BOSNIA & HERZEGOVINA | 2023

DEVELOPMENT FINANCE ASSESSMENT (DFA)

FINAL DRAFT

Bosnia & Herzegovina Development Finance Assessment (DFA)

ACRONYMS AND ABBREVIATIONS

AAAA	Addis Ababa Action Agenda
ABS	Activity Budget Sheet
APMF	Activity Performance Management Framework
B4SDG	Budgeting for SDGs
BBB	Building Back Better
BIOFIN	Biodiversity Finance Initiative
CAA	Common Country Analysis
CAPEX	Capital Expenditures
CSOs	Civil Society Organizations
DFA	Development Finance Assessment
EPU	Economic Planning Unit
F2F	Funding to Financing
FDI	Foreign Direct Investment
FMAS	Financial Management Accounting System
G2B	Government-to-Business
G2C	Government to Citizen
G2E	Government-to-Employees
G2G	Government-to-Government
GDP1	Gross Domestic Product
IMF	International Monetary Fund
INFF	Integrated National Financing Framework
JP	Joint Program
LNOB	Leaving No One Behind
MOIC	Ministry OBB Implementation Committee
MTBF	Medium-Term Budget Framework
MTEF	Medium-Term Expenditure Framework
MTFF	Medium Term Fiscal Framework
NBO	National Budget Office
ODA	Overseas Development Assistance
OECD	Organization for Economic Co-operation and Development
OPEX	Operational Expenditures
OT	Oversight Team
PBB	Performance-Based Budgeting
PFM	Public Finance Management
PPMF	Program Performance Management Framework
RC	Resident Coordinator
SDG	Sustainable Development Goals
UMIC	Upper-Middle Income Country
UNCT	United Nations Country Team
UNDP	United Nations Development Program
UNSDCF	United Nations Sustainable Development Cooperation Framework
VNR	Voluntary National Review
WBG	World Bank Group
WCFSD	Working Committee on Finance for Sustainable Development

“Agenda 2030 is an action plan for people, the planet and prosperity. It seeks to strengthen the universal peace in larger freedom. This plan will be implemented by all countries and stakeholders, acting in collaborative partnership. We are resolved to free the human race from tyranny, poverty and to heal and secure our planet.”

Contents

Charts

Tables

Figures

Executive Summary

1. As part of the Joint Program of the United Nations (UN), this comprehensive development finance assessment (DFA) was carried out in Bosnia and Herzegovina (BiH) between 2021 and 2023, with the aim to support BiH's efforts to build forward better by increasing access to integrated and sustainable financing to meet the financing needs of the BiH SDG Framework. As such, this DFA is the primary building block required to establish the Bosnia and Herzegovina (BiH) Sustainable Development Goal (SDG) Financing Framework (SDG-FF).

2. The DFA was carried out in accordance with the internationally recognized UN methodology for the assessment of development finances and with the technical support of a group of international and domestic experts for financing sustainable development. The DFA was conducted with the consultative support of members of the SDG Financing Working Group, which consists of representatives of the Council for Monitoring the Implementation of the Sustainable Development Goals of BiH, appointed representatives of the Ministries of Finance and other ministries from the level of BiH, the Federation of Bosnia and Herzegovina (FBiH), Republika Srpska (RS) and representatives of the Finance Directorate of Brčko District of BiH.

3. The DFA provides an extensive diagnostic of (i) the macro economical and financial context and development finance landscape in BiH; (ii) policy and macro level SDG financing overview and (iii) propose practical financial solutions and arrangement how Bosnia and Herzegovina can foster its sustainable development and accelerate the SDGs implementation up to 2030. Ultimately, the SDG Financing Framework in BiH after adoption by all levels of government in BiH, will offer new approaches/solutions for accelerating the realization of the SDGs in BiH and as such will be used as an entry platform for the institutions of BiH, FBiH, RS and Brčko District for mobilization of financial and other forms of support through financial institutions, international organizations and donors active in BiH and the Western Balkans region.

4. This DFA is structured around six chapters, providing the results of the assessment and diagnostic that guides the development of the SDG-FF Road Map (provided as a separate document), completing Phase I. Phase II builds from Phase I, and delivers the overall SDG Financing Framework.

THE DEVELOPMENT FINANCE ASSESSMENT

5. Chapter 1 provides the institutional context within which the BiH DFA is developed, to build a common understanding for readers. The chapter provides a summary of the BiH SDF Framework, and then states the objective of the DFA objective, which is to support BiH's efforts to build forward better by increasing access to integrated and sustainable financing to meet the financing needs of the SDG Framework. The section introduces the governance structure and dialogue process, and then introduces the DFA quadrant framework, which focuses on domestic public and private and international public and private flows. The review of these quadrants in essence provides the first full description of what the BiH funding and financing ecosystem looks like.

6. Chapter 2 presents key facets of the Macro-Economic and Fiscal Context of BiH, starting with a historical perspective, given that macro-economic vulnerabilities and resilience substantially shape investment futures. The section reflects on the nature of BiH's non-resilient economy, the challenges faced in emerging from the middle-income trap and the primary drivers of external and internal imbalances. The primary financing challenges identified include the need to better balance market and state economies, dominance of non-productive public spending, challenges to the social contract, openness to the international economy, how best to invest in smart cities and regions as engines of economic development, and the obstacles to boosting inclusion, resilience, economic efficiency and savings and investment. Addressing levels of informality, and the relative under development of capital and financial markets, and also key issues that impact sustainability.

7. Chapter 3 provides the heart of the analysis, as it presents the description and diagnostic of the BiH Development Finance Landscape. This section provides an overview of domestic public finance, domestic private finance, international public finance, and international private finance. The section covers government revenues, government expenditure priorities, public-private partnerships (PPPs), public enterprises, pension funds, public debt, state guarantee, central bank, commercial banking sector, capital markets, digital banks, micro-finance, insurance markets, portfolio investment, angel investment, NGO flows, and development banks. The description identifies both gaps and blind spots, that can be addressed by the SDG-FF, and picked up as priorities in the financing strategy.

8. Section 4 outlines the policy agenda and framework for the SDGs in BiH, including the macro-level financing needs and public planning and budgeting process. The costing of the SDGs allows for determining priority areas and tools for targeted financing, including demand-stimulating policies and public investment in physical and social infrastructure. The business case for SDGs is presented and emphasizes the need for an integrated approach to financing, mobilizing private capital, and gendered and ethical representation in decision-making. In terms of SDG alignment and integration the "Comprehensive Strategy for Public Finance Management (2022-2025)" provides the basis for reform, providing an anchor for the SDG-FF.

9. As BiH has a unique and complex public finance system, in order to facilitate the alignment and integration of SDGs into the planning and budgeting process, each tier of government will need to make sure that the SDGs are not only integrated into the public Investment Plans (PIPs) but also medium-Term and Annual Work Programs, by bring changes to the Global Framework of Fiscal Balance and Policies, Mid Term Work Plan, Budget Framework Papers (BFP), Government Annual Work Plan (GAWP), Public Investment Program (PIPs) and Annual Report on Budget Execution process. Given the importance of mobilizing and incentivizing private capital, the section outlines an approach to improved public private collaboration.

BiH SDG Financing Needs

10. Section 4 also provides the top-down calculations for macro level SDG financing needs for BiH, providing an understanding of the overall level of financing flows necessary to meet BiH SDGs. Based on the SDG costing model adopted (for details, see Annex 2), if BiH continues to practice a 'Business As Usual' (business as usual scenario' i.e., continues to keep trend GDP growth rate of 2.5-3.5% and the ratio of SDG spending per cent to GDP per cent is not changed), it would be spending around KM 79.9 billion on SDG financing over the period of 2023-2030. This would be insufficient to meet the SDGs.

11. As a result, the DFA concludes that an accelerated growth scenarios of high investment is needed. For this to happen, BiH must incentivize the spending necessary to meet the SDGs in the line with the other upper middle countries' spending on SDGs. This would imply an increase a total of KM from 79,96 to 86.1 billion over the 2023-2030 period or rather the annual average increase from some KM 10 to 10.8 billion, when compared to the 'business as usual scenario'. Achieving this level of additional investment however can be achieved by channeling resources toward priority sectors, based on urgently needed financial reforms and financing instruments selection that can assist in mobilizing private capital and bridging the financing gap.

Selection of Priority Investment Areas

12. Chapter 5 provides an overview of the sector priority areas identified for accelerated investment. In the light of the conclusions reached in preceding chapters, and the SDG financing needs for the accelerated growth scenario, criteria were established by the DFA Sub-Working Group in order to identify priority sector investment in the first 24-36 months of the SDG Financing Framework, with the greatest potential for mobilizing new capital and closing the financing gap. Criteria included sectors that (i) target one or more SDGs of particularly high priority to countrywide policy (ii) are alignment with the SDG Framework (iii) can be executed across all tiers of government (iv) have potential for crowding in private capital through scaling existing and / or new instruments (v) demonstrate quick and visible results for successful scaling (vi) be amenable to the short-term financing instruments (vii) contribute towards EU Integration and ERP priorities (viii) address critical cross-cutting issues such as gender, climate, and environmental concerns and (ix) align with the investment priorities of key anchor donor investors, and contribute towards leaving no one behind and building back better. Based on these criteria, the following three priority sectors have been prioritized.

13. ***Digitalization***: Digitalization was identified as not only essential for meeting the good governance and public sector management, smart growth, and society of equal opportunities development pathways, but also for building the sustainable society of the future. The cost of financing digitization is substantial and requires considerable investment flows from the private sector. The rationale for investment is clear. According to the Network Readiness Index, Bosnia and Herzegovina is ranked 90th out of 131 countries in 2022, and compared to the countries in the region, BiH is the worst ranked country. Digitalization accelerates economic growth and facilitates job creation, and it also allows the improvement of sector service delivery in education and health, for example. It provides a huge boost to economic output and creates both formal and informal sector jobs.

14. Digitalization directly targets SDG 9 (Build resilient infrastructure, promote inclusive and sustainable industrialization and foster innovation), while it also is also referenced in the targets related to climate change (SDGs 13, 14 and 15), gender equality and women empowerment (SDG 5), private sector development (SDG 8), education (SDG 4) and health (SDG 3). In terms of accelerators, the SDG framework focuses on the following actions: (i) Digital transformation of the public sector, (ii) digitization of the economy, (iii) strengthening public digital infrastructure, and (iv) digital skills development. Gender is a strong cross cutting issue for this priority.

15. ***Infrastructure and Energy***: Infrastructure and energy investment are central to the attainment of many SDGs, contributing to a carbon-net-zero economy, improved competitiveness and service delivery, lower transaction costs and high rates of return to growth, revenues and employment. The SDG Framework states that BiH must not only increase the investment rate but also within the investment structure increase the share of public investments in infrastructure, at least in the amount of 5-7% of Gross Domestic Product. The sector has direct and close relations with the EU Green Deal and Paris Agreement. The rationale for upscaling sector investment is clear (i) BiH’s transportation infrastructure is deteriorating, reducing competitiveness (ii) road and railway quality is poor, affected by underinvestment by financially weak state-owned companies and inefficiencies in spending and (iii) much of BiH’s energy infrastructure is obsolete, using carbon and energy intensive generation infrastructure. Transportation infrastructure is not in line with the country’s needs while public utility companies „Water supply and Sewerage“ is starved of necessary investments.

16. Infrastructure investments can deliver positive rates of return on investment, and importantly, with the correct investment mix, private capital can be used as key catalytic factor, through PPPs / blending and other investment mechanisms. Maximizing both economic and social rates of return will be guaranteed through the application of investment criteria. Infrastructure and energy investments impact multiple SDGs, including SDG 7, 9, 10, 11, and 13. These investments improve access to services, reduce greenhouse gas emissions, promote sustainable urbanization, and contribute to economic growth and improved living standards. Overall, infrastructure and energy investments are critical for achieving sustainable development. In terms of infrastructure and energy, the SDG framework targets (i) Resilient and inclusive public health infrastructure and institutions (ii) smooth function of key infrastructure (iii) development of transfer infrastructure (iv) increased public investment in infrastructure (v) ensuring equal access to modern transport infrastructure and, (vi) strengthening infrastructure of service providers by introducing new models (vi) decarbonization of the energy sector and (vii) green growth and clean energy.

17. ***Research and Development***: Given that efforts are underway to create a stimulating, innovative, developmental and sustainable environment, towards what is called smart specialization, boosting existing knowledge and competencies to increase competitiveness and using innovation to stimulate economic growth is critical. For this reason, the DFA-Sub Working Group identified Research and Development as a key investment priority. The justification is that cooperation between universities and the R&D industry is not at the appropriate level, with BiH ranked 119th out of 132 countries. In addition, according to the Global Innovation Index 2021 (GII 2021), BiH is ranked 75th out of 132 countries.

18. Increased R&D spending will provide BiH with solutions to socioeconomic problems through the development of new products and services or by improving existing ones. A number of countries have developed an extremely efficient research translation infrastructure, and BiH could therefore learn lessons from Germany's Fraunhofer Gesellschaft, Taiwan's ITRI, South Korea's ETRI, the Netherland's TNO and Great Britain Catapult Centres etc. The DFA notes that R&D can play a crucial role in achieving the SDGs, with SDG 9 building resilient infrastructure, promote sustainable industrialization, and foster innovation, and R&D spending will also impact many SDGs, including 11, 5, 3, 7, and 13.

19. BiH must increase its spending on the SDG priority areas (digitalization, infrastructure and energy and R&D) from KM 7.91 to 8.25 billion over the 2023-2025 period or for an additional KM 340 million. For the 2026-2030 period, the spending on SDG priority areas should be increased from KM 14.99 to 16,39 billion or for an additional KM 1.40 billion. In sum, the spending on the SDG priority areas over the 2023-2030 period should be increased by an averaged annul increase of KM 217.4 million.

Selection of Short and Long-Term Financing Instruments

20. To cover the digitalization, energy and infrastructure and research and development costs a number of innovative financing instruments and mechanisms have been identified, which when combined with reforms that promote Strategic Budgeting for the SDGs (B4SDG), constitute what the DFA states to be a right-financing approach. Right-financing allows the most optimal or appropriate instrument covering debt, equity, blending or grants, to achieve the stated investment purposed. Among the short-term options outlined include a Strategic Investment Fund (SIF), syndicate loans for larger infrastructure investments, an SME Apex Financing Structure to provide credit guarantees to close the 'missing middle' in SME financing and options for issuance of the first BiH SDG bonds.

21. As capital and financial markets deepen, longer-term financial instruments can be also mobilized, significantly boosting private sector participation in SDG Framework outcomes. Establishing of the proposed financing instruments substantially will contribute to closing of the annual financing gap. The DFA also recommends greening the banking system by introducing a green taxonomy, while also developing a taxonomy for PPPs.

Chapter 1

Introduction

1. INTRODUCTION

1. ***This Development Finance Assessment (DFA) is the primary building block required to establish the Bosnia and Herzegovina (BiH) Sustainable Development Goal (SDG) Financing Framework (SDG-FF).*** The SDG-FF has been developed to guide the financing of the BiH SDG Framework which established in December 2020. Established around three development pathways (Good Governance and Public Sector Management, Smart Growth and Society of Equal Opportunities), the SDG Framework is structured around 13 accelerators, and supported by two horizontal themes (Human Capital for the Future and Leaving No One Behind), this DFA describes the current financing landscape in Bosnia and Herzegovina, from which the Financing Framework is developed.

2. ***The SDG-FF emerged from the Addis Ababa Action Agenda (AAAA) of 2015.*** The Action Agenda established a strong foundation to support the implementation of the 2030 Agenda for Sustainable Development, providing a new global framework for financing sustainable development by aligning all financing flows and policies with economic, social, and environmental priorities.

3. That Action Agenda initiated the development a comprehensive set of policy actions by United Nations Member States which included a package of over one hundred concrete measures to finance sustainable development, transform the global economy and achieve the SDGs. The BiH SDG-FF therefore focuses heavily on improving the catalytic impact of national budget spending while also strengthening the financial architecture to crowd in private capital (domestic and foreign).

