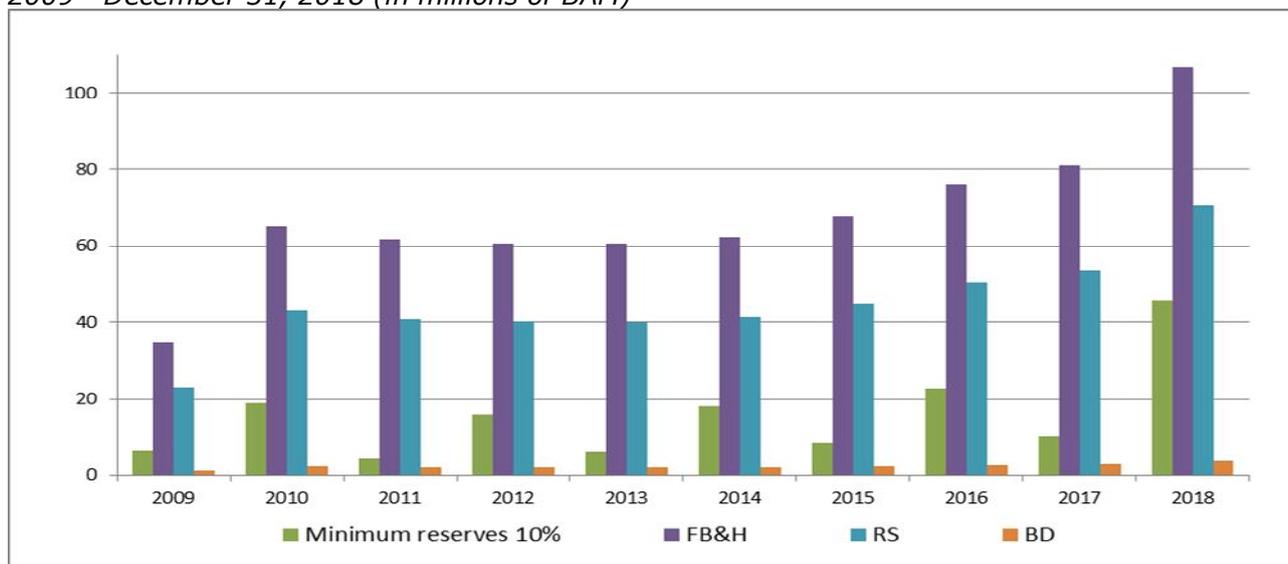
By the Law on Amendments to the Law on Excise Taxes in Bosnia and Herzegovina<sup>16</sup>, the amount of tolls for highways was increased from 0.10 BAM to 0.25 BAM. Started from 1<sup>st</sup> of February 2018 the tolls are collected on a special sub-account in the amount of 0.25 BAM per liter of the derivative sold on the B&H market.

Chart 9. System of allocation of revenues from highway tolls in B&H



Graph 10. shows the allocation of revenues from highway tolls to the customers in the period from 1<sup>st</sup> of July 2009 to 31<sup>st</sup> of December 2018 in millions of BAM.

Chart 10. Allocation of revenues from tolls for highways to the customers in the period July 1, 2009 - December 31, 2018 (in millions of BAM)



Source: Data of the Indirect Taxation Authority of B&H

<sup>16</sup> "Official Gazette of B&H", No. 91/17,

<sup>17</sup> In the period July 1, 2009 - January 31, 2018 tolls for the highways were 0.10 BAM, and since February 01, 2018 they are 0.25 BAM.

## Projections of tax revenues as an element of budgeting and medium-term fiscal management: international standards and practice vs B&H

(Author: Dinka Antić, PhD)

### Introduction

Projections of tax revenues represent an important segment of fiscal projections and forecasts. Leading international organizations, such as the IMF and the OECD, the professional associations of accountants and auditors of the public sector, and regional integrations, as the EU, have for many years created separate standards for fiscal projections, modifying them in line with the best world practice. Given that fiscal projections represent inputs in the budgeting process and the restrictions of medium-term fiscal frameworks, the fiscal projection standards have been incorporated into international standards of budgeting, both one-year, at the level of a fiscal-year, and mid-term and long-term budget cycles. In addition, fiscal projections also follow the fiscal structure of the countries, so the standards for their drafting are applied not only by the central (federal) governments, but also by the lower levels of government.

