

## SUSTAINABILITY OF PUBLIC DEBT IN THE REPUBLIC OF SRPSKA

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### ABSTRACT

**P**ublic debt is one of components of macroeconomic stability in the economy of each country. As such, the public debt is justified if it supports the macroeconomic stability, i.e. when the funds raised through borrowings are used for investments, encouraging the development of the overall economic environment, and greater benefits for citizens. The main question is how to spend the borrowed funds, because the ability to service the debt in the future will depend on that. After analyzing the situation and characteristics of the public debt, in this paper we shall present the amount of the public debt of the entity of the Republic of Srpska, as well as the opportunities to reduce the same, to prevent its negative consequences and stabilize the macroeconomic aggregates of the Republic of Srpska. In addition to that, the paper presents a comparison of the amount of the public debt in relation to the GDP in the countries of the EU and the Balkans.

**Keywords:** Republic of Srpska, public debt, budget, economic policy, economic growth, macroeconomic stability

## 1. Introduction

According to the GFS methodology (Government Finance Statistics), public debt is the total debt of the state budget, extra-budgetary funds and agencies, and the units of the local and regional self-governments, i.e. the total debt of a state [1]. During the global financial crisis, the consequences of the public debt depend on factors related to the conditions of the public debt occurrence (interest rates, repayment terms, places of borrowing) and the usage of the borrowed funds (budget or investment-developmental spending). Therefore, the overall economic trends in the country depend on these factors. In order to be able to service the public debt in the long run, the public debt must be less than the rate of the economic growth of the country. The condition for joining the EMU, among other things, is setting limits to the budget deficit share, and the public debt share in GDP to 60 %. The growth of the economy of Bosnia and Herzegovina, and, thus, of the entity of the Republic of Srpska, is slower than the growth of the public debt. Bosnia and Herzegovina, i.e. the Republic of Srpska is dealing with some transitional problems (high unemployment rate, negative foreign trade balance, low level of industrial production, low social spending, wasteful public spending, bloated administration of the country, corruption, crime, etc.), and, as such, it is exposed to crisis situations and to borrowings.

## 2. Institutional Framework

The Law on Indebtedness, Debt and Guarantees of the Republic of Srpska [2] regulates the area of the short-term and the long-term borrowings, and the issuance of the guarantees of the Republic of Srpska, towns and municipalities, and the manner and procedures of borrowing, which, together with the existing legislation in the area of the budgetary system [3] make a comprehensive legal framework for the improvement and control of the budgetary discipline, and the reduction in the risks of the over-indebtedness. Also, in addition to the above, a legal framework for borrowing through the issuance of the debt securities issued by the Republic of Srpska and local communities (municipalities and towns) has been established. The said type of borrowing has already been put in practice, and it has an important role in the further development of the financial market.

To determine the amount of the indebtedness of a country, the criteria of the Treaty on establishing the European Union, established in Maastricht in 1999, the so-called *convergence criteria* [4] are used. Out of the 17 countries in the Euro-zone, 12 of them have public debt that is greater than the allowed 60 % of GDP. According to the data from 2010, the most indebted European country is Greece, with debt that is 144.9 % of GDP, followed by Italy, with 118.4 % of GDP; then by Belgium, with 96.2 %; Ireland, with 94.9 %; Portugal with 93.3 %; and Germany with 83.2%, etc.

It may be noted that the public debt continues to increase. In late 2010, the debt in the Euro-zone countries amounted to 85.4% of GDP, which means that since 2008 it has grown by 15.3 %, and it is even by 25.4% above the set limit.

According to the criteria of the International Monetary Fund and the World Bank (borrowing over 80 % of GDP renders a country as highly indebted; borrowing from 48 % to 80 % of GDP – renders a country as moderately indebted one; and borrowing less than 48 % of GDP – renders a country as a low indebted one), the Republic of Srpska is a moderately indebted country [5]. In more than 50 % of cases, (i.e. 51.7%), the crisis broke out when the external debt was up to 60% of GDP, which is the critical value of the external debt.

It is important to note that in almost 20 % of cases, the crises would break out at a relatively low level of debt (below 40 % of GDP) in countries with a low tolerance for debt. Some countries are very vulnerable when it comes to the external debt (debt intolerance), i.e., the external creditors withdraw in cases of certain countries, even at the relatively low level of their indebtedness.