Financing Agenda 2030

Development Finance Assessment

The DFA is a tool developed by UNDP to support governments as they respond to COVID-19, and establish integrated national financing frameworks, to finance the agenda of building forward better with greater sustainability, resilience, and inclusivity.

Integrating Financing Resources

BiH SDG Financing Framework

The SDG-FF concept offers a holistic approach to development finance, taking all forms of financing into account – public, private, national, and international – and marshalling these to deliver SDG Framework.

4. ***Critical to establishing an affective financing framework to improve the resourcing of the SDG Framework in the existing constitutional governance structure in BiH, is to integrate the strategy across all levels of government, into the Budget Framework Paper (BFP) and Medium-Term Expenditure Framework (MTEF) process, as well as the sector investment programs.***

5. The introducing of new financial instruments, modalities and partnerships will therefore need to be operationalized across all levels of government in accordance with the existing constitutional and legislative framework, and focused on three priority sectoral areas, with the aim of demonstrating a cumulative impact through scaling. Given that the domestic budget constitutes over 40 per cent of Gross Domestic Product (GDP), the role that public spending plays in leveraging in new catalytic resources has never been more important, given the large financing gap.

6. ***Two central themes of the SDG-FF are Building Forward Better and Leaving No One Behind (LNOB), and both are now central to discussions on the Great Reset and Forth Industrial Revolution (4IR), that many economies have made central to public investment.*** Yet, as this DFA makes clear, to increase production and employment at a rate necessary to achieve the Copenhagen's criteria to enter the EU, annual economic growth rates must exceed 6 per cent over the longer term. For this to happen and to mobilize sufficient fiscal resources to finance development, BiH will need to advance innovation and adopt leading-edge technologies to serve society and achieve equitable and inclusive growth, happiness and social, environmental and governance sustainability. Given external shocks, supply side constraints, fiscal challenges, levels of informal unemployment, shallow financial markets, gender inequality and energy transition challenges, this DFA outlines resource needs against the resource gap to meet the SDGs.

1.1 The BiH SDG Framework

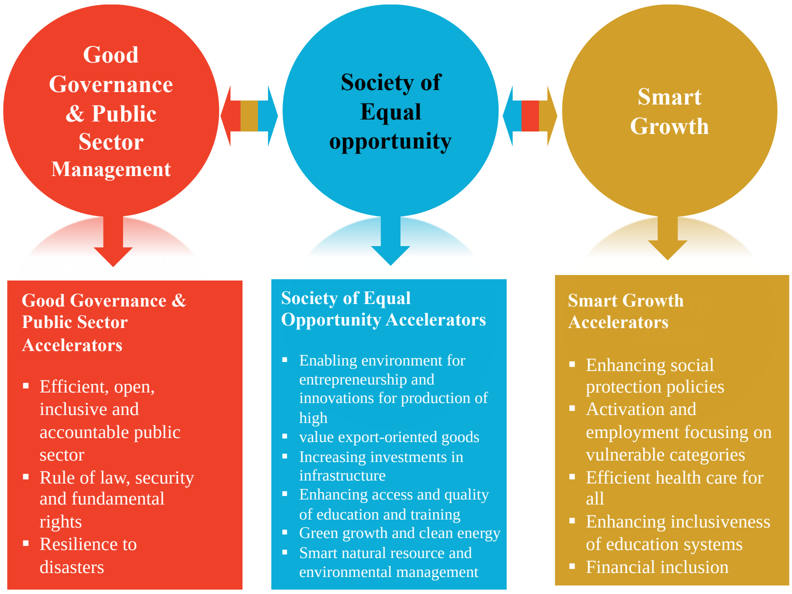
7. ***The December 2020 SDG Framework provides a cornerstone for the transition to sustainable development in Bosnia and Herzegovina.*** Not only does the framework outline the development pathways, accelerators, and horizontal issues, it also outlines how the SDG financing gap will be met, through the formulation of the SDG-FF and adoption of new financing instruments and measures. Importantly, the SDG Framework provides a common guiding document for all tiers of governance in their quest to attain Agenda 2030 SDGs.

8. Importantly, the SDG Framework outlined a set of key principles, which are therefore equally central to this DFA. The SDG Framework:

- Provides a holistic approach to development.
- Is complimentary and mutually reinforcing with the EU accession agenda.
- Is structured around broader development pathways.
- Informs the strategic planning and budgeting process at all levels of government.
- Is based on a fully participatory approach, inclusive of gender equality and the marginalized groups.
- Commits the authorities to align resources with the attainment of the SDGs, in accordance with capabilities and delegated authority.
- Fosters the commitment of governments to use established system for long-term coordination.

9. ***The three development pathways provide the overall framework for the SDG-FF, guiding the selection of the three strategic investment priorities, to be approved by the SDG Council.*** These pathways determine the various accelerators identified necessary to activate the drivers of change in a particular area. These drivers of change are at the policy, regulatory, institutional, financing modality and capacity level. Figure 1 below shows the three development pathways and associated accelerators.

Figure 1 BiH SDG Framework Development Pathways



10. ***The advantage of development pathways for the DFA is that it provides the overall direction for investment, but is not overly prescriptive, allowing different BiH governments to identify and finance their own priorities.***

1.2 BiH DFA Objective

11. ***The objective of this DFA is to support BiH's efforts to build forward better by increasing access to integrated and sustainable financing to meet the financing needs of the SDG Framework.*** This DFA provides a comprehensive picture of the economy (financing landscape), assessing both the size and complexity of resource flows as well as the institutions and management structures that govern them.[1] In meeting this objective, also provides the following:

An overview of BiH's financing ecosystem including the trends and composition all public, private, domestic and international of financial flows.	Identifies the strength and achievements of existing financing strategies, policies and institutional structures to meet key financing challenges.
Considers a prioritized focus on areas in depth, (particular finance flows or financial planning) that are central to BiH's ability to achieve results in the sustainable development space.	Identifies existing constraints that hinder institutional attempts to both mobilize and effectively channel finance into its priority areas (with a focus on its capacity to couple public and private finance).
Proposes realistic recommendations that once executed will support the attainment of SDG Framework Development Pathways and selected accelerators.	Provides the foundation for the SDG-FF Roadmap and BiH SDG Financing Framework, to be taken forward under Phase II.

1.3 The DFA Four Quadrant Framework

12. ***As noted above, this DFA provides the assessment and diagnostic element of the SDG-FF and is essentially structured around the domestic public and private and international public and private quadrant structure provided in Table 1 below***. In the process of describing the BiH financing landscape across the four quadrants, policies, institutions, instruments, and capacities are also assessed as they impact the supply and demand for SDG financing. These quadrants – and their integration – also shapes the SDG-FF Monitoring and Review and Governance and Coordination process and Financing Framework. The four discrete but inter-related quadrants also lead to an integrated financing response to the fiscal space challenges noted above.

[1] BiH consists of the Federation of Bosnia and Herzegovina and Republika Srpska with the Brčko District functioning as a decentralized system of local government. The Federation consists of 10 Cantons (federal units) with 16 cities and 74 municipalities, while Republika Srpska has 64 local self-governments (10 cities and 54 municipalities).

Table 1. DOMESTIC AND INTERNATIONAL, PUBLIC AND PRIVATE FINANCING QUADRANTS

	Public	*Private*
International	▪ ODA Grants ▪ ODA loans ▪ Other Official Flows ▪ Public agency guarantees ▪ Multilateral development banks ▪ South-south and triangular cooperation ▪ Climate Finance	▪ Foreign direct investment ▪ Portfolio equity ▪ International transfers (remittances etc.) ▪ International NGOs, foundation, and philanthropists ▪ Private borrowing (international lenders) ▪ Corporate social responsibility
National	▪ Direct, indirect and other tax revenue ▪ Natural resource related taxation ▪ Non-Tax Revenues ▪ Public Private Partnerships ▪ Public or publicly guaranteed borrowing ▪ Municipalities ▪ Sovereign wealth funds	▪ Domestic investment ▪ Private borrowing (domestic lenders) ▪ Domestic NGOs, foundations, and philanthropists ▪ Corporate Social Responsibility

N.B. South-South cooperation refers to development cooperation between developing countries in the Global South. When South-South Cooperation is implemented with the support of a Northern partner, it is referred to as Triangular Cooperation.
Source: UNDP, Development Finance Assessment Guidebook

1.4 THE SDG PUBLIC EXPENDITURE REVIEW (PER) PROCESS

13. ***This DFA has benefitted from a rapid SDG Public Expenditure Review (PER) with a particular focus on gender equality, as part of the commitment to LNOB.*** The PER has not only provided a greater understanding of the allocation of resources to the SDGs, but it has also been instrumental in identifying key public finance management and strategic budgeting issues, in describing the composition of SDG spending, against policy priorities.

1.5 REPORT STRUCTURE

14. ***This DFA is structured according to broad structure outlined in the SDG-FF Guideline.*** Following this introductory chapter, Chapter 2 frames the DFA within the context of the emerging macro-fiscal context. Chapter 3 provides the results of the assessment and diagnostic of the BiH financing landscape, including an assessment of financing risks. Chapter 4 provides the proposed macro-level SDG financing needs, Chapter 5 the prioritization for SDG attainment, Chapter 6 a summary of new financing instruments. The Road Map for the SDG Financing Framework is provided as a separate document.. The DFA annexes provide detailed notes list of technical terms, methodological notes and complementary financing instruments tables.

15. ***The report is closely aligned to and promotes the financing of BiH's development pathways as outlined in the SDG Framework***. The Financing Framework delivers a progressive approach aimed at meeting the financing gap, and key issues such as EU Integration, the EU Green Deal, 4IR, gender, climate and digital economy considerations are mainstreamed across the text. Moreover, a gender responsive road map has been developed to strengthen the SDG-FF Road Map, for integration into the Financing Framework, not as a public document but as a reference source.

BiH SDG FINANCING FRAMEWORK INTEGRATION

Develops a common understanding of the financing landscape and qualities as the SDG Financing Framework for sustainable development in BiH.

THREE LEVELS OF INTEGRATION

Integrating planning and financing policies.
Integrating public and private financing policies, and,
Integration of collaboration across government and partners.

A FOCUS ON RESOURCE MOBILIZATION

Increasing catalytic impact and leverage, revenue diversification, improved debt management, international climate finance, vertical funds, impact investment, thematic bonds, etc.

Chapter 2

Macro-Economic and Financial Context

2. Macro-Economic and Financial Context

2.1 Macro-Economic History and Outlook

16. ***Prior to the onset of the COVID-19 pandemic and the Ukraine crisis, the overall macro-economic situation was stable, and positive economic growth outturns were supported by increased investment in infrastructure and external demand***. Despite gains however, historically, economic growth has been below the pace needed to speed up convergence with the European Union (EU).

17. ***According to Global Fiscal Balance and Policies Framework***, the overall macro-economic and fiscal objective is to accelerate growth through structural reforms, increase the primary surplus and consolidate public spending to below 40 per cent of Gross Domestic Product (GDP).

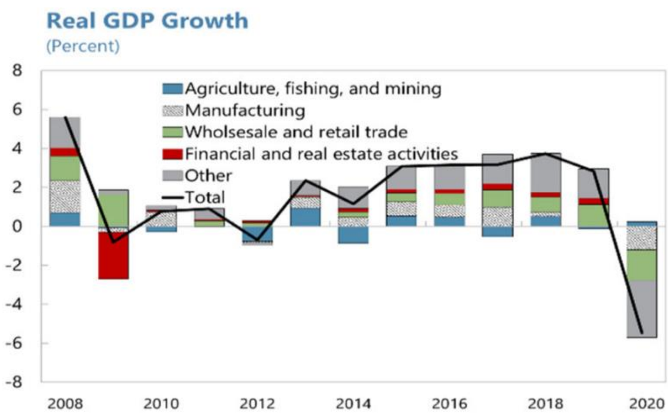
18. According to the IMF Article IV Consultation as of February 2021, (IMF, 2021 i 2022) '*institutional weaknesses…. a weak rule of law, poor, public infrastructure quality, and delays in implementing key regional connectivity projects remain the key factors undermining the country's attractiveness to private sector development and foreign investments*.'

19. These structural challenges and imbalances identified by the IMF underscore the challenge of crowding in private capital to key growth sectors, and this will likely impact the availability of private capital for priority sectors. As a result, this DFA identifies the financing gap for attaining the SDGs, while identifying new integrated ways of financing to improve market liquidity and investment.

2.1.1 Non-Resilient economy

20. ***BiH has limited export compacity leading to large foreign trade deficits.*** The country is very vulnerable to external shocks and when inflows of foreign exchanges are weakened[2], the economy is threatened by recession. With global recession however, the economic growth of BiH had virtually collapsed. Since then, it has been very weak, with an average annual growth rate of 1.9% over 2010-2020 (see Chart 1 below). The global recession of 2007-2009 undermined the BiH's economic growth, with a consequent risk to its economic, social, and political stability, with growth rates falling significantly.

Chart 1. GDP Growth Rate and Composition; BiH, 2010-2020



Source: IMF Article IV Consultation (2021)

[2] One type of these inflows, mother-bank loans to daughter-bank loans was very strong before the global financial recession of 2007-2009. Before that global crisis, foreign bank loans were a plentiful source of foreign exchange and financial sources of credit, and in line with that of strong aggregate demand increase and economic growth of almost seven percent.

21. ***BiH is consequently losing pace with comparators countries, suggesting an increased focus on identifying the resource gaps and constraints impeding increasing productively and resilience.***.[3] Together with three East European Moldova (Ukraine, Belarus and Moldova) and four Balkan countries (Serbia, Montenegro, Albania and North Macedonia) compose the eight-member group of not high-income European countries[4].

22. ***A key challenge for the BiH economy is to address challenges related to low output levels, particularly for exports, and the current trade imbalance***[5]. Given the low level of GDP per capita, there is an urgent need to boost GDP growth outturns even despite its pre-recession growth rates of 5-6 per cent.

23. The economy suffers from inefficiency - both static inefficiency (poor allocation of existing resources, especially labor) and dynamic inefficiency (low accumulation of capital of all kinds, primarily infrastructure). That is why GDP pc and exports are per capita at such low levels. Obstacles to economic and trade deficit reductions are significant, but they primarily originate from very small private sector, low competitiveness of the economy and consequently its low profitability and investment activities. As a result, exports, and GDP per capita are very low.[6]

2.1.2 MIDDLE INCOME TRAP

24. ***After recovering from post-war reconstruction and transition shock, BIH has entered the middle-income trap***[7]***, due to numerous reasons***: (i) lack of support for knowledge-based economy, (ii) lack of support for development of value chains (e.g. through public procurement, support packages to companies etc.), (iii) no renewal, or supporting of development of the research and development (R&D) sector (e.g. BIH is the last country in Europe regarding per capita investment basis for research and development) (iv) not introducing non-bank financial institutions, mechanism and instruments, (v) domination of non-productive (social and administrative) over productive public expenditures (research and development, physical infrastructure, primarily the information-communication infrastructure etc.), and (vi) failure to implement adequate pricing policy, especially the stabilization through stockpiles, etc.

25. ***Many countries have developed rapidly after WWII and became middle-income countries. Some of them continued to develop and became high-income countries.***[8] According to the World

---

[3] Comparators countries consist of a group of small - in terms of size and population - south and central European economies, namely North Macedonia, Serbia, Montenegro (the EU candidate countries), Czech Republic, Slovak Republic, Slovenia, , Croatia and Bulgaria (advanced transition countries), Greece and Portugal (advanced market economies) and Austria and Switzerland (developed federal countries with robust market economies).

[4] See https://data.worldbank.org/indicator/NY.GNP.PCAP.CD

[5] World Bank, 2020. Bosnia and Herzegovina - Systematic Country Diagnostic Update. Washington DC: World Bank; EBRD, 2022.Bosnia and Herzegovina country diagnostic: Private investment challenges and opportunities 2022. London: EBRD. According to the European Commission (2022:6): “The country’s Economic Reform Programme does not contain sufficient credible countrywide measures to address the major structural economic challenges”.