The need to create global standards for the production of fiscal projections and forecasts has become an urgent issue after the onset of the latest global financial and economic crisis, when the issue of transparency of public finances of countries came to the fore. The unification of standards started in 2011 under the Global Initiative for Fiscal Transparency - GIFT joined by IMF, OECD, World Bank, IBF (International Budget Partnership), IFAC (International Federation of Accountants), civil society organizations and many individuals. The GIFT network has developed a set of fiscal transparency principles that enable direct participation of public in the formulation and implementation of fiscal policy. In order to achieve the proclaimed principles of fiscal transparency, standards and norms have been defined, which, from time to time, have been revising in line with the best practices. However, there are no unified standards of fiscal transparency, nor unique best practices. The IMF Fiscal Transparency Standards are official international standards, while the OECD principles of budgetary governance (OECD, 2014) are part of the international law for member states. There are also different internationally accepted instruments and standards for assessing fiscal transparency, such as standards of the World Bank (PEFA).

### IMF

The IMF Fiscal Transparency Standards (IMF, 2014) are focused on all major segments of fiscal policy and system. The most important areas for the implementation of standards are fiscal reporting, fiscal projections and budgeting, and fiscal risks and management. Transparency of public finances largely depends on the type of socio-political arrangement, the level of development of democracy and institutions, and on the power of civil society. Therefore, it can not be expected that all countries will implement the standards of fiscal transparency at the same pace and in the same time period. In conditions of consciousness of reality, the IMF has provided basic, good and advanced practices for the pillars and principles within them. It is logical to expect each country to take over basic practice, and to gradually take on a good and more advanced practice in the next steps.

#### *The fiscal reporting pillar*

The fiscal reporting pillar requires that fiscal reports should provide a comprehensive, relevant, timely and reliable overview of the financial position and performance of government. Within this Pillar, for the revenue projections is relevant the integrity (1.4.) of fiscal data. Integrity basically means the consistency of reporting, which needs to ensure *ex ante* and *ex post* comparability of

budgets, reports and fiscal forecasts (IMF, 2018), with the necessity to include explanations of differences (1.4.3.). This is of great importance for countries that define fiscal targets in nominal terms. The comparability of fiscal forecasts and fiscal reports does not only apply to data, but also to the methodology and method of their presentation. However, the differences between fiscal forecasts and reports exist in a number of countries. The main reason is the fact that reports and forecasts are usually prepared by different institutions, which are guided by different goals and apply different approaches and accounting methodologies. An important reason for the occurrence of a distortion of integrity may also be the different coverage of the government, where fiscal revenue forecasts are made for the general government and reports are presented for a certain level of government or limited coverage of institutions (IMF, 2018).

Basic practice implies that at least one fiscal report is prepared on the same basis as the fiscal forecasts / budget. Good practice requires that fiscal forecasts / budget and outturn are comparable, and that outturn is reconciled with either fiscal statistics or final reports. Advanced practice integrates basic and good practice, with the outturn reconciled with both fiscal statistics and final reports.

The coverage of tax expenditures (1.1.4) is also of indirect importance for the quality of revenue projections. Tax expenditures represent fiscal losses resulting from tax reliefs (exemptions, refunds, tax credits, lower rates, etc.). Policy changes can have positive fiscal effects in terms of revenue growth, but also negative in terms of revenue fall due to tax reliefs. In order to achieve transparency, it is necessary to estimate tax expenditures as a loss of tax revenues. The principle requires that the government regularly publishes tax expenditures and manages revenue losses. The basic requirement to comply with this Principle implies that tax expenditures are published at least once a year. Good practice in this segment of reporting requires tax expenditures to be estimated by sector or policy area and published at least once a year. Advanced practice requires controlling the size of tax expenditures and the existence of the budget goals that they realize.

#### *Pillar of fiscal forecasts and budgeting*

For preparing revenue projections, the most important principles are defined under the second pillar of fiscal transparency, which requires that budgets and fiscal forecasts, on which the budgets are prepared, should provide a clear view of the government's budgetary and policy goals, as well as a comprehensive, timely and credible projection of public finance evolution. The budget documentation includes the following documents (IMF, 2018):

- the fiscal strategy of the government, which should contain clear fiscal objectives that will serve as a basis for assessing the effectiveness of the government;
- a medium-term fiscal framework (MTFF), which includes mid-term macroeconomic and fiscal projections for a period of two to four years beyond the current fiscal year;
- a medium-term budget framework (MTBF), which includes expenditure projections;
- a summary of government's national and sectoral policy priorities;
- annual budget estimates;
- draft budget;
- supplementary budget documentation and annexes.