In addition to these criteria, the generally accepted rule of the international financial institutions is the stand that a country is a highly indebted one if the due amounts of the annual repayment of principal and interest payments exceed 25 % of the value of the exports of goods and services. The country is highly indebted if the amount of the repayments exceeds the amount of the growth of GDP, or if the ratio of repayments and GDP is greater than the annual rate of the GDP growth.

### 3. Macroeconomic Indicators

**Table 1**

Forecasts and estimate of the macroeconomic indicators of the Republic of Srpska

Production Method	2009	2010	2011	2012	2013*	2014*	2015*
GDP-in million BAM-nominally	8,233	8,308	8,669	8,707	8,886	9,249	9,747
Population – in million	1.43	1.43	1.43	1.42	1.42	1.41	1.40
GDP per Inhabitant in BAM	5,756	5,798	6,073	6,013	6,274	6,560	6,945
% GDP Growth – nominally	-3.0%	1.0%	4.3%	-1.0%	2.0%	4.1%	5.4%
BDP Deflator ( % )	-0.1%	0.2%	3.5%	1.1%	1.2%	1.6%	1.8%
% GDP Growth – real	-3.0%	0.8%	0.8%	-1.0%	0.8%	2.5%	3.5%
Inflation – annual rate in %	-0.4%	2.5%	3.9%	2.1%	0.7%	2.2%	2.4%
Average Net Wages in BAM	788	784	809	818	819	845	880
Import in million BAM	3,602	4,053	4,584	4,488	4,743	4,928	5,205
Import Growth in %	-13.1%	12.5%	13.1%	-2.0%	1.1%	3.9%	5.6%
Export in million BAM	1,673	2,178	2,562	2,374	2,650	2,908	3,219
Export Growth in %	-13.0%	30.2%	17.6%	-7.3%	7.7%	9.7%	10.7%
Coverage of import by Export in %	46.9%	53.7%	55.9%	52.9%	59.0%	59.0%	61.8%
Unemployment Rate in %	21.4%	23.6%	24.5%	25.6%	25.5%	25.1%	24.7%

Source: Ministry of Finance of the Republic of Srpska

\*Estimated values

The forecasted economic growth rate of 0.8 % for 2013 is a realistic dimension, because the Republic of Srpska exited the recession in the third quarter. It is estimated to have the economic growth increased in the next year through the investment growth (significant infrastructural projects) and the net exports. In the economic policy of the Government of the RS, it is stated that the tax policy measures will have a positive effect on the growth of the private sector investments [6], through the stimulation of the investments by the reduction in the corporate income tax base, and by discouraging the payment of the net profit through taxation of dividends and shares.

### 4. The public debt situation in the Republic of Srpska

If we observe in the integrated manner the level of the public debt of the Republic of Srpska: the budget of the RS, towns and municipalities, the non-budgetary funds and the KBC (the Clinical and Hospital Centre), it can be concluded that the ratio of the public debt and the GDP in the Republic of Srpska in 2011 amounted to 41.1 %, which falls into the zone of the low indebtedness (Table 5).

If the debt of the public enterprises and the IRB is added to the above stated indicators of the public debt, the total debt ratio of the Republic of Srpska towards the GDP amounts to 49.0 % in 2011.

Also, the forecasted values of GDP and public debt situation in the Republic of Srpska in 2012 and 2013 range within the acceptable limits (44.1% and 45.6 %).

The ratio of the external debt to exports of 17.6 % in 2011 (the critical value is 30 %) still indicates the possibility for the debt repayment (Table 1).

The public debt management in 2013 is one of the most important segments of the government's priorities in the economic policy [6]. The basic guidelines of the Government of the Republic of Srpska should be oriented towards timely servicing the due obligations, as well as the liabilities incurred in the previous period. Bearing in mind that the estimated liabilities, in respect of the domestic debt, were verified and recorded in the previous period, they were still implemented through the activities of settling these obligations through the issuance of bonds in 2012. As an alternative source of funding, the auctions of treasury bills and issuance of the long-term bonds were used. In 2011 and 2012 nine auctions of treasury bills were conducted to solve the liquidity, and their sequel is also planned in 2013. Furthermore, in addition to the above stated T-bill auctions, the three issuances of the long-term bonds were also conducted to finance the budget of the Republic of Srpska. In 2013, the access to the payment of obligations from the budget should be a priority, as well as from the escrow accounts of the privatization and succession funds (the so called escrow accounts).