[6] “Five years have passed since the first Systematic Country Diagnostic (SCD), and there has been limited progress in overcoming the identified obstacles to growth and shared prosperity. Fundamental obstacles that held Bosnia and Herzegovina (BiH) back then are still present: the country’s unique institutional setup and resulting governance challenges, demographic decline, and the unfinished economic transformation.(…) BiH must move from growth driven by public sector spending to growth led by private sector competitiveness and productivity. (…) BiH must move from an economy based on consumption to one based on investment.(…) BiH must move from an inward-looking economy to an export-driven one” (World Bank, 2020. Bosnia and Herzegovina - Systematic Country Diagnostic Update, pp. 9 and 15).

[7] The middle-income trap refers to a situation whereby a middle-income country is failing to transition to a high-income economy due to rising costs and declining competitiveness. Few countries successfully manage the transition from low to middle to high income (see more in “Gill, S.and Kharas, H. 2015. The Middle-Income Trap Turns Ten. Policy Research Working Paper; No. 7403. World Bank, Washington, DC.).

[8] After WWII only 30 countries have managed to pass the way from middle income to high income. (Felipe, Kumar and Galope, 2014).

Bank, certain countries are stuck in the middle-income trap.[9] Factors that enable high growth of countries with low income (natural resources, cheap labor, and easy technology transfer) are not key factors in transition from middle- to high-income country.

26. ***That transition requires the direction of resources into innovative, highly productive, and skill and knowledge intensive activities***. The production of higher value-added goods seeks skillful employees who ask for higher wages. Due to the increase of wages, the manufacturing companies of countries with upper middle income often deal with situation of not being competitive on export markets where producers that are more efficient are operating. **Moving from a middle income to high-income country is based upon export-led development (i.e., the exploitation of global demand at deep elastic markets for their products).**

27. Growth rates in BiH are still the lowest in the Western Balkans. ***While economic growth rates of 6% per year would be desirable, in the current context they are likely unachievable***. Regardless, it is necessary to increase production to improve productivity and competitiveness by 4% per year (in order to achieve Copenhagen's criteria to enter the EU) and increase employment to 2% per year.[10]As a result of lower growth outturns however, and lack of opportunity at home, young people often look for opportunities aboard leading to large remittance inflows.

28. ***A middle-income trap' country (as defined in footnotes above) is one that stays in that state more than the average time of retention***. Escaping the middle-income trap – which is desirable – will take considerable commitment to structural reforms and incentivizing new kinds of investment, including in areas where SDG Framework highlights the need to finance the energy and circular economy transition, as well as digitization for example.

2.1.3 EXTERNAL AND INTERNAL IMBALANCES

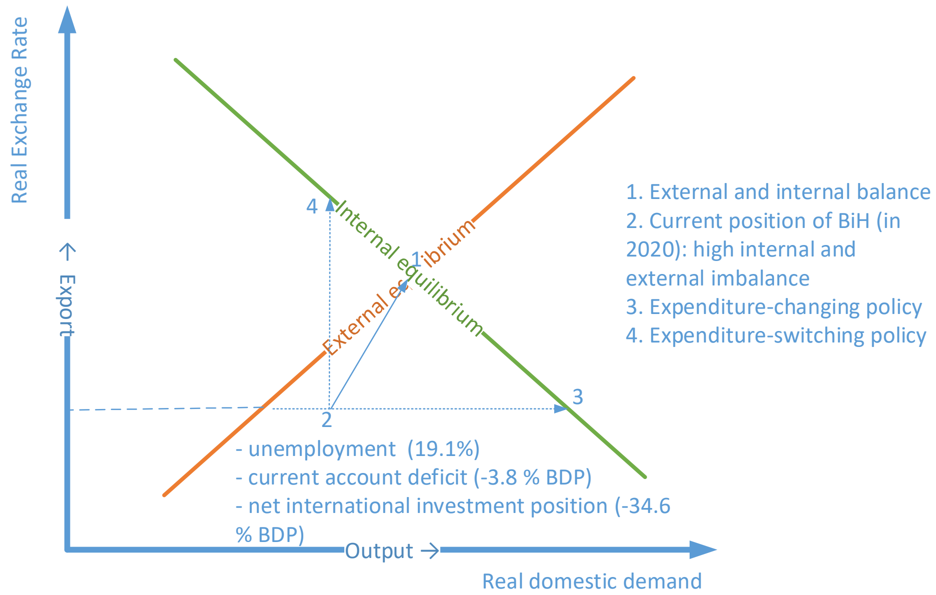
29. ***The BiH economy does not have a proper mechanism of adjustment, as shown by the long-term internal and external imbalances***. There is a high unemployment rate, high trade deficit and growth rates significantly below its potential size. These overall imbalances impact the attainment of SDG 8 (decent work and economic growth) and other sustainability goals and given the relatively week business enabling environment and shallow financial market, the need to identify new financial instruments and partnerships seems even more compelling.

30. The classis Swan model provided in Figure 2 below represents BiHs respective internal and external balance with the axes representing real exchange rate and the country's fiscal deficit. This imbalance reflects policies and incentives that favor the public sector, consumption and imports over private sector, investment exports.

[9] This term was introduced first by Gill and Kharas 2007 in study "An East Asian Renaissance: Ideas for Economic Growth." According to the World Bank, the middle-income trap refers to a situation whereby a middle-income country is failing to transition to a high-income economy due to rising costs and declining competitiveness. Few countries successfully manage the transition from low to middle to high income. https://elibrary.worldbank.org/doi/10.1596/9780821387856_CH04

[10] BIH was on the threshold of high growth rates in 2007 with growth rate of 6% and in 2008 it had 6.8%. In those successive years, BiH was even close to 7%. With 7% growth rate, it could reach in 10 years income of US$ 9.400. This would overpass today's global average. By increasing growth rate to 10,5-11,0% in ten years BIH would have ensured income per citizen of US$ 12.196, (i.e., entering the club of countries with large income).

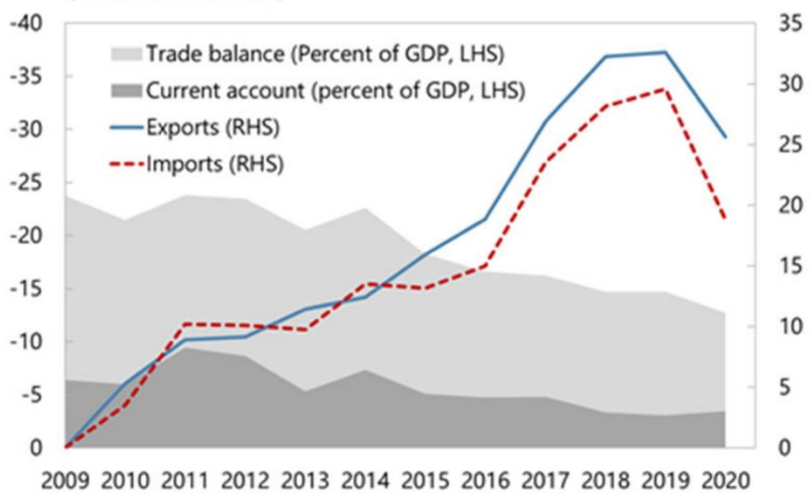
Figure 2 THE SWAN DIAGRAM



31. ***Since there are no efficient policies to correct the external imbalances that have marked the period following the Dayton Agreement, net international investment position of the country (of what BIH is investing abroad minus what foreigners invest to BIH) is -34.3% of GDP[11] (EU, 2023), hence, at the edge of acceptable -35%***. Fortunately, for BIH, this imbalance is not financed with credits only, but with non-credit resources such as international transfers and FDI and portfolio investments into the BiH economy.

32. ***The structure of the economy reflects BiHs transitional, upper middle income and limited market reform status***. BiH is a small, open economy, dominated by services with a moderately developed industrial and manufacturing sector, with a limited agricultural base.

Chart 2. CUMULATIVE CHANGE IN EXPORTS AND IMPORTS (2019-2020)



33. ***Since 2015, the growth of goods exports has outpaced the increase in imports (See Chart 2). and more than compensated the reduction in transfers***. However, BiH is still lagging most peer

[11] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM%3A2022%3A781%3AFIN&qid=1669158965799

countries and the new EU member states in trade and supply side integration, because of weaknesses in investor protection, contract enforcement, and property rights

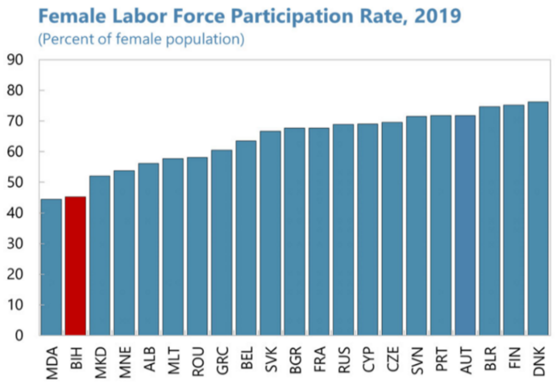
34. ***Market share in world imports has been in decline.*** Analysis of the external sector would encourage investing in transport infrastructure and connectivity to lift supply-side constraints and enhance competitiveness. Structural reforms and improved governance would also improve the business and investment climate, particularly for export-oriented activities that require stability and the rule of law. (IMF, Article IV Consultation, February 2021 and June 2022).

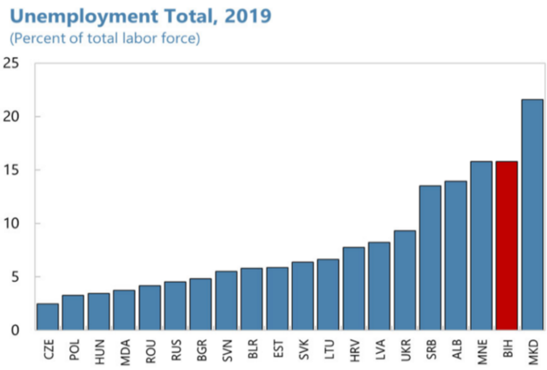
35. ***BiH has seen a large population decline since 2008, with considerable out-migration because of high unemployment and other push and pull factors, and the lure of European economies***. The number of employed people has improved since 2008, BiH still has a declining population which has a potential impact on the ability of government to finance its trade deficit. The country finances its trade deficit through extensive remittances from the 1.7 million-strong BiH diaspora living outside the country (UN, DESA, 2020)

36. ***In terms of the aggregate structure of employment, the services industry employs around 50 per cent, industry 31.7 per cent and agriculture around 17.96 per cent of the population***.[12] The unemployment rate in 2022 based on the national definition was 14.8 per cent. As provided in Chart 3 below, the female labor participation rate and employment total for 2019 shows BiH lag behind regional comparators. Enhancing formal labor market participation, especially for women, and reducing skills mismatches for youth will be key as will an investment focus on improving the business environment, economic governance, and digitization.

37. ***One key issue explored in greater depth in this DFA is the role of women in the economy and women's access to financial markets, given the impact of inequality on LNOB.*** Currently, the level of financial inclusion of women in BiH is similar to the Europe and Eurasia (E&E) average but lags considerably behind upper-middle income countries. Financial inclusion has been recognized as a central factor in promoting broad economic development and reducing poverty. A financial gender gap still exists in BiH where only 47 percent of women have an account in a financial institution, compared to 59 percent of men.[13] This impacts the structure of economic opportunity.

Chart 3. Female Labor Force Participation Rates and Employment Total Comparators (2019)





[12] https://www.statista.com/statistics/454016/employment-by-economic-sector-in-bosnia-herzegovina/

[13] Level of financial inclusion in BiH is similar to the Europe and Eurasia (E&E) average but lags considerably behind upper-middle income countries. Financial inclusion has been recognized as a central factor in promoting broad economic development and reducing poverty. According to 2014 Financial Inclusion Index (FINDEX) data, 53 percent of the BiH population had an account at a financial institution. However, a considerable financial gender gap still exists in BiH where only 47 percent of women have an account in a financial institution, compared to 59 percent of men.

2.2PRIMARY FINANCING SUSTAINABLE DEVELOPMENT CHALLENGES

38. ***While both entities have identified economic challenges through the Economic Reform Program (ERP), in assessing challenges related to financing sustainable development, OECD states that much more financing is needed to support investment and growth***. Low domestic savings (coupled with low FDI and other external financing) constrain domestic private investment which at an average of 7.7% of GDP over the past four years (World Bank, 2023), is among the lowest in the region. Investment is also impeded by weak access to finance, particularly for start-ups and SMEs, due to prohibitively high collateral and other banking-sector requirements, as well as the relative lack of awareness and availability of non-bank financing options.

39. On the public-sector side, high fiscal revenues have not translated into quality public services due to high current expenditures (on wages and social transfers) and weak public investment. The large, inefficient and highly indebted SOE sector imposes a high fiscal burden that limits the funds available for investments in infrastructure, education, health and other areas of development importance.[14]

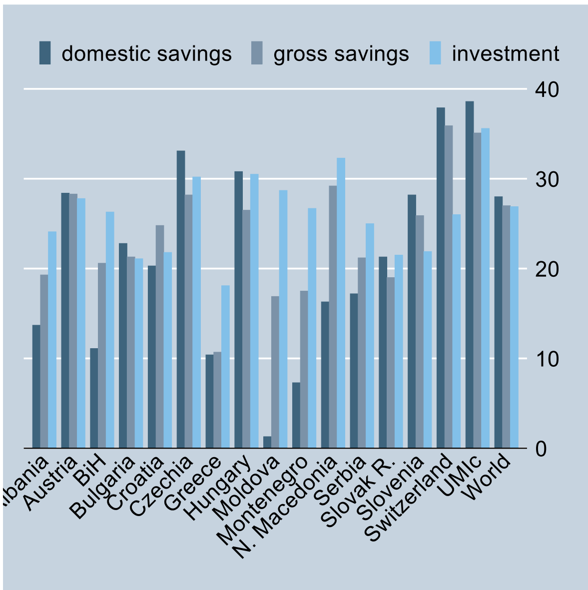
40. Three major financing challenges are identified:

- Low domestic savings and limited external financing have constrained investment.
- Strong revenue performance does not translate into quality public services and infrastructure due to high current expenditures and weak public investment.
- Access to finance is limited for SMEs, particularly start-ups and microenterprises.

2.2.1 INCLUSION, RESILIENCE, EFFICIENCY, SAVINGS AND INVESTMENT

41. ***One of the lessons from the experiences of countries that have strong development, and some of them became world miracles, is that there was not high economic growth without high rates of savings and investment***. For example, China has saved each year more than a third of GDP for more than a quarter century, but in recent years, it saved about half of gross domestic product.

Chart 4. SAVING AND INVESTMENTS; BIH AND COMPARATORS, 2021 (IN % GDP)



Source: DFA Consultant Calculations based on World Bank (2023)[15]

[14] https://www.oecd-ilibrary.org/sites/8e6d1ccd-en/index.html?itemId=/content/component/8e6d1ccd-en#section-d1e31851
[15] https://databank.worldbank.org/source/world-development-indicators

42. ***BiH has lower investment and particularly saving rates than comparators countries (see Chart 4) what means that it is 'importing' savings from abroad i.e., it has the inflow of foreign capital in the size of these differences***. There are three main reasons for the low savings rate and consequently the investment rate and GDP growth rate are the (i) underdevelopment of the financial system of the country and (ii) and the ways of amassing wealth and bypassing financial institutions by the rich and (iii) insufficient income and the inability to save in certain categories of the population.

43. ***There is no variety of financial institutions and financial instruments capable of mobilizing resources ranging from a few BAM (micro institutions that deposit collecting) to several billion BAM (through infrastructure bonds issuances).*** There is no law in BiH on mutual guarantee funds, savings banks, savings and loan associations (there are to certain extent in the Republika Srpska), financial holding companies, and credit guarantee funds for almost three decades.

44. ***Reform of the financial markets could provide a GDP growth of two percentage points[16] (MF, 2019). Simply put, only reform of the financial system and attracting of diaspora funds can increase GDP growth rates for at least two percentage points*** (Mitra (IMF), 2016).