The Pillar of fiscal forecast and budgeting has four dimensions: comprehensiveness, orderliness, policy orientation and credibility.

The dimension of comprehensiveness (2.1) requires that fiscal forecasts should provide a comprehensive overview of fiscal prospects. Revenues should be expressed without netting off against expenditures of agencies which collect revenues. In addition, tax revenues should be fully reported, irrespective of whether they are of a general or earmarked nature, or the way of their

distribution. Nontax revenues collected by certain government agency are reported in full amounts irrespective of their belonging, i.e., whether they are distributed to the public revenues accounts for financing budget expenditures or are retained by the agency for their expenditures.

It is required within this Principle that budget projections should be based on comprehensive macroeconomic projections, which should be published and explained (2.1.2). The basic practice in applying this Principle should include the minimum requirement that the budget documentation includes forecasts of key macroeconomic variables. Good practice also includes the publication of underlying assumptions on which macroeconomic projections have been made, and advanced entails the inclusion of forecasts and explanations of key macroeconomic variables and their components together with assumptions.

The Principle (2.1.3.) requires medium-term budget frameworks to include outturns and projection of revenues, expenditures and financing over the medium term on the same basis as the annual budget. Basic practice implies that budget documentation includes the outturns of the two preceding years and mid-term projections of aggregate revenues / expenditures / financing. This is a minimum and at the same time the maximum requirement for revenue projections, while for the expenditures and financing both good and advanced practice are offered.

Principle of policy orientation (2.3) requires fiscal forecasts and budgets to be presented in a way that facilitates government policy analysis and accountability.

Economic and fiscal forecasts should be credible (Principle 2.4). Countries are often prone to optimism when making macroeconomic and fiscal forecasts. Fiscal councils or similar co-ordination bodies in the sphere of fiscal policy are often established as a corrective for such practices. The fiscal councils are independent evaluation mechanisms for government forecasts. They conduct independent analyzes, reviews and supervision of government policies, plans, and outturns, prepare independent macroeconomic and budget projections in order to assess government projections.

Credibility involves an independent evaluation (2.4.1) of the government's economic and fiscal forecasts and outturns. Given that these are fiscal forecasts and projections, there are possible deviations of the outturn from the projections, because of the effects of various internal and external factors. Basic practice requires budget documentation to include comparisons between government's economic and fiscal projections and those of independent institutions. Good practice implies that an independent entity evaluates the government's economic and fiscal forecasts, and advanced practice also include the evaluation of outturn in comparison with fiscal policy objectives.

The Principle of credibility implies an identical approach in the forecast reconciliation (2.4.3). Forecasts are by their nature uncertain, especially with regard to external economic shocks, which have repercussions on tax revenues. Another factor that can put uncertainty into projections is the inconstancy and uncertainty of future fiscal measures. Bearing this in mind, it is normally to expect an impact on fiscal projections. The Principle of government's responsibility implies that the government will provide clear explanations of the impacts of macroeconomic developments and discretionary government measures on fiscal projections. The Principle stipulates that budget documentation and subsequent updates should explain any material changes in comparison with the previous government fiscal projections. It is necessary to distinguish the fiscal impact of a new policy measure from the baseline forecast. Revision of fiscal / tax forecasts is usually done once a year, and the reasons may be significant changes in macroeconomic indicators or changes in fiscal objectives and tax policies. Basic practice implies that all the differences between successive vintages of the government's revenue, expenditure and financing forecasts are shown at

aggregate level with a qualitative discussion of the impact of new policies on forecasts. Good practice suggests that the above mentioned differences in forecasts are broken down into the overall impact of new policies and macroeconomic determinants. Differences regarding the basic practice relate to the presentation of the effects. The effects of the tax policies need to be distinguished from the effects of changes in macroeconomic variables. Advanced practice imply that forecast differences are broken down into the effects of individual policy changes and the effects of other factors such as technical factors or accounting adjustments. Advanced practice *de facto* implies a detailed decomposition of the various effects on the projections of tax revenues: from the changes in macroeconomic variables and tax policies, to the influences of government's discretionary competences and technical-administrative factors. Decomposition of factors may help the analysis of projections, in terms of their reality and sustainability.

### *Pillar of fiscal risk analysis and management*

The third pillar of fiscal transparency refers to fiscal risks and fiscal management. The government is obliged to publish, analyze and manage risks to the public finances, as well as to ensure effective coordination of fiscal decisions making process across the public sector.