##### 5. Servicing external and domestic debt

When it comes to servicing the external debt, Table 3 shows that there are no outstanding obligations (interest and principal payments) and that the Republic of Srpska regularly records and settles liabilities. It may be stated that the principal debt has constantly been growing since 2010, and major obligations are expected only in 2013 (Graph 1). It can be concluded that the reprogramming of the existing liabilities and commitments has been continuously made, along with new borrowing which has caused such dynamics in the principal debt.

**Table 3**

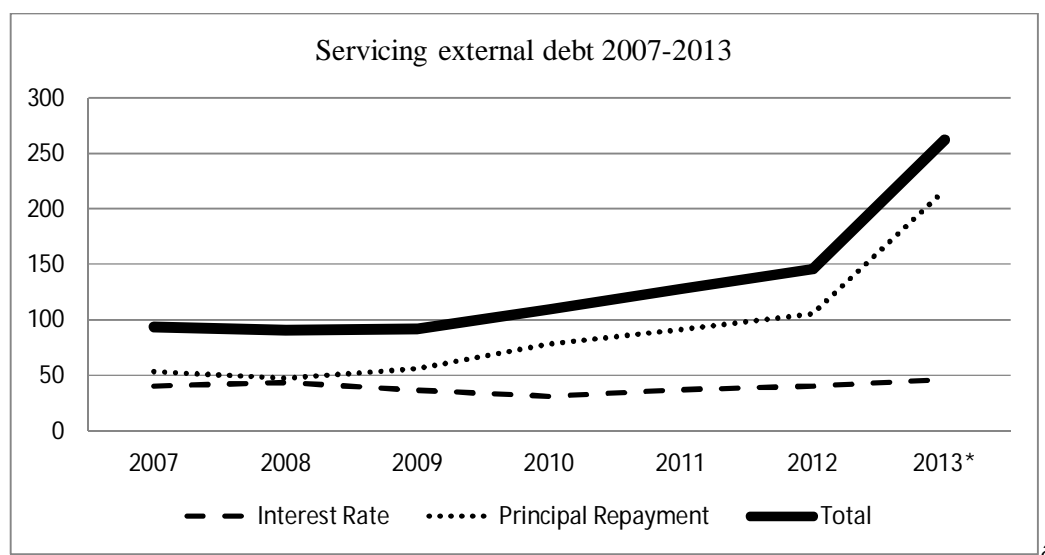
External debt service in 2007-2013 (in million BAM)

DESCRIPTION	2007	2008	2009	2010	2011	2012	2013*
Interest	40.40	43.30	36.22	30.99	37.02	40.08	46.07
Principal repayment	53.10	47.20	55.70	78.41	90.98	105.51	216.12
Total	93.50	90.50	91.92	109.40	128.00	145.59	262.19

Source: Ministry of Finance of the Republic of Srpska

\* Estimate for 2013

Graph 1.



In the previous period the estimated liabilities based on the domestic debt were verified and recorded (Table 4). Their settlement was implemented through the issuance of bonds. Accordingly, the priority access is set for the payment of obligations from the budget, as well as from the escrow accounts of the privatization and succession funds (the so called escrow accounts).

**Table 4**

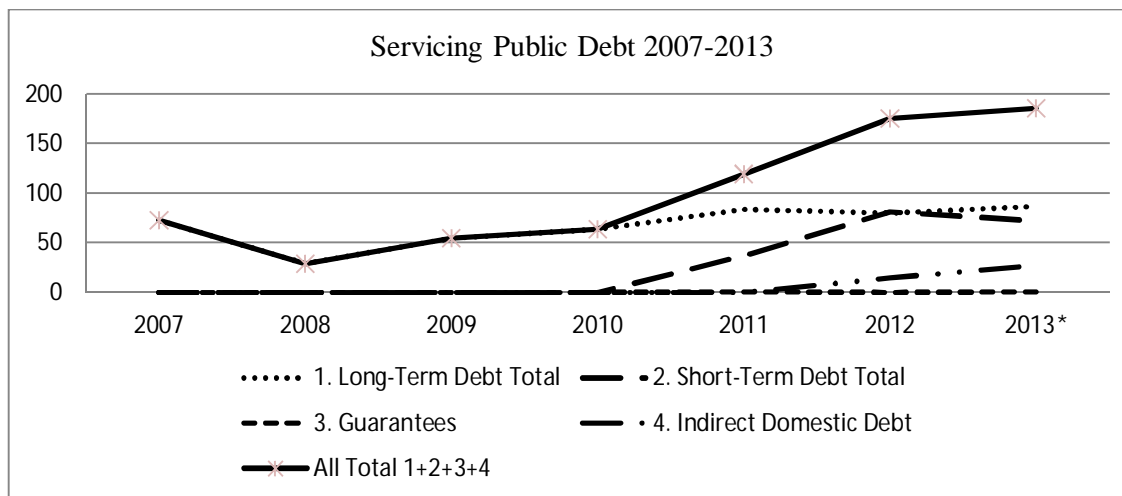
Servicing domestic debt 2007 - 2013 (in millions BAM)