45. Commercial banks, and the only banks - with the exception of two development banks, control about 88.8% of the financial system of BiH. Of the remaining 10-odd percentages, insurance companies control half (precisely, 5.2%, predominantly due to mandatory car insurance) and the remaining half form the leasing companies (0.9%), investment funds (2.2%) and microcredit organizations (2.9%) (CBBiH, 2021)

46. ***There is a dominance of foreign commercial banks in the financial system of BIH***, which own 81% of share capital of the banking system (EBA, 2019). Worst of all, the *law on banks prohibits non-banking financial institutions, because no institution other than a bank can collect deposits and grant loans*. There is no doubt that BiH and FBiH[17] especially with the transposition of EU legislation shall abolish this practice.

47. ***Real interest rate on loans can be lowered and increased on deposits only by creating competition in the financial market and the inflows of funds from abroad***. Extremely difficult task is to lower the interest rate, particularly under currency board regime. Since 1995, efforts to aimed at lowering interest rates have met with limited success. What should the government do in this regard? *The correct way of pushing banks towards reducing interest rates is to reduce systemic risk and increase competition in the financial market.*

48. ***Aggregate savings of BiH is the total of its private savings by household and companies (private savings) as well as the public sector (public savings).*** Since the country is running a current account deficit, it means capital from abroad is entering BiH and is considered part of the supply of financial capital.

Table 2. SUPPLY AND DEMAND OF FINANCIAL CAPITAL; BIH, 2016-2021 (BAM BILLIONS)

	Variables	2017	2018	2019	2020	2021	Source
1	**Demand for financial capital (2+3)**	**7.8**	**8.3**	**8.9**	**9.7**	8,8	
2	Gross capital formation (GFCF)	7.8	8.3	8.9	7.9	8,4	BHAS
3	Budget deficit (G-T>0)				-1.8	-0.4	CBBIH
4	**Supply of financial capital**	**8**	**8.5**	**9**	**10**	9,3	
5	Private saving	5.7	6.6	7.3	8.7	8,4	
6	Current Account	-1.5	-1.1	-1	-1.3	-0,9	CBBH
7	Budget surplus (T-G>0)	0.8	0.8	0.7			
8	Discrepancies	-0.2	-0.2	-0.1	-0.3	-0,5	

[16] The main channel at play seems to be that of an improvement in the allocative efficiency of financial markets (IMF, 2019)
[17] There is a legal possibility of establishing credit unions in Republika Srpska (the Official Gazette no. 93/2006).

Source: DFA Team Calculation based on the World Bank, Central Bank of Bosnia and Herzegovina and Agency for Statistics of Bosnia and Herzegovina

49. ***There are also two main sources of demand for financial capital in the BiH economy: private sector investment, I, and government borrowing, where the government needs to borrow i.e., when government spending, G, is higher than the taxes collected, T. Businesses need to borrow to finance their investments in equipment, premises, and personnel.*** So, both business investment and the government can demand (or borrow) the supply of savings. There are two main sources for the supply of financial capital in the BiH economy: saving by households and firms, called S, and the inflow of financial capital from abroad, which is equal to the current account deficit.

2.2.2 CUTTING NON-PRODUCTIVE PUBLIC EXPENDITURE

50. ***BiH must focus on fiscal consolidation and improve fiscal management***. Fiscal consolidation must seek to increase the operational efficiency *of* government while maintaining a strong focus *on physical infrastructure and strongly increase R&D expenditure* (to 1% over the next two years, then to 2% over the following two years, and in turn at 3% and strive to maintain this rate until 2030). With debt to GDP at around 35 per cent, there is space for increasing serviceable debt for high rate of return investments, implying a focus on improving public investment planning.[18] Creating fiscal space for the SDGs will need to come from a balance of more efficient spending and higher rate of return public investment.

51. ***It is necessary to support tax administration strengthening to increase fiscal resources for development.*** This should focus, among other things, on ***making local*** and cantonal authorities more dependent on income tax, profit tax etc. and force them to make business environment more conducive to companies, FDI etc., albeit within the framework of the law (Hunziker and Dejonghe, 2019).

52. ***It is also necessary to review public expenditure on social programs***. A set of measures is needed to support, starting with the introduction of ID cards (to determine who, how, how much and from whom receives, as from BiH and outside of it, and put the whole social security system under control), to political and a legal review of the basis for granting aid.

53. Measuring the effectiveness and efficiency of the public sector (of public expenditure and public companies) is very limited in BiH. It is necessary to start benchmarking the activities of these institutions, i.e. to simulate operation of the market in non-market activities.

2.2.3 REDUCTION OF NON-OBSERVED ECONOMY[19] AND TAX EVASION

54. ***The tax morale is the driver as it was recently included in the survey of the informal economy***. The calculations show that in some countries the tax morale amounts for to 30% of the informal economy. Reducing the tax morale by 1% increases the informal economy by 0.20% (Torgler and Schneider, 2007; Torgler, 2011). Simply put, if the taxpayer does not respect the government, he/she will "manage" in a variety of ways not to pay taxes and at the same time will have no remorse, quite on the contrary.

[18] The FBiH parliament adopted a new insolvency law, harmonized with the insolvency laws in the RS and Brčko District.

[19] ILO's Committee of Experts on the Application of Conventions and Recommendations requests the Governments to continue to provide statistical data…including the size of the informal economy… and visible underemployment (see Observation (CEACR) - adopted 2021, published 110th ILC session (2022)

55. Incentivizing formalization of the economy will not however be quick, given that formalization implies additional costs for micro and small enterprises, many of which only turn sufficient profit for minimum wages. [20]

56. ***If the informal economy accounts for a quarter of total output and a quarter of employment at least, as in BiH (Medina and Schneider, 2018; ILO, 2020) , it is clear that it cannot be eradicated overnight***. BiH would achieve a great result if in the mid-term managed to reduce the informal economy by a fifth of that i.e. force it from a quarter to a fifth of GDP. Sequence of moves must be clear, starting from that which would cause the least social and political tensions. Firstly, it is necessary to reduce the informal payments, then to reduce the informal income and ultimately to reduce the informal employment.

57. ***Few people understand that in BiH the public sector (the government and public companies) create the informal economy***. However, everyone can see there are a number of public institutions and companies (mines for example.) that do not pay contributions to workers. If taxes and contributions are not paid, the public entity and its workers are automatically considered informal employment and informal economy. Also, within a range of organizations, both public and private, part of the wage or salary is paid as a minimum wage, and payments over it are informal to that extent.

58. ***Around six billion of cash is outside the Central Bank and banks***[21]. There is no doubt that at least part of it is used for cash payments in the informal economy.

59. To stop these flows it is necessary to determine the maximum amount that can be paid in cash (which already exists in Bulgaria, the Czech Republic, Croatia, Slovenia, Slovakia, etc.), necessary usage of POS terminals for certain types of sectors and types of companies (which exist in South Korea), a lottery for those who picked up the bills for which VAT is paid, tax incentives for buyers and merchants who use electronic payment (e.g. the return of 0.02% VAT) (as seen in South Korea and Uruguay). According to EYGM, if BiH starts this way it could further increase tax revenues in the size of 4.2 % of GDP. This is BAM 1.2 billion, which is even more than the latest arrangement with the IMF (EYGM, 2016).

[20] An example of a progressive move in taxation can be seen in the Republike Srpske Economic Reform Program for 2022-2024: tax shift away from labor and reduction of parafiscal burden lead toward reduction of grey area in reporting turnover.
[21] http://statistics.cbbh.ba/Panorama/novaview/SimpleLogin_bs_html.aspx

Chapter 3

The BiH Development Finance Landscape

3. The BiH Development Finance Landscape

60. ***This section builds from the overall characterization of macro-economy and fiscal issues and challenges outlined in Section 2, providing a detailed description of development finance landscape for BiH***. Given the integrated approach to the DFA, this section covers domestic public and private and international public and private flows, and their integration. This description lays the foundation for better understanding the macro level SDG financing requirements, as well as the financing gap. Moreover, the analysis provides evidence of the current, emerging, and future policy, institutional capacity and financing market arrangements, an understanding of which is vital to develop recommendations for SDG-FF Road Map and Financing Framework.

3.1 Domestic Public Finance

3.1.1 Government Revenues

61. ***BiH has among the highest revenues as a share of GDP in the world***. The government collects revenues at a much higher rate (42.1 percent of GDP) than the averages of 35 percent in Western Balkan countries. This has contributed to positive fiscal indicators (sustainable fiscal balances, declining general government debt), but it is coming at the cost of stifling the economy. Recent estimates (Khwaja and Iyer, 2013) indicate that government revenues are higher than the country's economic potential i.e., that high taxes are reducing growth. Similarly, labor taxes, particularly in FBiH, are high, stifling entrepreneurship, reducing employment, and forcing many into the informal sector (World Bank, 2020).

Table 3. Public Revenues; BiH, 2016-2020 (Million BAM)

	2017	2018	2019	2020	2021
REVENUE (1)	13479.30	14389.59	15018.10	14430.70	16054,3
Taxes (11)	7151.08	7688.43	8014.08	7363.31	8,485
111 Taxes on income, profits, and capital gains	1149.44	1253.09	1264.40	1212.88	1,326.3
112 Taxes on payroll and workforce	0.00	0.00	0.00	0.00	0.0
113 Taxes on property	115.92	119.69	127.33	115.51	134.6
114 Taxes on goods and services	5842.36	6274.08	6571.43	5976.88	6,972.7
115 Taxes on international trade and transactions	0.01	5.29	6.14	5.73	0.0
116 Other taxes	43.35	36.29	44.79	52.32	51.8
12 Social contributions	4734.23	5041.78	5345.66	5383.93	5,798.0
121 Social security contributions	4734.23	5041.78	5345.66	5383.93	5,798.0
122 Other social contributions	0.00	0.00	0.00	0.00	0.0
13 Grants	40.13	44.91	103.48	74.16	94.4
131 From foreign governments	30.47	39.60	93.36	65.34	84.9
132 From international organizations	8.96	5.31	10.12	8.83	9.4
133 From other general government units	0.70	0.00	0.00	0.00	0.0
14 Other revenue	1553.85	1614.47	1554.88	1609.30	1,676.6
141 Property income	191.18	348.38	151.04	121.59	188.6
142 Sales of goods and services	967.46	966.41	1018.28	898.25	958.7
143 Fines, penalties, and forfeits	73.79	77.52	82.00	72.61	88.0
144 Voluntary transfers other than grants	321.41	220.79	301.98	514.73	440.3
145 Miscellaneous and unidentified revenue	0.01	1.36	1.57	2.11	0.8
GDP	31376.24	33444.00	35296.00	34240.00	38637,00
Revenues/GDP (in %)	43.0	43.0	42.5	42.1	41,6

Source: Central Bank of Bosnia and Herzegovina (CBBiH, 2022a)

3.1.2 Government Expenditure Priorities

62. ***Since 2011, the Global Fiscal Framework (GFF), which sets the country's fiscal policy objectives over a three-year period, aims at bringing expenditure below 40 percent of GDP, precisely to be in the range between 40.3 and 37.2 per cent of GDP***. The goal of bringing public expenditures below 40 per cent has yet to be achieved, bearing in mind the impact of the pandemic and Ukraine, reducing public spending is not expected to be achieved any time soon, and there is a chance that instead public investment could instead scale up (Chaponda et al., IMF, 2018). Table 3 provides a breakdown of public expenditures for the period 2016-2020.

Table 4. Public Expenditures; BiH, 2016-2020 (in M BAM)

	2017	2018	2019	2020	2021
2. EXPENSE	11.913.4	12.738.4	13.334.3	14.474.8	14797,0
21 Compensation of employees	3.312.6	3.422.1	3.738.1	3.921.8	4039,2
211 Wages and salaries	3.151.2	3.254.5	3.547.3	3.722.2	3836,0
212 Social contributions	161.4	167.6	190.8	199.6	203,2
22 Use of goods and services	2.230.7	2.401.4	2.559.3	2.572.4	2676,2
22 Use of goods and services	2.230.7	2.401.4	2.559.3	2.572.4	2676,2
23 Consumption of fixed capital	109.9	132.6	128.9	130.3	171,6
24 Interest	223.0	242.5	241.1	255.9	240,2
241 To non-residents	124.5	117.1	123.9	126.0	107,8
242 To residents other than general government	98.5	125.4	117.2	129.9	132,3
243 To other general government units	0.0	0.0	0.0	0.0	0,0
25 Subsidies	444.0	475.8	507.3	870.1	742,9
251 To public corporations	211.9	237.3	252.8	265.7	290,6
252 To private enterprises	232.1	238.5	254.4	604.5	452,2
26 Grants	4.2	6.4	2.4	8.1	3,5
261 To foreign governments	0.0	0.3	0.5	3.2	0,8
262 To international organizations	4.2	6.1	1.9	4.8	2,7
263 To other general government units	0.0	0.0	0.0	0.0	0,0
27 Social benefits	4.758.5	5.013.2	5.223.4	5.508.0	5,718,3
271 Social security benefits	3.603.3	3.820.9	4.034.1	4.229.0	4417,8
272 Social assistance benefits	1.119.3	1.155.7	1.148.5	1.226.1	1246,0
273 Employer social benefits	35.8	36.5	40.8	52.8	54,5
28 Other expense	830.4	1.044.5	933.7	1.208.2	1205,2
281 Property expense other than interest	0.0	0.0	0.0	0.0	0,0
282 Miscellaneous other expense	830.4	1.044.5	933.7	1.208.2	1205,2

Source: Central Bank of Bosnia and Herzegovina (CBBiH, 2022a)

63. ***The highest proportion of taxes is used for social security benefits (29.2% of total expenditures in 2020) and to cover government salaries (27.1% of total expenditures in 2020)***. It is obvious that BiH's public sector is large in relation to its income level, which means that a high proportion of the taxes and revenues collected is used to cover salaries of public servants. The public sector, with its multiple layers, has an estimated 233,000 employees, and public sector wages account for 10.3 percent of GDP, compared with 8.9 percent in healthcare and 4.6 percent in education (World Bank, 2020).

64. However, despite the high revenue collection ***public investment is low***. Execution of public investment is poor, partly because high current spending (wages and social benefits) crowds out public investment. BiH is not allocating enough resources to finance the capital investments that the country requires. For instance, deficiencies in connectivity within the country and with neighboring countries and the EU member countries hamper the country's competitiveness. Similarly, there are other areas where public investment is needed, including energy and decarbonization (World Bank, 2020).

3.1.3 PUBLIC PRIVATE PARTNERSHIPS (PPPS)

65. There is a basis to support the governments in their aims to structure possible public private partnerships (PPP) transactions. ***Although the governments or authorities are keen to promote PPPs, relatively few projects have materialized***.[22],[23]

66. The two entities have separate PPP and concession legislation. In the FBiH, there are eight laws on PPPs for the cantons, and 14 laws on concessions. There is however a Law on Public Private Partnership in the Republika Srpska ("Official Gazette of the RS, nos. 59/09, 63/11 and 68/20) and the Law on Concessions ("Official Gazette of the RS, nos. 59/13, 16/18, 70/20 and 111/21). Both laws are harmonized with the relevant EU directives.

67. The PPP laws at cantonal level seek to comply with EU regulations but the main problem is the failure to recognize that concessions and PPPs are treated in unified legislation in most countries, that is, a concession is a form of PPP. (Chaponda et al., IMF, 2018).

68. Approvals for PPPs are given by several bodies, starting with the line ministry, a high-level Commission, the local government and the Ministry of Finance. The approval process for PPPs appears to be quite complex as it involves numerous and not coordinated different bodies (Chaponda et al., IMF, 2018).[24]

69. Although still relatively new, PPPs and concessions are not included in the budget. Concessions or PPPs are few and none are reported, as the existing legislation does not require information on PPP transactions to be included in the capital investment budget of line ministries.

70. With the recent adoption of legislations in cantons and a draft PPP law for the FBiH under consideration, these forms of financing for public infrastructure are expected to become more prevalent and could increase fiscal risks, if not properly monitored (Chaponda et al., IMF, 2018).