The Principle 3.1 requires publication and analysis of fiscal risks. The government is required to publish on a regular basis reports on the risks for the outcomes of fiscal projections. The risks include macroeconomic risks (3.1.1) and specific fiscal risks (3.1.2). The government should report on how fiscal outcome differs from the basic forecasts as a result of different macroeconomic assumptions. Sudden changes in the movement of macroeconomic indicators and external shocks can be of crucial importance for revenue outturn. The basic practice implies that budget documentation includes a deliberation of the sensitivity of fiscal forecasts to major macroeconomic assumptions. Good practice requires that budget documentation includes both sensitivity analysis and alternative macroeconomic and fiscal forecast scenario. It is necessary to quantify the impact of the shocks on revenue collection. Sensitivity analysis usually includes preparing an optimistic and a pessimistic scenario (IMF, 2018). Growth in economy, price increases, dynamics of oil and raw material prices on the world market largely determine the movement of customs and tax collection, especially in small and open economies. Basically, these are alternative scenarios of fiscal projections, which are based on alternative macroeconomic projections of the most important aggregates, such as GDP and prices. Advanced practice also includes the preparation of probabilistic forecasts of fiscal outcomes.

The government is obliged to provide a regular report on the main risks to fiscal projections (3.1.2). Basic practice requires that the main specific risks to the fiscal forecasts be disclosed in a summary report and discussed in qualitative terms. Good practice also implies estimating the magnitude of the impact of specific risks to fiscal projections. Advanced practice includes estimating the likelihood of occurrence of specific risks as well. The government is obliged to publish projections of public finance evolution on a long-term basis, especially when it comes to sustainability of pension and health financing (3.1.3). The Principle 3.2. requires management of specific risk to the public finances, which should be regularly monitored, disclosed and managed. These are risks related to exposure to the financial sector, use of natural resources or ecological risks.

## **OECD**

The requirements of international fiscal transparency standards related to fiscal projections can be analyzed through the phases of the budgeting process in which, depending on the stage, different forms of fiscal transparency of revenue projection need to be provided.

According to the OECD (2017), transparency of fiscal and macroeconomic projections should be ensured at all stages of the budget process. It is necessary to have macroeconomic assumptions and revenue projections already in the drafting process of the budget. The budget should include a detailed explanation of all incorporated taxes. It should have a medium-term horizon illustrating how tax revenues will move in at least forthcoming two fiscal years. Likewise, the budget proposal for the next fiscal year must be aligned with the projections contained in the earliest fiscal reports for the same period, and all deviations must be explained.

In the phase of preparing a budget proposal it is necessary to define the objectives of tax policy in the next fiscal year and in the medium term. The earmarked tax revenues must be clearly indicated in the budget proposal. Forecasts of the cash flow of the budget should be based on revenue projections. Special attention needs to be paid to the effect of the seasonal factor on revenue collection, leading to the oscillations over the year, as well as to other one-off and irregular factors that can influence stronger fluctuations in revenues. Good practice requires publication of revenue forecasts at the end of the year, or at the beginning of the next fiscal year.

According to OECD standards (2002), revisions of revenue forecasts are possible during the year. The revised forecasts must be shown separately. It should be compared in the budget outturn reports a current collection with the revenue forecasts. In the case of significant differences between actual collection and forecasts, they need to be explained. Likewise, when comparing outturn with forecasts, it is necessary to ensure comparability of the period. The OECD suggests that revenue forecasts are revised semi-annually, and these are mid-term revenue projections that include forecasts for the current fiscal year and at least for the next two years. Likewise, there should be half-yearly revisions of the economic assumptions on which the budget projections are based. The key fiscal risk for governments are deviations of key economic assumptions from the forecast.

## EU

Tax revenue planning in the EU is an integral part of annual budgeting and multi-annual fiscal planning. The obligation of multi-annual budget planning has existed since 1998, when Regulation No. 1466/97 entered into force. This obligation is also referred to as the preventive dimension of the Stability Pact. The members are obliged to submit to the European Commission a mid-term budget plans on an annual basis (late April). The plans should contain, among other things, the planned growth of government revenue under the conditions of unchanged policies (the so-called basic or baseline scenario), as well as the quantification of government's discretionary measures in the area of revenue. In order to further strengthen the medium-term planning commitments, it was necessary for the member states to commit themselves to mid-term budgeting at national level. The Budgetary Frameworks Directive<sup>18</sup> prescribes that the horizon of national fiscal planning extends beyond the obligation of preparing the annual budget. According to Article 9 (1) Member States are required to establish a credible and effective medium-term budgetary framework that will provide a fiscal planning horizon of at least three years, to ensure that national fiscal planning follows a multi-annual fiscal planning perspective. Member States are required to produce projections of the main revenue items for the budget year and beyond, based on unchanged policies, and to describe medium-term policies with an impact on government finances, analytically, by the main types of revenue. It is necessary to quantify the effects of adjustment needed in relation to projections based on unchanged policies. Since the government can control expenditures to a greater extent, and revenues to a lesser extent, medium-term revenue projections are often presented in a separate document that follows projections of expenditures.