DESCRIPTION	2007	2008	2009	2010	2011	2012	2013*
Long-Term Debt:							
<i>Interests and Other Costs</i>	0.6	5.4	7.5	7.2	6.5	11.8	14.17
<i>Principal repayment</i>	71.9	23.4	46.9	56.4	76.7	68.2	71.16
<i>1. Long-Term Debt Total</i>	72.5	28.8	54.4	63.6	83.2	80.0	86.4
Short-Term Debt:							
Treasury Bills (principal +interest)	0	0	0	0	36.5	80.7	71.8
<i>2. Short-Term Debt Total</i>	0	0	0	0	36.5	80.7	71.8
<i>3. Guarantee</i>	0	0	0	0	0.1	0.0	0.3
<i>4. Indirect Domestic Debt</i>	0	0	0	0	0	14.4	27.1
<i>All Total 1+2+3+4</i>	72.5	28.8	54.4	63.6	119.18	175.1	185.6

Source: Ministry of Finance of the Republic of Srpska

\* Estimate for 2013

Graph 2



The main risks to the forecasts of the domestic debt are present in the possibility of changing the legal provisions which would regulate the obligation of settling the domestic debt differently than provided by the existing legislation. This would lead to a failure in planning and controlling repayments, and to contingent liabilities that would result from solving the problem of restitution, which are financed from the budget of the Republic of Srpska.