3.1.4 PUBLIC ENTERPRISES

71. ***The only European transition country where the State-owned enterprises (SOE) footprint appears to have increased, and nontrivially so, is BiH (Richmond et al., IMF, 2019)***. The quality of basic public services that SOEs provide is poor, especially at the local level. Citizen satisfaction with public services—many of which SOEs provide—is the lowest in the region (World Bank, 2020).

72. There are at least 550 SOEs in BiH, in almost all sectors but they are dominant in energy, mining, telecommunications, transportation, and utilities. Most are small and medium-sized municipal utilities, but entity-owned SOEs have the largest operations and account for most SOE employment. SOEs. The largest 20 SOEs, in the terms of fixed assets and turnover, represent around 80 percent and 70 percent of total SOEs fixed assets and turnover, respectively (Cegar and Parodi, 2019).

73. ***SOEs are large employers, employing about 80,000 employees (Cegar and Parodi, 2022), and dominate many segments of the economy, including economic activities in which BiH ownership does not seem to be justified (World Bank, 2020***). SOEs account for 11 percent of total employment

[22] In 1990-2021, five PPP projects in the infrastructure field were realized in BiH. Three of them, totaling 0.8 billion US$, in the electricity sector and two of them, totaling 0.9 billion US$, in the ICT sector (https://ppi.worldbank.org/en/snapshots/country/bosnia-and-herzegovina).

[23] „PPP initiatives were launched in the Republika Srpska in the health sector back in 2000. Although certain activities in this area have been present for 20 years, we can say that so far there have been no significant results, which is illustrated by the fact that there is only one official PPP project in Bosnia and Herzegovina" (Amoviić, Maksimović and Sonja Bunčić, 2020).

[24] "Assessment excludes Republika Srpska, and Brcko District" (Chaponda et al., IMF, 2018).

and own about 40 percent of fixed assets. However, many are barely profitable or loss-making and some are engaged in activities with no obvious public-policy objective.

74. SOEs distort labor markets because average salaries are 40 percent higher than in the private sector, despite low productivity—less than half of the EU level. (World Bank, 2020).

75. ***Most public companies, at all levels of government, lose money, and their debts are currently at €4 billion (26 percent of GDP)***.[25]About 15% of SOEs are insolvent, with negative equity totaling EUR 290 million, or 2% of GDP, and they require financial and operational restructuring, which may include capital injections. Roughly 50% of the companies are illiquid and require direct or indirect budgetary support, which is estimated at about 5% of GDP annually[26]creating enormous fiscal pressure (World Bank, 2020).

76. ***SOEs*** are largely loss making and have incurred considerable as of 2017 debt. This includes considerable arrears to suppliers, including other SOEs, such as electricity and water companies. It also includes tax and social security contribution arrears, mainly affecting the pension and healthcare funds, which already face considerable sustainability challenges. It is estimated that arrears on tax and social security contributions of SOEs are more than €600 million (Cegar and Parodi, 2019).

77. ***According to IMF and OECD, the SOE sector also poses a significant fiscal burden and limits the funding available for infrastructure, education, health and other productivity-enhancing expenditures***. SOE governance falls short of OECD guidelines and ranks low compared to regional comparators, increasing corruption vulnerabilities (IMF, 2021).

78. ***The SOE sector is not contributing enough to the economy***. During 2015-2017, the SOE sector Return on Equity (ROE) averaged -0.3 percent, implying that government investment in the sector was yielding negative returns. With an average Return on Assets (ROA) of -0.2 percent, the SOE sector does not extract value from the assets at its disposal (Cegar and Parodi, 2019).

79. SOEs are highly inefficient, consume budgetary resources that could be better used in improving public services, have an aggregate negative effect on the economy, and crowd out the private sector. BiH forgoes up to 3 percent of GDP in potential income every year because of inefficiencies in the SOE sector (IMF 2019a; World Bank, 2020).

3.1.5 Pension Funds

80. ***Two entities in BiH have been operating two separate public pension systems, both of them functioning on pay-as-you-go and defined-rights principles (World Bank, 2020b)***. Pensions account for most social spending, about 10 percent of GDP, on par with the EU average (10.3 percent in 2016) but higher than in most former transition countries (World Bank, 2020a).

81. There are three main shortcomings of pension funds: 1. efficiency: high pension spending is largely the result of early retirements and large numbers of people receiving disability or special pensions (special pensions are provided to war veterans and survivors); 2. fairness: although one-third of all pensioners are younger than 65 (because of early retirement and special pensions), approximately 38 percent of elderly adults may not be collecting any state pension at all., and 3. sustainability: each contributor supports more than 1.13 pensioners. This is one of the highest burdens per contributor in Europe. Low formal labor market participation (high inactivity and unemployment partly) threatens the stability of pension funds (World Bank, 2020a).

[25] The SOE debt stock is not fully reflected in public-sector debt statistics because of aggregation and consolidation difficulties
[26]State-Owned-Enterprises-in-Bosnia-and-Herzegovina-Assessing-Performance-and-Oversight

Table 5. Pensioners and Pension Expenditures In BIH, 2017-2021 (in BAM)						
Year	FBiH		Republika Srpska		BiH	
	Number	Expenditure	Number	Expenditures	Number	Expenditures
2017	412,539	1825341657	263,952	1005404465	673,119	2830746122
2018	416,828	1944415793	267,479	1051486793	680,780	2995902586
2019	424,009	2083855906	271,004	1105149793	691,488	3189005699
2020	428,117	2220563924	272,585	1160894302	699,121	3381458226
2021	429,545	2194311662	243,627	1209168700	702,130	3403480362

Source: Pension Funds or FBIH and of RS

82. ***Unpaid pension contributions in both entities have been mounting over the past three decades, creating eligibility obstacles for insured individuals and financial problems for the fiscal authorities***. The outlook of both pension systems is stable in the medium term, but the challenges for pension adequacy stem from a low level of formal employment (particularly, a low level of female employment) high informal employment, a low pensionable age and growing number of pensioners.

3.1.6 Public Debt

83. ***Public debt remains sustainable under a scenario with higher capital spending, even though downside risks have increased***. ***IMF's analyses indicate that BiH's public debt remains sustainable in the medium term, even after the impact of the pandemic***.

84. ***The*** higher capital spending scenario shows that there is room for more absorption of IFIs' financing for growth enhancing projects with limited impact on debt dynamics and government financing needs (IMF, 2021). However, the picture would be complete and the outlook much clearer if the total of internal debts relating to state-owned companies (SOEs) and arrears included.

85. In 2018, total liabilities of the RS health sector were around BAM1 billion (8 percent of RS-GDP), of which arrears might be BAM 0.5 billion. In FBiH, total unpaid social contributions are estimated at BAM 1.1 billion (4 percent of FBiH-GDP)—mostly from SOEs. There same efforts aimed at producing consolidated public debt numbers, but this could take a few years (IMF, 2021).[27]

Table 6. External debt; BiH, 2016-2021 (Million BAM)						
	2016	2017	2018	2019	2020	2021
GDP	29904.46	31376.24	33444.00	35296.00	34240.00	38637.00
Debt	8547.59	7852.95	8204.91	8142.77	8698.26	9348.4
Debt/GDP (in %)	28.6	25.0	24.5	23.1	25.4	24.2

Source: CBBiH (2023).

86. Once the recovery is well underway, BiH should return to a debt stabilizing fiscal policy to rebuild fiscal buffers. This would imply a gradual reduction of the primary deficit to about 1 percent of GDP (IMF, 2021). Large arrears and SOEs create risks and undermine fiscal sustainability.

87. Although overall government debt does not appear high (38.3 percent of GDP in 2020), significant fiscal risks arise from unmeasured off-budget liabilities and arrears and large liabilities of SOEs. Many SOEs are highly leveraged, and they will not be able to reduce debt without government support or better performance. Some with low liquidity rely on short-run government support - implicit or explicit. Their high employment levels are adding to arrears, including to the social welfare system, and these will make privatization or restructuring difficult.

[27] Both entities and Brčko District have taken steps to establish PE oversight units and have started conducting basic financial analysis of key SOEs. (IMF Article IV, July 2022)

3.1.7 State Guarantees

88. ***Generally, guarantee funds are a powerful tool to provide firms, especially SMEs, with additional resources to withstand liquidity shocks and/or finance working capital***. However, in BiH SMEs' access to finance remained particularly constrained. The governments' loan guarantees had a positive impact on the private sector's access to finance but for many micro and small companies gaining access to those guarantees appears to have been difficult (EU, 2021).

89. The utilization of guarantee schemes has been low in BiH. However, the governments of the two entities supported lending by providing temporary guarantees to private sector loans. The volume of those guarantees amounts up to about 0.5% of GDP (EU, 2021). That is why that authorities in BiH need to improve the utilization of guarantee schemes by increasing government risk coverage and streamlining administrative procedures (IMF, 2022)

90. In 2020 the Energy Community Secretariat launched an infringement case on Tuzla Block 7 because of a state guarantee of the FBiH for a Chinese loan due to possible violation of State Aid provisions of the Energy Community acquis. However, an American supplier of important equipment has recently stepped out, making the Tuzla 7 project's future uncertain (EU, 2021). In 2022, the State Aid Council of Bosnia and Herzegovina, annulling its decision from 2018, also decided that the guarantee constitutes illegal State aid which the Federation's Ministry of Finance is obliged to recover (EU, 2022)

91. Major steps are required to align the legislative framework with the EU acquis on the internal market, including further aligning the law on State aid with the EU acquis (EU, 2022).

3.1.8 Central Bank

92. ***In BiH, financial market regulatory community basically consists of the Central Bank of BiH (CBBiH), two entity-based banking agencies (Banking Agency of the FBiH, FBA, and the Banking Agency of Republika Srpska, BARS) four entity based insurance regulators (the Insurance Supervisory Agency of FBiH, the Insurance Agency of RS, the BiH Insurance Agency, and the BiH Deposit Insurance Agency) as well as 2 security commissions (Securities Commission of Republika Srpska and the Securities Commission of the Federation of BiH)***.

93. The role of the CBBiH is to ensure and maintain the stability of the domestic currency (the convertible mark) by issuing the domestic currency in line with the currency board arrangement (CBA), according to which each issued convertible mark must be backed by free convertible foreign currency assets with a fixed rate of 1 BAM = 0.5 EUR. As specified by the Law, the convertible mark is the only legal tender in Bosnia and Herzegovina (CBBiH, 2022b).

94. ***The CBBiH's objective of keeping the domestic currency stable remains in contrast with the primary objective of monetary policy in the EU, which is price stability (EU, 2021)***. The two banking agencies in the respective entities support the CBBH as they are empowered to ensure the financial soundness of banks to participate in the payment system. The banking agencies can issue and revoke banking licenses, authorizing them to perform operations in internal payment transactions.

3.2Domestic Private Finance

95. ***The financial system in BiH is dominated by a moderately concentrated banking sector. The banking sector accounts for 88.4 percent of financial system assets, which are equivalent to 91,7 percent of GDP as of end-2021***. The remaining 11.6 percent of financial system assets is distributed among insurance companies (5.5 percent), leasing companies (0.9 percent), investment funds (2.4 percent) and microcredit organizations (2.9 percent) as of end-2021 (see Table 7). Obviously, the development of non-banking financial services such as leasing, factoring and insurance is at an early stage.

Table 7. The Financial Intermediaries Assets Value; BiH, 2018-2021 (Million BAM, %)

	2018		2019		2020		2021	
Type	Value	Share	Value	Share	Value	Share	Value	Share
Banks	29,854.2	88.5	32,508.2	88.7	32,905	88.8	35.442	88,4
Leasing Companies	297.2	0.9	323.7	0.9	343.8	0.9	373,7	0,9
Microcredit organizations	887.5	2.6	991.0	2.7	1078.8	2.9	1.162,3	2,9
Investment Funds	887.3	2.6	852.1	2.3	811.1	2.2	947,1	2,4
Insurance and reinsurance companies	1818.7	5.4	1966.9	5.4	1911.0	5.2	2.190,1	5,5
TOTAL	33,744.8	100.0	36,641.9	100.0	37,049.7	100.0	40.115,3	100.0

Sources: FBA and BARS, FBiH and RS Securities Commission, Entities' Agencies for Supervision of Insurance Companies, BiH Insurance Agency, CBBiH (as in CBBiH, 2021)

3.2.1 Commercial Banking Sector

96. ***The financial sector is dominated by commercial banks with good liquidity and strong risk aversion***. Banks are currently adequately capitalized and liquid. Their overall capital adequacy ratio was 18,7% at the end of 2021, significantly above the regulatory minimum of 12% (CBBiH, 2022).

97. The banking sector has shown resilience during the crises thanks to the good capital positions built up after the 2008 financial crisis. Supervisory and regulatory banking sector standards have received equivalence status to the EU by a European Banking Authority assessment, published in November 2021 (EBA, 2021; IMF, 2022).

98. However, vulnerabilities have been rising and the outlook remains highly uncertain. Strict enforcement of prudential requirements and the development of contingency plans for dealing with potential liquidity pressures is essential for preserving financial stability. The authorities should also identify the obstacles to NPL resolution and design an NPL action plan that includes an out-of-court resolution mechanism (IMF, 2022).

99. Over the past 13 years total assets and deposits have continued to increase and in December 2022 total assets were 82% higher than in December 2010. This pace of growth has not been matched by a corresponding growth in loans, which increased as they have grown at a slower pace than deposits (133% vs. 56%). As a result, banks are quite abundant in cash.

100. The highly-liquid position of banks is quite visible in the breakdown of asset composition, where one-third of assets (as of December 2022) are held in cash. This particular situation may be due to the lack of adequate investment opportunities that otherwise would drive banks to extend credit to the private corporate sector. This is also confirmed by the banks' loan structure. While the share of household and corporate loans was relatively similar in 2010 (45% vs. 49% of total loans), the former has been increasing faster over the past 13 years (respectively, 4.6% vs. 2,3%).

101. In terms of the source of funding, banks remain predominantly funded by deposits (80% of total liabilities), with a minimal contribution of capital instruments (4% of total liabilities), also due to the capital market' limited dimensions.

3.2.2 CAPITAL MARKETS

102. ***Supply of financial capital to the BiH financial markets is about 23 percent of GDP i.e. amounting to BAM8.0-8.5 billion (see Table 8). At present, the capital market represents a small part of the financial system that is not just small, but it is also fragmented***. However, it has the potential to play a more important role in the country's future (World Bank, 2015; 2022). Table 8 provided an overview of the supply of financial capital between 2016 and 2021.

Table 8. SUPPLY OF FINANCIAL CAPITAL; BIH, 2016-2021

No.	Variable	2017	2018	2019	2020	2021
1	Domestic Capital	6.5	7.4	8	6.9	8,4
2	Capital inflows	1.2	0.8	0.6	1.0	0,9
3(=1+2)	Supply of financial capital	7.7	8.2	8.6	7.9	9,3
4	Gross domestic product (Y)	33.1	34.9	36.5	35.4	38,6
5 (=3/4)	Supply/GDP	23.3	23.5	23.6	22.3	24,1

Source: own calculation based on CBBiH 2022)

103. ***The legal and regulatory framework is basically sound and the securities market infrastructure pretty well developed***. (DEP, 2021b). The country has two stock exchanges – one in Sarajevo (in the Federation of Bosnia and Herzegovina) and one in Banja Luka (in the Republika Srpska) but they are not an important funding source for companies (EBRD, 2022). According to business reports of the Banja Luka Stock Exchange (BLSE) and the Sarajevo Stocks Exchange (SASE), total turnover at the two BiH stock exchanges reached BAM 1.28 billion in 2020, BAM 0.70 billion in 2021 and BAM 1.07 billion in 2022.

104. The total turnover on BH stock exchanges in 2021 decreased significantly since governments that are the main drivers of activities in the primary market of debt instruments issued debt on BH stock exchanges to a much lower extent (CBBiH, 2022)**.**

105. The overall level of preparedness in the securities market remains low. The size of the non-bank alternative financing sector and of the capital markets has remained small, with a market capitalization of the country's stock markets of about 17.5% of GDP in May 2022. The use of venture capital has continued to be very limited (EU, 2022)

106. ***Regarding international capital flows, long-term capital transactions are mostly liberalized, but restrictions remain for short-term capital transactions***. Investment rules for institutional investors are subject to limitations on investment in foreign securities (World Bank, 2015; EU 22).