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<sup>18</sup> Council Directive 2011/85/EU on requirements for budgetary frameworks of the Member States  
Banja Luka: Bana Lazarevića, 78 000 Banja Luka, Tel/fax: +387 51 335 350, E-mail: [oma@uino.gov.ba](mailto:oma@uino.gov.ba)  
Sarajevo: Zmaja od Bosne 47b, 71 000 Sarajevo, Tel:+387 33 246 081, Fax:+387 033 246 080, Web: [www.oma.uino.gov.ba](http://www.oma.uino.gov.ba)

With regard to planning horizons, it is necessary to balance the benefits and shortfalls of a short or long horizon. A shorter period contributes to the reliability of the outturn of projections, while the longer the period contributes to the quality of public finance management, given the wider fiscal picture (Sherwood, 2015). The Budgetary Frameworks Directive obliges Member States to adopt a fiscal planning horizon of at least three years. This provision should be considered a minimum period<sup>19</sup>, which does not prevent Member States from extending the planning period. In most Member States, a rolling principle is applied, which implies a shift in the fixed period, by losing the first year of the previous planning period, which becomes a current budget year, while the year following the previous planning period is added. Often the fiscal planning period also depends on election cycles.<sup>20</sup> Article 11 of the Directive even recognizes the problem of fiscal planning under conditions of the change of government. The elected government may carry out a revision of the medium-term budget framework adopted by the previous government, in accordance with its objectives and priorities, indicating the differences between the revised framework from the one previously adopted.

### Practice in the world

Survey on the efficiency of revenue forecasts conducted by Danninger, Cangiano and Kyobe (2005) has covered 34 countries, of which 1/5 were transition economies and the rest were low-income countries. Although it was a quite heterogeneous sample, the research has shown little differences in revenue planning practices.

Basing on the practice research, Kyobe and Danninger (2005) conclude that the scope of projections in terms of the coverage of tax revenue is much wider in the higher income countries in the Western Hemisphere, because they include all levels of government, extra-budgetary funds and public enterprises. On the other hand, revenue projections in low-income countries typically include only central government tax revenues. Approximately one-third of the countries covered by the Survey prepare projections for medium-term planning horizon, but often the medium-term revenue projections are not adequately integrated into the annual budget process. The most common length of the planning period is three years.

Kyobe and Danninger (2005) have shown that all countries covered by their Survey prepare macroeconomic projections, but about 1/5 countries use macroeconomic assumptions that differ from the macroeconomic projections. This phenomenon points to the problem of coordination of institutions included in the budget process as well as the efficiency of fiscal management. This practice is not common only in low-income countries. Even the most developed countries, such as Canada and the Netherlands, use cautious growth forecasts to minimize the risk of fiscal shocks. On the other hand, it is also noticed the tendency of countries to use more optimistic macroeconomic growth assumptions than in the official projections, which can be explained by the fact that the projections are used as outturn targets, and are prepared under political influence (Kyobe et al., 2005) .

In most countries surveyed, the ministry of finance is the only institution responsible for budget and revenue projections. However, a number of institutions that have an impact on revenue collection, such as customs and tax administrations, extra-budgetary funds etc., may be involved in the process of preparing the projections. Likewise, it is usually only one agency involved in preparation of macroeconomic projections. Engaging multiple institutions in revenue projecting

<sup>19</sup> Most Member States set a fixed period of three years, while Austria, Denmark, Estonia, Germany, Greece, Italy and Luxembourg set a fixed period of four years. Belgium and France prescribe a minimum period of three years, which means that they can in practice extend the planning horizon. Source: Sherwood (2015).

<sup>20</sup> Finland, the Netherlands and the United Kingdom do not apply the rolling principle, and the planning horizon coincides with the term of an elected government. Source: Sherwood (2015).

often leads to parallel projections, which can be either integrated into one final projection, or the ministry of finance has a final say in choosing the projection. In about 2/3 of the countries involved in the Survey, the government adjusts projections, based on its discretionary authority. One of the reasons for involving in preparing projections is concealing the government's problems or existence of intents for imposing the higher outturn goals for tax administrations (Kyobe et al., 2005).