## 7. Borrowing by the countries in the region as % of GDP

**Table 5**

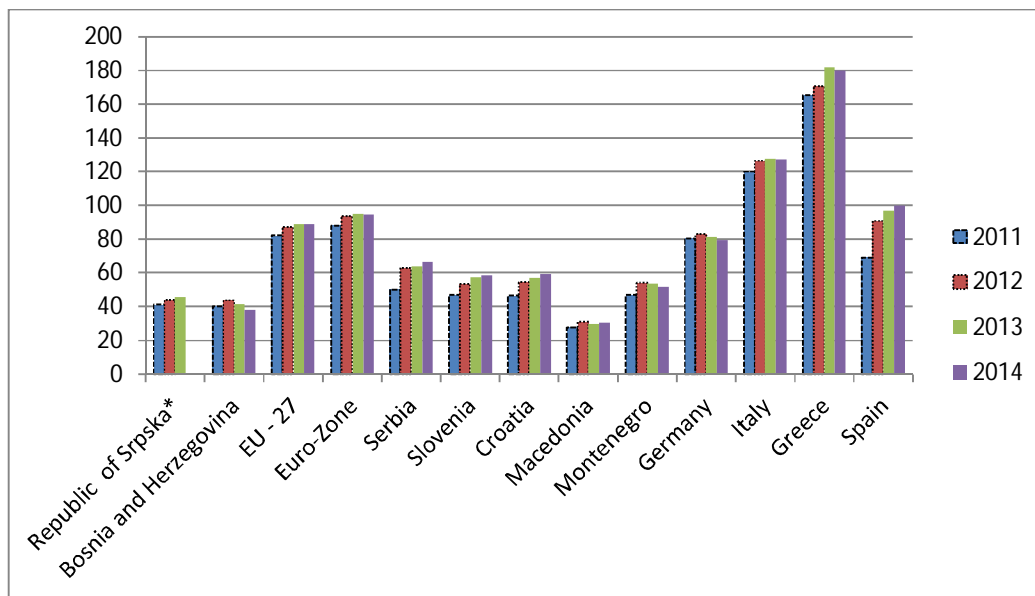
Borrowing as % of GDP

	Rep. Srpska*	BiH	EU (27)	Euro-zone	Serbia	Slovenia	Croatia	Macedonia	Monte Negro	Germany	Italy	Greece	Spain
2011	41.2	40.3	82.1	88.0	50.1	46.9	46.7	27.7	46.9	80.6	120.1	165.4	69.1
2012	44.1	43.7	87.2	93.6	63.1	53.2	54.3	30.9	53.9	83.0	126.3	170.7	90.7
2013	45.6	41.3	88.8	94.9	63.9	57.4	57.0	29.7	53.6	81.5	127.8	181.8	96.9
2014	-	38.1	88.8	94.7	66.5	58.7	59.4	30.2	51.6	79.6	127.3	180.2	100.0

Source: IMF, Republic of Srpska – Ministry of Finance of the Republic of Srpska (estimates for 2012 and 2013)

\* Data refer to the public debt for the purpose of its comparison with the IMF data

Graph 3. Indebtedness as % BDP-a



Graph 3 shows that the greatest long-term debt is evident in Greece. The most indebted country in the region is Serbia, followed by Croatia, Slovenia, Montenegro, and Bosnia and Herzegovina. The lowest debt in relation to the % of GDP in the Balkans has Macedonia (estimate for 2014 is 30.2%).

Due to the major economic and financial crisis that has been coped with in recent years, the Balkans countries are increasingly becoming indebted in order to manage maintaining some sort of economic stability and prosperity for their citizens. However, many estimates suggest that the whole region is already positioned in great debt bondage.

According to the data by the Ministry of Finance and Treasury of Bosnia and Herzegovina, the public debt of Bosnia and Herzegovina amounted to about BAM 10.4 billion by December 31, 2012, or EUR 5.3 billion, out of which the external debt equaled to about BAM 7.1 billion, or 68.15 %, and the domestic debt to about BAM 3.3 billion, or 31.85 %. In the total amount of the public debt, the Federation of Bosnia and Herzegovina participates with 57.74 %, the Republic of Srpska with 41.5 %, Brcko District with 0.49 %, and the institutions of Bosnia and Herzegovina with 0.27 %.

## 8. Conclusion

There are many factors that affect the sustainability of debt in relation to GDP. Some of them are the rate of the economic growth, inflation rate, financial market development, foreign investment attraction, and increase in the foreign trading, etc.

Based on these indicators and their analysis, it can be concluded that the public debt of the Republic of Srpska, as per the scheduled plan, shall be regularly serviced towards the international institutions.

Legal solutions to forecasts of domestic debt must be permanent, that is, unchanging, because their change would result in the settlement of the domestic debt differently than provided by the existing legislation. The consequences would lead to failure in planning and controlling repayments, and contingent liabilities that would result from solving the problems of restitution, which are being financed from the budget.

The stabilization of the debt share in GDP should move within the recommendations of the IMF and the Maastricht Treaty, the so-called convergence criteria. The debt of Bosnia and Herzegovina, and, therefore, the debt of the Republic of Srpska, relative to GDP, should not exceed a limit of 60 % of indebtedness, and as such (in addition to Macedonia) it is the lowest public debt in the Balkans.

In order for the debt to remain at the above stated or a lower level, it is necessary to continuously maintain the average maturities, which are about 10.7 years, and to constantly keep a low share in the short-term debt (relative to the treasury bills), which cannot be greater than 5 % of the regular common income realized in the previous fiscal year.

The measures for introducing a protection mechanism against the currency risk should be permanent, since there are four major currencies in the currency composition of the debt: BAM, EUR, SDR and USD. It can be considered as favorable that the share of the local currency BAM and EUR in the currency structure of the debt is the largest, so the subsequent foreign borrowing should be in EUR, as well. Borrowings in other currencies is to be denominated in EUR currency, through the so-called "currency swop".

The development and improvement of the domestic securities market should represent a continuous process through issuing the short-term securities (T-bills) and the expansion of the circle of investors investing in the securities, which will have positive effects on the liquidity, and, thus, the domestic accumulation and savings will be in operation to promote the development of the Republic of Srpska.

Moreover, entering the international securities market (Eurobonds) is one of the alternative sources of financing the development of the economic growth and the increase in GDP, and the balancing in the macroeconomic trends.



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