3.2.3 DIGITAL BANKS

107. ***Digital banking involves high levels of process automation and web-based services providing the ability for users to access financial data through desktop, mobile and ATM services***.

108. The number of Internet banking users in BiH has been on the rise in the last 10 years. Currently, all commercial banks in BiH offer alternative distribution channels services such as e-banking, m-banking, SMS banking, ATM and POS devices, etc. (Husejinovic and Husejinovic, 2021). Moreover, the data show a marked increase in the number of clients using these services.

3.2.4 MICRO-FINANCE

109. ***The microcredit organizations (MCO) sector in BiH is less than 3 percent of financial system assets in 2021 i.e., with the size of BAM 1.2 billion*** (CBBiH, 2022)

110. In the FBiH as of September 2022, there are 13 Microcredit Organizations (MCO)[28] that comprise the microcredit sector in the FBiH, of which 10 are MCFs (non-profit organizations) and three are MCCs (profit organizations). The microcredit sector in the FBiH, as of 30/09/2022 had:

- Total assets amounted to BAM 711.3 million.
- Total microloans of BAM 590.0 million.
- Total capital of BAM 494.43 million.
- Total of 1,412 employees.

111. In Republika Srpska, as of September 2022, there are 14 Microcredit Organizations (MCO) that comprise the microcredit sector in Republika Srpska, of which two are MCFs (non-profit organizations) and 12 are MCCs (profit organizations). The microcredit sector in Republika Srpska, as of 30/06/2021 had (ABRS; 2022):

- Total assets amounted to BAM 535.1 million.
- Total microloans of BAM 435.0 million.
- Total capital of BAM 171.4 million.
- Weighted effective interest rate for loans of 31,94%.
- Total of 655 employees.

3.2.5 INSURANCE MARKETS

112. ***The insurance sector in BiH has independent insurance supervisory agencies in each entity***. In addition, it has one country wide level insurance agency, the Insurance Agency in Bosnia and Herzegovina (IABIH), the mandate of which is to act as a coordinating body, responsible for harmonizing the regulation in both entities and towards compliance with the EU directives (World Bank, 2015).

113. The share of nonlife insurance is about 1.7 percent of GDP, while life insurance accounts for only 0.4 percent of GDP. The nonlife segment collects over 79.3 percent of insurance premiums. In the structure of non-life insurance premiums, compulsory motor third party liability insurance (MTPL) is the most represented with 64.45 per cent followed by land vehicles insurance with 12.01%, and accident insurance with 8.01%.(AIABIH, 2022)

114. ***In 2021, in the insurance sector of BiH were 25 insurance companies and one reinsurance company***. Out of the 25 insurance companies, 16 companies were engaged exclusively in non-life insurance, while the other nine companies were active in both life and non-life insurance. In 2020, 11 insurance companies and one reinsurance company operated in the Federation of Bosnia and Herzegovina, while 14 insurance companies operated in the Republika Srpska. The total gross written premium in the FBiH amounted to BAM 529.1 million. In Republika Srpska, the total gross written premium amounted to BAM 226.8 million (AIABiH, 2022).

115. ***Both entities adopted a methodology for the supervision of branch offices in inter-entity operations to implement the existing protocol on cooperation and harmonization of inter- entity business operations***. Despite some incremental awareness raising initiatives and surveys on qualitative

[28] The largest three creditors of the FBiH microcredit sector, according to their share in total loan obligations of MCOs are EFSE with 14.3%, Blue Orchard Switzerland with 6.5% and EBRD with 5.1%.

requirements for alignment carried out by the insurance companies, no progress ogress has been made in preparing for transition into the Solvency II-based regulatory framework (EU, 2021).

3.2.6 PORTFOLIO INVESTMENT

116. In addition, there are company securities, practically shares resulting from the mass privatization program undertaken at the beginning of the 2000s. Very few companies or institutions have actually used the securities markets to raise capital to finance growth and expansion.

117. BiH is moderately prepared in the area of free movement of capital. There was no progress in the alignment with the EU acquis on the free movement of capital (EU, 2021).[29]

3.2.7 ANGEL INVESTMENT

118. ***The use of venture capital in BiH has continued to be very limited (EU, 2021)[30]***. V***enture capital is still mostly missing, though – beyond a few angels and the €40M regional South- Central Ventures fund, there are not that many funding opportunities for innovators in BiH (Yovchev, 2021)***.

119. The main cause of the wide productivity gap between BiH and its comparator countries lies in a low level of innovations (caused, inter alia, by low level of investments in the public and private R&D) and consequently very low technological progress. An effective innovation system - consisting of institutions, rules and procedures that nurture~~s~~ ideas, research and knowledge stock, and results in new techniques, processes and goods and services - does not exist in BIH.

3.2.8 NGO FLOWS

120. ***Non-profit institutions serving are a very heterogeneous group of business entities registered as associations and other non-profit organizations and non-profit funds and foundations.*** In 2021, the output size of the NGO sector is about BAM 327 million but the continues increase in its size was slowed down by the pandemic of Corona virus (See Table 9 below).

Table 9. OUTPUT OF NGOS; BIH; 2016-2021 (MILLION BAM)

2016	2017	2018	2019	2020	2021
237 639	251 159	293 318	313 638	312 879	327321

Source: Agency for Statistics of BiH (BHAS, 2022)

3.2.9 DEVELOPMENT BANKS

121. ***In addition to commercial banks there are two development banks operating at the entity level***. They are financial institutions with a task to implement the Government economic policies to foster economic development and employment through extending loans by lending or on-lending. [31]

[29] In July 2022, the Republika Srpska entity also amended the law on securities markets to regulate crypto currencies and custodian wallet providers, contributing to the fight against money laundering and terrorism financing involving those currencies.

[30] In BiH there are no progress in developing an adventure capitalism, the excellent example of which are SAD. A few thousand investors, mostly based in Silicon Valley, running less than 2% of the world's institutional assets over the past five decades have funded enterprising ideas that have gone on to transform global business and the world economy. America's VC funds have seeded firms that are today worth at least $18trn of the total public market. More recently VC-backed unicorns (private start-ups worth over $1bn) have come of age in a bonanza of public listings. Over the past golden decade, an index of American VC funds has made compound annual returns of 17% (the Economist, 2021).

[31] More on development banks see in the papers prepared by V. Domljan: (i) Razvojne banke-koncept za BiH.Prezentirano na VIII. medjunarodnom simpoziju „Reforme u BiH: put ka europskim integracijama, Neum 24.-26. 2007; (ii) "BiH i Montereyski konsenzus". V: august-septembar/kolovoz-rujan. Prizma, Sarajevo (2006); (iii) Istraživanje o Investicijskoj Banci Jugoistočne Europe **(SEEIB)-„**Ekonomija i Biznis", Skopje, No. 135, Juni 2009, Skopje; (iv) A Proposal for Establishing the South East Europe Development Bank,

122. The FBiH Development Bank is entirely owned by the Federation of BiH. It manages over 400 million BAM worth assets.[32] The Republika Srpska Investment-Development Bank is entirely owned by the Republika Srpska. It manages over 134 million BAM worth assets.[33]

123. ***Development banks[34] need to become financially viable and focus on alleviating financial market failures***. Both entities have been working for years with the World Bank on modernizing the development banks. These banks engage in standard financial-sector activities and should be under banking agency supervision because they pose financial-sector risks. Also, new legislation to fully reflect the updated mission should be passed by entity parliaments (IMF, 2021)

124. ***Development banks do not play part in innovation system by providing development finance in the form of specific credit lines or venture capital funds***. On the other hand, the experience of high-income countries shows that loans for technical realization and market tests, either in the form of matching funds (to match equivalent resources provided by innovative companies or another interested agents) or subsidies reimbursable in case of success can be very useful. In addition, credit lines for value chains initiatives, the provision of equipment in laboratories etc. could be useful.

3.3 International Public Finance

125. ***International public financing flows have been critical to meet the financing needs of BiH, though with the value of FDI, remittances and ODA changing substantially, it will be vital for the DFA, Road Map and Financing Framework to be well prepared (progressive and forward focused).*** Support from multilateral and bilateral institutions (grants and loans), other official flows, public and publicly guaranteed borrowing, multilateral development banks and climate financed dominate international public finance flows.

3.3.1 Official Development Assistance (Grants and Loans)

126. ***In 2020 Net Official Development Assistance (ODA) totaled some US$ 437.5 million, down from US$ 460.5 in 2019 and US$ 355.9 million in 2018.*** Gross ODA over the same period was US$ 641 million, US$ 692 million, and US$ 521.3 million respectively (OECD, 2023).[35]

127. Primary ODA donors and the composition of ODA is provided below and shown in Chart 5.

- ***Top ODA Donors***: EU institutions provided US$ 231.6 million on average for the period 2019-2020, followed by Germany (US$ 62.1 million), the IMF (US$58.9 million), USA (US$ 46.6 million), Turkey (US$ 33.9 million), Sweden (US$ 24.9 million), OPEC (US$ 23.1 million) Switzerland (US$ 22.3 million), Japan (US$ 22 million) and Austria (21.1 million).
- ***ODA Composition***: 41.09 per cent was committed to other social infrastructure and services, 21.20 per cent on education, 16.18 per cent on economic infrastructure and services, 6.11 per cent on multi-sector, 6.42 unallocated, 4.96 per cent production, 2.0 per cent on health and population and 2.0 per cent on humanitarian assistance.

[32] For details see https://rbfbih.ba/rbfbih-en/basic-information/
[33] For details see https://www.irbrs.org/azuro3/azuro/uploads/Godisnji_izvjestaj_2018.pdf
[34] For details see https://www.undp.org/publications/role-public-development-banks-scaling-sustainable-finance
[35] Bilateral ODA by Sector for Bosnia and Herzegovina, 2019-2020 average

128. ***While ODA does not constitute the most significant inflow to the economy, given that all ODA is policy based and a substantial amount is directly linked to the EU accession agenda, in many ways the overall spend has a significant multiplier in the development policy domain.***

129. While the impact of ODA spending because of the crisis in Ukraine is unknown, ODA has fluctuated around US$ 360 to US$ 460 million in recent years, and it is assumed over the near term to volume is likely to remain at similar levels (OECD, 2023).

Chart 5. ODA Flows to BiH from 2018-2020

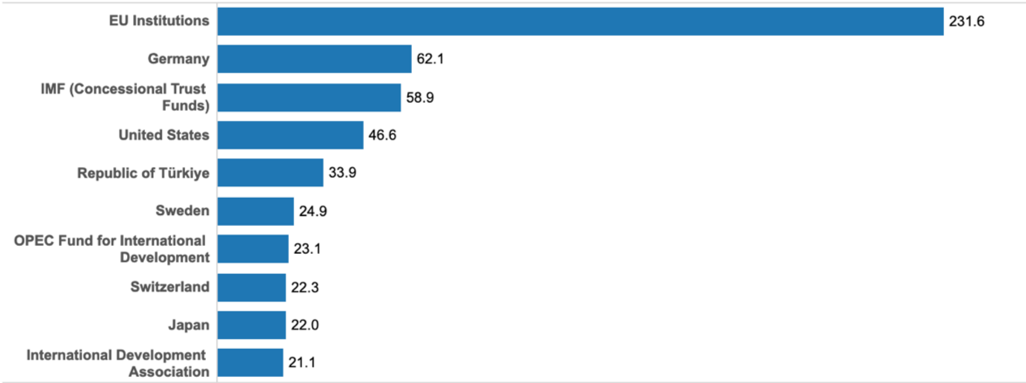
Receipts for Bosnia and Herzegovina

	2018	2019	2020
Net ODA (USD million)	355.9	460.5	437.5
Net ODA/GNI (%)	1.8	2.3	2.2
Gross ODA (USD million)	521.3	692.0	641.3
Bilateral share (gross ODA) (%)	56.9	44.3	44.6
Total net receipts (USD million)	992.9	690.7	786.6

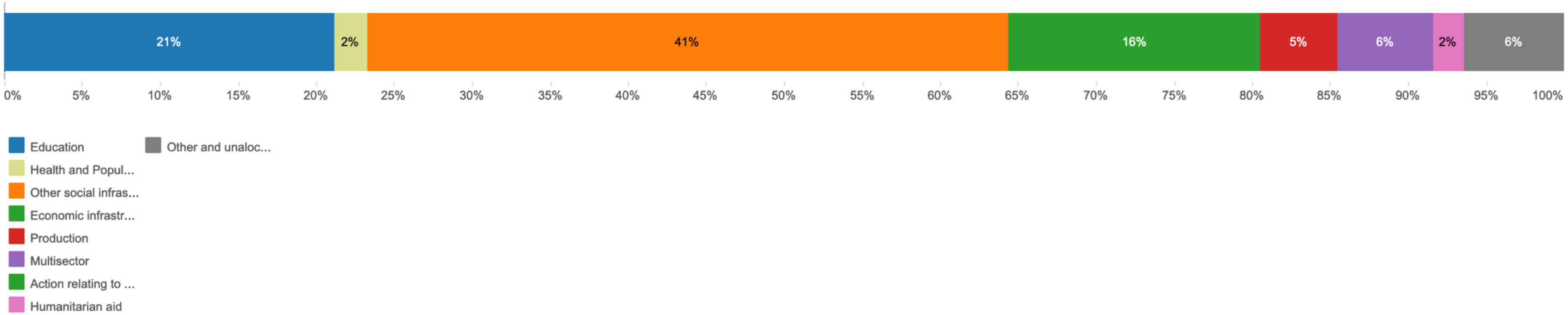
For reference

	2018	2019	2020
Population (million)	3	3	3
GNI per capita (Atlas USD)	5,750	6,180	6,090

Top Ten Donors of Gross ODA for Bosnia and Herzegovina, 2019-2020 average, USD million



Bilateral ODA by Sector for Bosnia and Herzegovina, 2019-2020 average



3.3.2 CLIMATE FUND FLOWS

130. ***While the EU Green Deal has considerable potential in BiH, there is considerable scope for increasing climate related finance, beyond the Green Climate Fund (GCF) and Global Environment Facility (GEF).***

131. Moreover, given the decentralized political structure, it is essential to focus efforts on adaptation and mitigation at the municipal-level financing and through bottom-up programming and the development of municipal financing frameworks for climate change.[36]

132. Under the GCF[37] BiH project at total of US$ 17.3 million there is a particular focus on flood insurance risks, given that the European Environment Agency (EEA) estimates that annual flooding losses are expected to increase five-fold by 2050 and up to 17-fold by 2080. A public and private risk pool is being established, to support risk transfers, through the introduction of mandatory insurance against catastrophic risks, alongside new mechanisms for property insurance. There is also a focus on scaling up investment in low carbon public buildings.

133. Under GEF, total national funding received for 19 projects is US$ 34, million, though BiH also has access to regional GEF allocations. GEF also provided US$ 5 million for the Special Climate Change Fund.[38]

134. ***Outside of developing a national carbon market, the greatest future flow to support the energy transition is the EU Green Deal***. The European Green Deal is an opportunity for development in BiH and the country can modernize its energy system and make it competitive and sustainable regarding the environment. The European Green Deal envisages complete decarbonization of the energy sector by 2050. And the reduction of greenhouse gas emissions by 55% by 2030, with the possibility to increase the ambition in the meantime, as well as total decarbonization by mid-century.

135. The first step in the process for all EU countries, but also the countries in the region, including BiH, is to bring and implement a National Energy and Climate Plan – NECP.[39] Moreover, an EU tax on carbon dioxide and the Carbon Border Adjustment Mechanism (CBA), will be introduced in 2026 but a reporting system will apply as from 2023.

136. ***IRENA (2020)[40] states that the Western Balkans region has enormous cost-effective potential for renewables***. Financing for renewables however remains incredibly limited as is funding for both decarbonization and digitalization. What is clear is that support for climate change and energy transition will take billions of Euros, and involved considerable private capital, making financing the energy transition, bearing in mind IRENA's road map.