Most countries produce revenue projections once a year. A small number of staff (up to 5 people) engaged in revenue projection uses the most commonly simple statistical techniques. The practice of countries has been tested based on three main characteristics of forecasting - transparency, formality and organizational simplicity. Within each of these characteristics, elements are defined on the basis of which the practices of the countries from a sample have been tasted and made a kind of review which should be used as a starting point for testing a national revenue-planning practice (see Box No. 1).

### **Box 1: Overview of revenue forecasting elements**

#### **Formal aspect**

Forecasting responsibilities formally defined

Forecasting formally initiated

Formal revisions

Formal documentation

#### **Organization**

Forecasts produced by single agency

Only one uniform forecast produced

Macro forecast produced by single agency

#### **Transparency**

Nongovernmental agencies participate in forecast

Information published outside budget document

#### **Informational content in budget document**

Aggregate revenue forecasts

Breakdown of forecast into revenue types

Data on past revenue outturns

Analysis of past developments and forecasts

Summary of macro assumptions

Decomposition of forecast into various effects

#### **Interference**

Significant discretionary adjustment of technical forecast

Source: Kyobe et al. (2005).

Formality is tested on the basis of meeting the four requirements. Competencies for preparing revenue projections should be formally prescribed in writing to avoid arbitration. Forecasting should be formally initiated, timely in accordance with the previously defined budget calendar, and well-structured and documented. For the quality of the budget, it is necessary to test whether there are legal provisions that allow or even impose compulsory revisions.

Organizational simplicity implies a request for quality assurance of projections at low cost. The requests are mutually conflicting. If one wants to reduce the resources and time to produce projections, the process will include a single agency or a small number of people. However, such an approach does not contribute to the quality of projections. On the other hand, the inclusion of multiple agencies that will create their own projections entails an element of the competition and positively influences the quality of projections, but with the increased resource consumption and additional costs of coordinating the work of the agencies and the possibility of exceeding deadlines

for projections, which jeopardizes the budgeting process. The index of organizational simplicity according to Danninger et al. (2005) represents an unweighted sum of three variables: whether a single agency is responsible for revenue projections, whether a single agency is responsible for macroeconomic forecasts, and whether only one projection is produced.

Transparency, as a feature of the revenue projection process, implies that projections are available to the public outside the budget document and that non-governmental agencies have been also involved in the preparing process. In addition to this, for the transparency of the projections is also important information in the budget document related to the presentation of the projections (aggregate revenue forecast, revenue broken down by types, outturn data for the previous year, analysis of previous trends and forecasts, summarizing the macro-projections and decomposition of forecasts on different effects).

Finally, the forecasting process often tends to increase organizational complexity and openness to interference. Interference is defined as the significant deviation between the final budget projections and purely technical projections that arise from government interventions (Danninger et al., 2005). Adjustments of projections are appearing in order to adapt to inconsistent expenditure plans or to increase the targets of outturn.

### Practice in the B&H

Revenue projections represent a segment of the budgeting process in B&H, in the traditional sense, as an input for preparing the budget for the next fiscal year, as well as in terms of multi-annual fiscal planning.

In accordance with a decentralized fiscal system, in which there is no supremacy of the central level of government authority over the medium level of government (entities, District), each level of government is competent for budgeting and thus for the preparation of revenue projections. However, the indirect tax reform has brought the centralization of legislation, administration, collection and distribution of indirect tax revenues. In the conditions of new tax arrangement, it has been necessary at the B&H level to legally prescribe the preparation of indirect tax projections (see Box 2), to define carriers and deadlines for their delivery to the relevant institutions (see Box 3). The entities and District are responsible for the projections of source tax revenues, while the indirect taxes for the purposes of entity budgeting are projected in accordance with the concept of distribution of indirect taxes, in the form of revenue transfers, where the features of indirect tax structures are lost.

#### **Box 2: The legal framework for producing indirect tax projections in B&H**

Law on Financing of the Institutions of B&H ("Official Gazette of B&H" nos. 61/04, 49/09, 42/12, 87/12 and 32/13)

Article 5a „ (3) *Not later than 15 April, the Macroeconomic Analysis Unit of the Governing Board of the Indirect Taxation Authority is obliged to prepare the Draft revenue projections of indirect taxes for the current and the following three years.*"

Article 7 „ (4) *If during the course of the year, after the deadline prescribed in Article 5a. Paragraphs (2) and (3) of this Law, the Directorate for Economic Planning or the Macroeconomic Analysis Unit of the Governing Board of the Indirect Taxation Authority revises the macroeconomic and fiscal projections used for estimation of revenues, and Fiscal Council adopts a decision on any changes to the previously adopted budget frameworks, the Ministry of Finance and Treasury will also revise the projection of revenues in the draft budget for the next year, which is submitted to the Council of Ministers. "*

According to the Law on the Fiscal Council<sup>21</sup>, this body is responsible for the coordination of fiscal policy in B&H. It is responsible for adopting the Proposal Document "Global Framework of Fiscal Balance and Policies in B&H", which is the most important document of fiscal coordination. The Document contains, *inter alia*, a proposal of macroeconomic projections, a proposal of indirect tax projections and a proposal of distribution of indirect tax revenues for the next fiscal year.

### **Box 3: Projecting revenues from indirect taxes in B&H**

#### Carrier of activity:

Macroeconomic Analysis Unit of the Governing Board of the ITA

#### Dynamics of preparation:

Spring projections - until April 15<sup>th</sup>

Revised projections - generally on mid October (prior to finalization of the budget)

Extraordinary projections – in case of extraordinary circumstances<sup>1</sup>)

Alternative projections - based on alternative macroeconomic indicators of the Directorate for Economic Planning (reflecting revenue sensitivity), for the needs of ERP (November)

#### Time horizon for projecting:

Four fiscal years - the current fiscal year + the next three (e.g. projections for the period 2020-2023 will be prepared in April 2020), rolling principle

#### Projection users:

Ministry of Finance and Treasury of B&H

Federal Ministry of Finance

Ministry of Finance of RS

Finance Directorate of Brcko District

The Fiscal Council Advisory Group

ITA, Directorate for Economic Planning, IMF

#### Projection assumptions:

Macroeconomic indicators of the Directorate for Economic Planning (DEP) for the current and the next three years;

Effects of changes in indirect tax policies (VAT, excise duty, customs duties, road tax);

Effects of the application of international agreements (e.g. SAA, EFTA, adapted SAA) whose application begins in the time horizon of projection;

Historical trends (2006 -...)

Current trends in revenue collection from indirect taxes

#### Types of projection scenarios:

Baseline (includes the effects of adopted changes in indirect tax policies)

Program (includes the effects of potential changes to indirect tax policies)

#### Publication:

MAU Bulletin, [www.oma.uino.gov.ba](http://www.oma.uino.gov.ba)

<sup>1</sup> For example, extraordinary projections were made in June 2014 in order to reflect the effects of flooding on indirect tax revenues

<sup>21</sup> Law on Fiscal Council, "Official Gazette of B&H", No 63/08

The process of preparing revenue projections in Entities and the Brcko District is fully harmonized, as part of the process of drafting a budget framework document (see Box 4).

#### **Box 4: Projecting revenues in entities and the District**

##### **Federation of B&H**

Law on Budgets in the Federation of Bosnia and Herzegovina (Official Gazette of the Federation of B&H, nos. 102/13, 9/14, 13/14, 8/15, 91/15, 102/15 and 104/16, 5/18), Article 16:

*BFD is an act that contains macroeconomic projections and forecasts of budget resources and expenditures over the next three years and on which is based the preparation and development of the budget*

##### **Republic of Srpska**

Law on the Budget System of Republic of Srpska (Official Gazette of Republic of Srpska, nos. 121/12, 52/14, 103/15 and 15/16), Article 16:

*(1) The preparation and development of the budget shall be based on the Budget Framework Document (hereinafter: BFD).*

*(2) BFD is an act containing macroeconomic projections and forecasts of budget resources and expenditures for the next year and the following two fiscal years.*

##### **Brcko District**

Law on Budget of Brcko District of Bosnia and Herzegovina (Official Gazette of Brcko District of Bosnia and Herzegovina, nos. 34/08, 40/15 and 39/17), Article 10:

*(1) Budget management and budgeting shall be based on a budget framework document covering at least a fiscal year and the two following fiscal years.*

*(2) The fundamentals for developing the budget of the District are relied on estimates of economic development, social sector development, macroeconomic indicators and forecasts of revenues and expenditure for the years covered by the budget framework document.*

*(3) Three-year budget planning is an obligation for all budget users and extra-budgetary funds.*