137. BiH will need to position itself to benefit from the Euro 600 billion Green Deal financing. Importantly the European Commission will present its Sustainable Europe Investment Plan to help meet the funding needs with at least 30% of the InvestEU Fund will contribute to fighting climate change. A revenue stream could involve allocating 20% of the revenue from the auctioning of EU Emissions Trading System to the EU budget. Carbon market development will also remain an important priority.

---

[36] https://undp-climate.exposure.co/managing-risk
[37] Led by the Republika Srpska Ministry of Physical Planning, Civil Engineering and Ecology (the country's UNFCCC and GCF focal point), with support from UNDP and financing through the Green Climate Fund (GCF), the Readiness and Preparatory Support Program is building core readiness capacities.
[38] https://www.thegef.org/projects-operations/country-profiles/bosnia-herzegovina
[39] https://balkangreenenergynews.com/reset-european-green-deal-is-chance-for-energy-transition-in-bih/
[40] The International Renewable Energy Agency (IRENA) report "Renewable Energy Prospects for Central and South-Eastern Europe Energy Connectivity (CESEC)"

3.4 INTERNATIONAL PRIVATE FINANCE

138. ***International finance flows are limited to Foreign Direct Investment, remittances, and limited portfolio flows.*** Of these flows, remittances dominate, providing direct support to the current account and assisting the government in its balance of trade. FDI remains relatively low, as does portfolio investment.

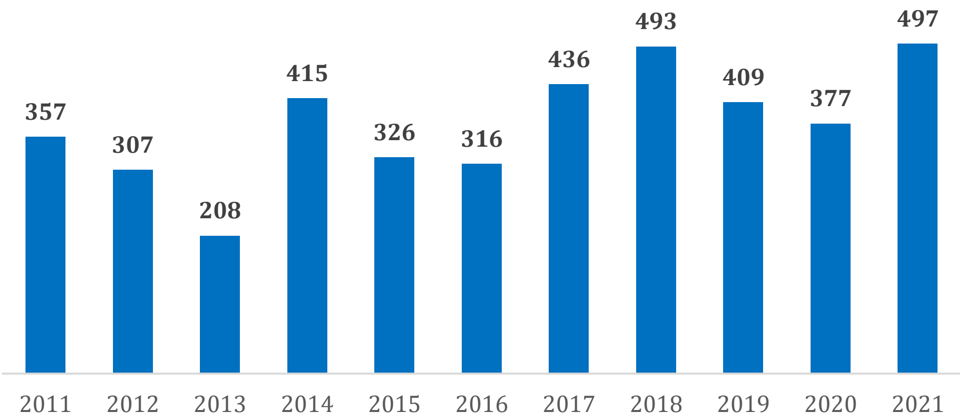
3.4.1 FOREIGN DIRECT INVESTMENT

139. ***FDI has remained stable despite the COVID-19 pandemic***. In 2021, foreign direct investments amounted to BAM 899 million. According to the data for the period January-September 2022, FDI growth continues in BiH amounting to BAM 840.8 million (CBBiH)

140. Investment inflows could be considered as positive, related to the global recession that has affected the ability of foreign investors. However, it should be noted that the majority of investments were reinvested earnings from existing companies with foreign investment, while investments in the form of ownership shares were much lower.

141. FDI in 2018 generated the highest annual inflow during the entire previous period that was recorded after 2007 and 2008, as shown in Chart 6 below.

Chart 6. FLOW OF FDI IN BOSNIA AND HERZEGOVINA (2011-2021) (EUR MILLION)



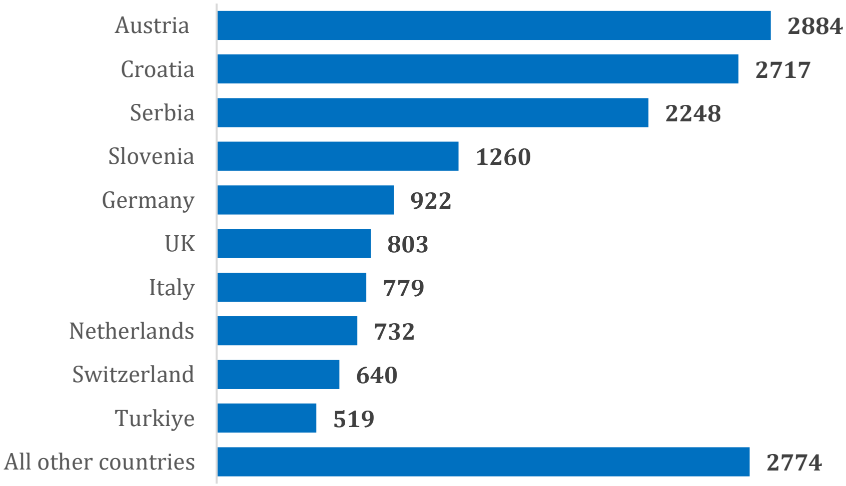
Source: Central Bank of B&H (CBBH), September 2021 [41]

142. ***Total amount of Foreign Direct Investment (FDI) in Bosnia and Herzegovina on December 31, 2021 was 16,3 billion BAM***. In the structure of FDI, equity and reinvested earnings were 14 billion BAM and other capital was 2,2 billion BAM.

143. ***Chart 7 below provides the aggregate FDI inflows on December 31, 2021 by investor country, showing Austria, Croatia and Serbia topping the list***. Despite the growth of investments from the Russian Federation and the Middle East, European countries are still the most important investors in Bosnia and Herzegovina. Investments from EU-27 countries amounted to 64% of total FDI in B&H.

41 http://www.fipa.gov.ba/informacije/statistike/investicije/FDI%20Position%20and%20Performance_september%202022_E.pdf

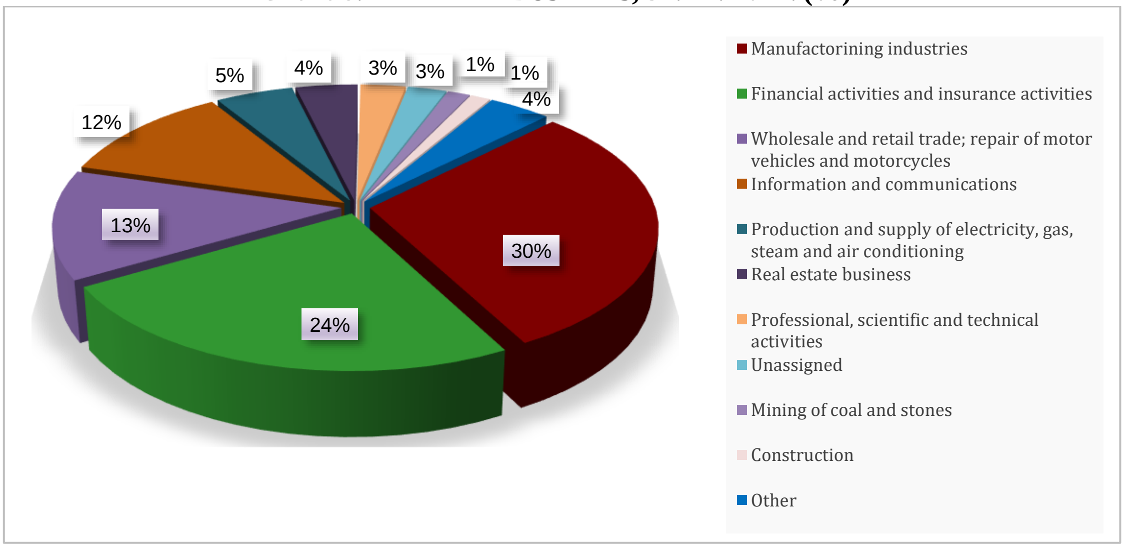
Chart 7. TOP INVESTOR COUNTRIES (UP TO 31.12.2021) (MILLION BAM)



Source: Central Bank of B&H (CBBH), September 2022

144. ***Chart 8 shows the sectoral composition of FDI on December 31, 2021, showing a clear dominance in manufacturing (30 per cent), banking (24 per cent), trade (13 per cent) and telecommunications (12 per cent).*** Increasing linkages between FDI and domestic productivity must remain a key priority. Moreover, other external financing inflows, such as remittance, foreign aid or FDI might also reflect potential drains resulting from deterioration in the external environment.

Chart 8. FDI PER INDUSTRIES, 31. 12. 2021. (%)



Source: Central Bank of B&H (CBBH), September 2021

3.4.2 PORTFOLIO INVESTMENT

145. ***Since portfolio investment is a direct way to access financial markets, and thus it provides liquidity and flexibility, it is associated with financial markets and with their specialized service providers, such as exchanges, dealers, and regulators, and one of indicators of their level of development***. As Table 10 demonstrates, the role of portfolio investment in the BiH is very moderate. In 2021, their inflow was just BAM 346.9 million, while their outflow was BAM 266.7 million or rather net inflow was just BAM 80.2 million.

Table 10. PORTFOLIO INVESTMENT; BIH 2016-2021 (BILLION BAM)

No.	Type	2016	2017	2018	2019	2020	2021
1 (=2-5)	Portfolio investment, net	166.92	156.56	255.68	213.95	9.77	80.21
2 (=3+4)	Net acquisition of financial assets PI	98.59	92.18	253.65	179.06	-19.90	346.86
3	Debt instruments	92.09	86.94	257.37	180.80	-19.29	303.06
4	Equity and investment fund shares	6.49	5.24	-3.72	-1.74	-0.61	43.80
5	Net incurrence of liabilities PI	-68.34	-64.38	-2.02	-34.89	-29.68	266.65
6	Equity and investment fund shares	4.63	8.94	-3.68	1.54	6.70	-9.53

Source: WB, CBBiH, IMF

3.4.3 REMITTANCES

146. ***Net current transfers from abroad comprises transfers of income between residents of BiH and the rest of the world that carry no provisions for repayment i.e. they are equal to the unrequited transfers of income between residents and non-residents***. They comprise compensations of employees, personal transfers, pensions, grants to governments in BiH (see Table 11).

Table 11. IMPORTANCE OF INTERNATIONAL TRANSFERS; BIH, 2017-2021 (BILLION BAM)

	2017	2018	2019	2020	2021
Compensations of employees	831.3	884.0	983.4	647.4	
Personal transfers	2544.6	2727.1	2884.0	2373.1	
Pensions, insurance	1215.6	1253.3	1318.8	1340.3	
Grants to governments	70.3	29.4	100.0	77.4	340.1
Total	4661.8	4893.9	5286.3	4438.2	4696.6

Source: DFA Team Calculation based on the World Bank, Central Bank of BiH and IMF

147. ***The BiH emigrants frequently invest in their economy of BiH, whether they intend to return or have left permanently***. Sometimes the attachment to the BiH economy, and the willingness to invest there, carries over to subsequent generations of the emigrants. Such investments can take numerous forms, but financial investments (notably bank deposits and portfolio investment) and investments in real estate are most common.

148. Small enterprises, located in BiH and sometimes managed by relatives, also benefit from investments by emigrants. However, these transactions that are considered as cross-border investments, but they are not included in official balance of payment.

149. ***Mitra (IMF) (2016) found that net current transfer from abroad can help raise long-term economic growth in emerging Europe, on average, by 1.4 percentage points of GDP***.

150. In the post-global crisis of 2007-2009 BiH has had GDP growth rate oscillating around 1.9 %. Accordingly, tapping into diaspora's resources could almost double the GDP growth rate. BiH could provide a higher GDP growth rate than the average for Central and East European countries due to the abundance of its diaspora and the size of remittance sent to BiH (Mitra (IMF), 2016).

Chapter 4

Policy and Macro-Level SDG Financing

4.POLICY AND MACRO-LEVEL SDG FINANCING

151. ***This section lays out the overall policy agenda and framework for the SDGs, links it to the medium-term public planning and budgeting process and presents the overall macro-level SDG financing needs for BiH as the basis for the SDG financing business case***.

152. Costing of the SDGs at the macro level allows the overall country-wide SDG financing gap to be established, following which SDG financing needs in selected priorities areas can be determined. Among the tools related to targeted financing are demand-stimulating macroeconomic policies to promote full employment and public investment.

153. ***The business case for the SDGs does not just set out how much money is required to meet certain goals and targets, it also outlines how the 'integrated' approach to financing increases resources flows to meet priority SDGs, but also to contribute towards the better resourcing of country-wide development.***

154. Given the importance of mobilizing private capital in BiH – towards a Funding to Financing (F2F) approach – the roadmap and SDG Financing Framework will need to enable new private capital flows, as part of the more integrated public and private approach. [42]

155. The lens for identifying appropriate public investment programmes/ projects and credit targets needs to be gendered and ethically representative, underscoring the important role of affirmative action in private and public decision-making bodies.

156. ***The business case for adopting a more integrated approach to sustainable development financing in BiH is compelling given that the average growth rate of real GDP from 2000 to 2020 was a modest 2.52 per cent.*** Moreover, with the average growth rate of public revenues from 2005 to 2020 at 4.62 per cent and public expenditure at 4.38 per cent, increased investment is necessary to drive growth and improve governments fiscal position.

157. Macro-level and sector-level SDG costing allows both the overall SDG financing envelope to be stated, but also the financing gap. To fill the financing gap, greater efficiency in public financing combined with new sources of financing and new modalities of public private collaboration, can align to fill this gap.

158. Financing for gender equality gap is an investment that yields an income stream and growth effects. Both physical and social infrastructure spending have the ability to create fiscal space to propel growth rates by generating increased productive capacity. [43]

159. ***Quantifying BiH's SDG financing needs is however a complex and necessarily imprecise process since estimates rely on a large number of assumptions, among which the long-term impact of COVID-19, the Ukraine crisis and elevated inflation constitute exogenous shocks beyond the control of government to easily mitigate***.

[42] https://unsdg.un.org/sites/default/files/UNDG-UNDAF-Companion-Pieces-5-Funding-To-Financing.pdf
[43] the DFA Could bring in data to showcase the trends and challenges in current distribution of tax types for local authorities, compare the trends with the ones in the wider region and suggest considering the tax distribution scheme as one of the areas to streamline selected SDG achievements directly via local governments through better resource redistribution to LGs (with maybe conditionality on SDG achievement).

160. As a result, the macro-level SDG financing needs developed here constitute the overall resource envelope within which SDG financing needs are stated for the 2-3 priority areas made central to the first three-years of the SDG Financing Framework Road Map.

161. ***The principles of inclusive macroeconomic policy identified here also reflect the fact that growth based on inequality, as it has been in the past, is not sustainable***. Needed, instead, are macro policies that make equity compatible with development and growth. Government spending has distributional implications and requires associated policies to ensure equitable outcomes.

162. Spatially targeted public investment (e.g., to geographic areas where unemployment and poverty rates are high), sectoral policies, and affirmative action policies can be used to reach priority groups, such as women agriculture workers and farmers.

163. ***Given the centrality of public flows in financing the SDGs, and the importance of crowding in private capital to fill the SDG financing gap, more SDG aligned financing flows, are substantially determined through the medium-term planning, budgeting, and procurement process, across all tiers of government***.

164. This section therefore links the overall development vision for BiH with the medium-term planning and budgeting process, approach to public private collaboration and macro-SDG costing funding and financing needs.

4.1 Medium- and Long-Term Development Vision

165. ***The 2020 SDG Framework for Bosnia and Herzegovina lays out the common vision for all government levels in the country while also outlining the development pathways and accelerators within which targets will be achieved.***[44]

166. The 2021 SDG dashboard for BiH provides an important point of reference for all goals, two or which are likely to be met (SDG 1 and SDG17), with all other 15 requiring considerable new levels of investment. The SDGs currently lack data to ascertain their exact status.

167. ***The SDG Framework also defines the institutional arrangements for implementation, monitoring, and reporting***. As a result, the framework serves as a unique country-wide common development platform that ties together the SDGs, the EU integration requirements and domestic development priorities.

168. Considering the multi-tier governance structure of BIH, further operationalization of the framework is to be ensured through its mainstreaming into national and sub-national development strategies, implying a focus on SDG localization.

169. Importantly, in the new 2021-2027 planning cycle, SDG-aligned development strategies will for the first time be linked with mid-term and annual institutional plans and budgets, informing the allocation of public funds. In addition, program-based budgeting is to be introduced, improving both alignment and integration into medium-term planning and budgeting processes.