#### **Revenue projections as a standard for assessing the efficiency of tax administration**

Revenue projections are usually prepared at least twice a year for the purpose of developing an annual budget. At an early stage, tax revenue projections are made on the assumption that there were no changes in government policies. The goal is to establish the level of resources needed to make certain decisions regarding the budget. In the final phase, the forecasts include all budget decisions on tax changes, and as such are presented in parliament. The second budget revenue projections also have ancillary use within the government. They are usually used for setting the outturn objectives for tax administrations and agencies. In researching the appropriateness of using revenue projections as a standard tax administration efficiencies, Golosov and King (2002) conclude that the impact of such defined set revenue targets depends on further steps, i.e. whether the tax administration rewards or punishes if the outturn exceeds the projections, or if the collection fails. One suggests that revenue projections should be set low in order to encourage the tax administration to exceed them. Others, however, believe that projections should be as much as possible in order for the tax administration to make additional efforts to realize them. While the second approach is very common in practice, the question arises how highly projections can be set, given the fact that they are based on unchanged tax administration procedures. In other words, changes in administering taxes, from partial changes (e.g. introduction of electronic communications with taxpayers in the form of submitting the electronic applications) to reforms (e.g. direct access of tax administration to taxpayers' accounting records) should, to a greater or lesser extent, bring positive effects in terms of lower tax evasion and higher revenue collection. Furthermore, one should bear in mind that revenue collection is only one of the aspects of tax

administration efficiency, and that there are a number of other indicators of tax administration efficiency. Measuring tax administration efficiency by the level of revenue collection can be misleading, since tax policy measures which imply a reduction in the tax base (reliefs, exemptions, deductions, etc.) or lower rates, result in a lower tax revenues, with perhaps even greater tax administration efforts.

Taking into account the diversity of tax systems and the organization of tax administration, it was initiated a specific project called TADAT<sup>22</sup>, which is focused on the collection of tax revenues. TADAT is a global tool that can be used to assess the strengths and weaknesses of tax administrations (TADAT, 2015). The project<sup>23</sup> focuses on the most important taxes that dominate in tax structures. In developed countries, it is the income tax, including withholding tax (PAYE), profit tax and VAT, while in developing countries, it is mainly focused on the VAT administration. The project implies an assessment of the tax administration's performance in nine areas. The indicators for each area are defined for the purposes of analyzing the efficiency of tax administration. One of the areas of analysis is efficient management of revenues. The basic request in this area instructs the following:

- revenue collection has to be fully observed in comparison with the budget expectations and analyzed for the purposes of preparing a forecast of government revenue;
- eligible tax refunds to individuals and companies must be paid immediately.

To assess the fulfillment of the mentioned standards in the field of revenue management efficiency, three indicators are defined:

- Contribution to government tax revenue forecasting process (P8-22);
- Adequacy of the tax revenue accounting system (P8-23);
- Adequacy of tax refund processing (P8-24).

The tax administration should provide the government with inputs for the preparation of tax revenue forecasts and revenue estimates. The inputs include data and analyses of tax administration that are required for the forecast and projection process. As a rule, primary responsibility for drafting the projections rests with the ministry of finance that presents them to the government. The ministry of finance sets up a set of operational tax revenue targets for the tax administration based on various factors, including changes in the macroeconomic environment, and prepares the forecasts for various taxes. In case of occurrence of changes in the main factors that determine the projections during the fiscal year (e.g. sharp fall of GDP, price shocks on the world market), the finance ministry is obliged to revise the projections in a timely manner. It should be borne in mind that there are many factors beyond the control of the tax administration, although it is expected from the same to contribute to the quality of revenue projections.

The contribution of the tax administration to the quality of inputs for revenue projections is reflected in the existence of internal analytical capacities in terms of the following analyzes:

- Analysis of collection trends
- Analysis of control effects in terms of revenue collected
- Analysis of compliance by the taxpayers
- Analysis of tax payment patterns by type of tax and category of taxpayer
- Analysis of the effects of tax expenditures due to application of exemptions, deductions, differentiated rates, postponing the tax liabilities etc.

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<sup>22</sup> Tax Administration Diagnostic Assessment Tool

<sup>23</sup> TADAT is supported by the European Commission, the IMF, the World Bank and the governments of Germany, Japan, the Netherlands, Norway, Switzerland and the United Kingdom.

In addition, the tax administration is obliged to regularly monitor and report to the government on the collection of basic tax types in order to detect the appearance of deviation at the earliest stage, and to analyze the causes of deviations in relation to fiscal forecasts (TADAT, 2015).

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