170. Table 12 below presents the three development pathways (good governance and public sector management, smart growth, and a society of equal opportunity) and related accelerators. Figure 3 below provides the overall BiH SDG dashboard trend and status for each SDG. BiH has an SDG Index Rank of 47/165, an SDG Index Score of 73.7 and a spillover score of 95.8.[45]

---

[44] Okvir za Ciljeve održivog razvoja u BiH
[45] https://dashboards.sdgindex.org/profiles/bosnia-and-herzegovina

Figure 3 BIH SDG DASHBOARD (TREND) STATUS (2021)

171. ***A review of Table 12 (SDG Framework Development Pathway and Accelerators) show a dependence on public sector funding for good governance and public sector management, a particular dependence on private capital for Smart Growth, and a balance between public and private sources for development pathway three on society of equal opportunity***. EU integration is fully integrated into government development policy at all levels of government.

Table 12. SDG FRAMEWORK DEVELOPMENT PATHWAYS AND ACCELERATORS

SDG Accelerators	*SDGs*	*Activities*
Pathway: Good Governance and Public Sector Management		
Efficient, Open, Inclusive & Accountable Public Sector	***SDG 5*** (Gender Equality, ***SDG 16*** (peace, justice and strong institutions)	(i) Accountable administration focused on citizens and business sector (ii) efficient public financial management (iii) digital transformation of the public sector (iv) de-politization and professionalization of public enterprises, and (v) functional system of policy design and sustainable development management
Rule Of Law, Security and Fundamental Rights		(i) Efficient judiciary system (ii) efficient fight against corruption (iii) protection of workers' rights (iv) fight against various forms of crime and terrorism and (v) protection of human rights
Resilience to Disasters		(i) Smooth delivery of social services and essential goods (ii) sustainable recovery (iii) improved crisis communication (iv) social protection for all (v) resilient and inclusive public health infrastructure and institutions (vi) improved public procurement system and more efficient regulation and (v) smooth functioning of key infrastructure
Pathway: Smart Growth		
Enabling environment for entrepreneurship and innovations for production of high value export-import oriented goods	***SDG 3*** (Good Health and Wellbeing) ***SDG 4*** (Quality Education) ***SDG 6*** (Clean Water and Sanitation) ***SDG 7*** (Affordable and Clean Energy) ***SDG 8*** (Decent Work and Economic Growth) ***SDG 9*** (industry, Innovation and Infrastructure) ***SDG 10*** (Reduce Inequality) ***SDG 11*** (Sustainable Cities and Communities) ***SDG 12*** (Responsible Production and Consumption) ***SDG 13*** (Climate Action) ***SDG 17*** (Partnerships for the Goals)	(i) Increasing investment in infrastructure, research, development and innovations (ii) facilitating business operations and support to rapid growing firms (iii) digitalization of economy (iv) mobilizing diaspora potentials (v) support to creating global value chains (vi) strengthening the role of cities and regions as drivers of development (vii) development of "translation infrastructure".
Increasing investments in infrastructure		(i) A bigger share of public investment in infrastructure (ii) ensuring equal access to modern transport infrastructure and (iii) strengthening public digital infrastructure.
Enhancing access and quality of education and training		(i) Teachers' capacity building, modernization of schools and teaching methods (ii) digital skills development (iii) universal and quality pre-school education (iv) strategic investment in research-development activities of educational institutions (v) efficient system of life-long learning and (vi) curriculum reform at all levels of education.
Smart natural resource and environmental management		(i) Decentralization of electricity system (ii) energy poverty reduction (iii) de-carbonization to the energy sector and (iv) development of "green skills".

Green growth and clean energy		(i) Disaster risk management (ii) mine clearance of contained areas (iii) protection and renewal of natural capital institutions (iv) develop a system of circular economy institutions (v) stronger control and monitoring of the ecosystem quality and (vi) sustainable tourism.
Pathway: Society of Equal Opportunities		
Enhancing Social Protection Policies	***SDG 1*** (No Poverty) ***SDG 2*** (No Hunger) ***SDG 3*** (Good Health and Wellbeing) ***SDG 4*** (Quality Education) ***SDG 5*** (Gender Equality) ***SDG 10*** (Reduced Inequalities)	(i) Focused and better targeting public expenditures for social protection (ii) strengthening infrastructure of service providers by introducing new models (iii) upgrading the system for identification and monitoring vulnerable families and families at risk
Employment to Vulnerable Categories		(i) Increasing the activity rate and including vulnerable categories in the labor market and (ii) increasing employability of unemployed persons through development of social entrepreneurship
Efficient Health Care for All		(i) Implementing reforms for financial health care services (ii) enhancing access and quality of health care (iii) preventive health measures (iv) strategic approach for retaining the existing staff and to human resource development in the health sector generally
Enhancing Inclusiveness of Educational System		(i) Equitable access to education (ii) establishing the early detection and intervention system for children at risk and difficulties in their development (iii) increasing the coverage of children with preschool education (age 3 to 6 years) (iv) measures for reducing early school leaving and (v) reducing number of persons without knowledge or skills and their integration in the labor market
Financial Inclusion		(i) Enhancing affordability of financial services for the most vulnerable categories of population (ii) better access to microcredits with affordable interest rates

4.2 Public Medium-Term Planning and Budgeting Process

172. ***The BiH 'Comprehensive Strategy for Public Finance Management (2022-2025) provides the basis for reform to the medium-term planning and budgeting process***. The strategy aims to secure a stable macroeconomic environment by embarking on a number of structural reforms grouped into six main areas of which a set of reforms in the public finance area, taxation and fiscal sustainability is particularly important.[46].

173. ***Despite the need to crowd in private capital, the SDG Financing Framework will still largely be financed by public resources in the short to medium term***. This is not just because the budget is the central tool of public policy, but also because both good governance and public sector management will continue to be dominated by domestic and international public flows, in order to create an enabling environment for smart growth and a society of equal opportunity.

174. Furthermore, substantial effort will be required to align and integrate SDGs into the four-tiered medium-term planning and budgeting process, from which the SDG goals and targets can be financed in line with the SDG framework.

175. ***The current medium-term planning and budgeting process is therefore the anchor for the SDG Financing Framework***. Given that BiH is a highly decentralized country it will be necessary to

[46] The Comprehensive Strategy for Public Financial Management in BiH (hereinafter: the Comprehensive Strategy) reflects the commitment of the authorities in BiH to implement public financial management reform as a segment of reforms defined by the Joint Socio-Economic Reforms 2019-2022. year and the Strategic Framework for Public Administration Reform 2018-2022, which provides that each level of government in accordance with constitutional competencies to adopt its own Strategy for Public Financial Management. With the preparation and adoption of the Comprehensive Strategy, Bosnia and Herzegovina is fulfilling its commitments in the field of European integration and at the same time follows the recommendations of international organizations and institutions.

align and integrate the SDG Financing Framework across all tiers of government, implying a process of *bottom-up medium-term planning and SDG localization*.

176. Moreover, given that the primary outcome of the SDG Financing Framework is to increase the fiscal space available to governments to execute the SDGs, it is vital to identify the primary fiscal balance as the starting point to resource mobilization.

177. ***The BiH Economic Reform Plan (ERP)[47] outlines the overall fiscal framework and links it to the medium-term planning and budgeting process***. The Global Framework of Fiscal Balance and Policies is established by the Fiscal Council based on inputs provided by the Entities (Federation of BiH and Republika Srpska), Brčko District and the Institutions of BiH. The Global Framework presents the aggregate income, spending, fiscal balance, interest payments and primary fiscal balance available to government to cover all expenditure priorities as provided in Table 13 below.

Table 13. FISCAL FRAMEWORK OF THE GENERAL GOVERNMENT IN BIH 2020-2024

Fiscal Indicators (% of GDP)	2020	2021	2022p	2023p	2024p
Total public revenues	**39,9**	**43,3**	**37,3**	**41,7**	**41,2**
Total public expenditures	**42,3**	**43,2**	**37,3**	**42,0**	**39,8**
Fiscal balance	***-2,3***	***-0,9***	***0,0***	***-0,2***	***1,4***
Interest expenditures	0,7	0,8	0,8	0,9	1,0
Primary fiscal balance	***-1,7***	***-0,1***	***0,8***	***0,6***	***2,4***

p-projection

Source: BiH Economic Reform Program (2022-2024)

178. Given the importance of aligning and integrating the SDGs with public spending across all levels, the SDG Financing Framework will need to identify entry points for all tiers of governance.

4.2.1 BIH PUBLIC FINANCE MANAGEMENT SYSTEM

179. All levels of government in Bosnia and Herzegovina adopted a comprehensive strategy for the reform of public financial management (PFM) in June and July 2022. Each level of government started implementing their own PFM strategy for 2021-2025; PFM monitoring reports for 2021-2022 are being prepared.[48]

180. The Federation of BiH amended and adopted the Law on Budgets in March 2022 with the aim to apply programme-based budget model as of 2025. In December 2021, the Republika Srpska entity adopted the 2021-2024 medium term debt management strategy, joining other levels of government, that already have one in place for 2021-2023.[49]

181. ***BiH has a unique and complex public finance system***.[50] It comprises the country wide level, the two Entities (FBiH] and RS) and the Brčko District (BD). Direct taxes are governed at the level of the FBiH, the RS and the BD, while indirect taxes are governed at the country wide level. In addition to direct taxes, tax authorities at the entity level collect social contributions. Non-tax revenues are

[47] Each enlargement country prepares an Economic Reform Programme (ERP) annually, which sets out **a medium-term macro-fiscal policy framework and a structural reform** agenda aimed at ensuring competitiveness and inclusive growth. The ERPs are the basis for country-specific policy guidance jointly adopted by the EU and the Western Balkans and Türkiye at ministerial level in May each year (**see Economic Commission, 2021. Guidance for the Economic Reform Programmes 2022-2024 of the Western Balkans and Turkey**).
[48] European Commission, 2022. Bosnia and Herzegovina 2022 Report. Brusells: European Commission. SWD(2022) 336 final
[49] European Commission, 2022. Bosnia and Herzegovina 2022 Report. Brusells: European Commission. SWD(2022) 336 final
[50] OECD 2021 Monitoring Report on the Principles of Public Administration

collected by all level of authorities.[51] In 2023, BiH should implement the countrywide strategic framework for public financial management 2021-2025 at the country wide level. [52]

182. The adoption of individual PFM strategies for the period 2021-2025 at all four levels provides an important reference point for the SDG Financing Framework. Each of the four PFMR strategies are broken down into six pillars, one of which concerns the improvement all the important aspects of planning and budget management including a specific measure to address public investment management reform needs. This pillar of public investment provides an important entry point for the SDG Financing Road Map and Financing Framework.

183. Procedures for budget planning are similar at all levels of government: all of them prepare a framework budget document (FBD) on which the preparation and drafting of the annual budget is based, with the obligation to adopt it in the legislative bodies of each level of government by the end of the calendar year.

184. All levels of government, except the Brčko District of Bosnia and Herzegovina, prepare public investment programs that should be aligned with development strategies and policies. All levels of government are responsible for the execution of the adopted budgets through individual systems of unique accounts of the treasury. This also applies to liability controls, cash management and payments.

185. ***As a result, the SDG Financing Framework will need to integrate with the existing medium-*** term ***planning and budgeting process at all levels of authorities.*** Currently medium-term budgets direct financing for (i) the development of state functions related to fulfilling the European Partnership requirements (ii) securing funds for implementation of the Stabilization and Association Agreement (SAA) (iii) adjusting activities to support the Partnership for Peace (PfP) (iv) multi-annual projects and (v) other policy measures and priorities.

186. ***In order to facilitate the alignment and integration of SDGs into the planning and budgeting process, each tier will need to make sure that the SDGs are not integrated into the public Investment Plans (PIPs) but also medium-Term and Annual Work Programs***.

187. The key medium-term planning documents at all levels of the administration include the Medium-Term Government Program (Institutions of BiH, FBiH and RS), annual and medium-term institutional plans (the Institutions of BiH , the FBiH, the RS and the BD), the Government Annual Work Plan (GAWP), the Budget Framework Document (BFD), and sectoral strategies.

4.2.2 Integrating the SDGs into Key Planning and Budgeting Processes

188. ***The medium-term policy-planning systems is currently established through separate laws and regulations at all levels of the administration.*** Given the need to integrate SDGs across multiple planning domains, it is necessary to improve the identification, formulation, and prioritization of public investment programs, aligned with development and sector strategies and the SDG Framework.

189. Under Pillar III of the Comprehensive PFM Strategy, SDGs will benefit from expanding the scope of the budget to ensure that total expenditures are directed towards strategic development

[51] "Given this structure, there is no single framework for public financial management (PFM). Rather, four different PFM systems exist, and there is no centralised domestic organisation that publishes centralised consolidated data on public finances (OECD, 2021, p. 14)

[52] European Commission, 2022. Bosnia and Herzegovina 2022 Report. Brusells: European Commission. SWD(2022) 336 final

priorities in the medium and annual perspective at all levels of government. The goal of this pillar will be achieved by the following measures.

190. Key elements of the planning and budgeting process for the SDGs are as follows:

- ***Global Framework of Fiscal Balance and Policies***: The Global Framework for Fiscal Balance and Policies (GFFBP) forecasts is developed centrally with inputs from all the entities (through the Fiscal Council), setting out the agreed countrywide macro-economic framework within which the individual BFPs are developed. The GFFBP is the equivalent of a Medium-Term Fiscal Framework (MTFF). The GFFBP is developed early in May each year followed by the BFPs in June. The GFFBP provides the overall framework for the BFPs, and it also determines the income and entity level allocation of indirect taxes after first allocating revenue to the Institutions of BiH, and payment of debt obligations. Improving fiscal space for development (for example reducing the COVCID-19 related budget deficit, accelerating human and physical capital investment, increasing fiscal buffers), will improve the level of discretionary finance available to implement the SDG Framework.

- ***Mid Term Work Plan:*** Three-year workplans and monitoring and reporting documents are established, providing the strategic documents for the four tiers of government; Institutions of BiH, entity, canton and municipality. The documents in the strategic planning, monitoring, and reporting process include the development or sector strategy and the implementation documents (Budget Framework Paper, Public Investment Programs and Annual budget). Governments develop implementation reports to monitor impact.

- ***Budget Framework Papers (BFP)***: Based on budget instruction at the respective level of authorities, multi-annual budget plans are produced under the respective legislation as BFPs. This document is adopted by governments and Council of Ministers in the case of the Institutions of BiH. The BFP provides the fiscal framework within which fiscal rules are set for that level of government. This enforces fiscal discipline and the BFPs are therefore an important reference point in increasing fiscal space to finance the SDGs.

- ***Government Annual Work Plan (GAWP) and of Council of Ministers in the case of the Institutions of BiH*** : GAWPs are the annual plans of government and the Council of Ministers, within which outcomes and baselines are set. While improving, in most cases SDGs still need to be integrated into the medium-term plans, BFPs and the annual work plan. Alignment between central planning documents at all levels of the administration therefore must to be strengthened and the priorities expressed in the GAWPs and the BFPs will need to include SDGs, including targets and indicators.

- ***Public Investment Program (PIPs)***: PIPs are multi-year public investment programs that are formulated for execution through the respective government budget, and these are integrated into the Public Investment Management Information System (PIMIS). PIPs present the basis for the management of public sector resources and the mobilization of external aid, and SDGs therefore need to be aligned, costed and integrated into these investment programs.

- ***Annual Report on Budget Execution***: Annual reports on budget execution at respective level of the government are developed based on both an economic classification and program-based reporting This covers both the operating and capital budgets.

Box 1. MOVING FROM SDG ALIGNMENT TO SDG BUDGET INTEGRATION

Ideally strategy documents of governments should reflect the SDGs, making the SDG Framework a policy framework for government complementary to EU Integration, for example.

Alignment will encourage existing spending to be linked to the SDGs, and for performance to reported on an annual basis. However, to be fully effective, SDG financing instruments will need to be integrated into the budget, PIP[53] and related procurement processes.

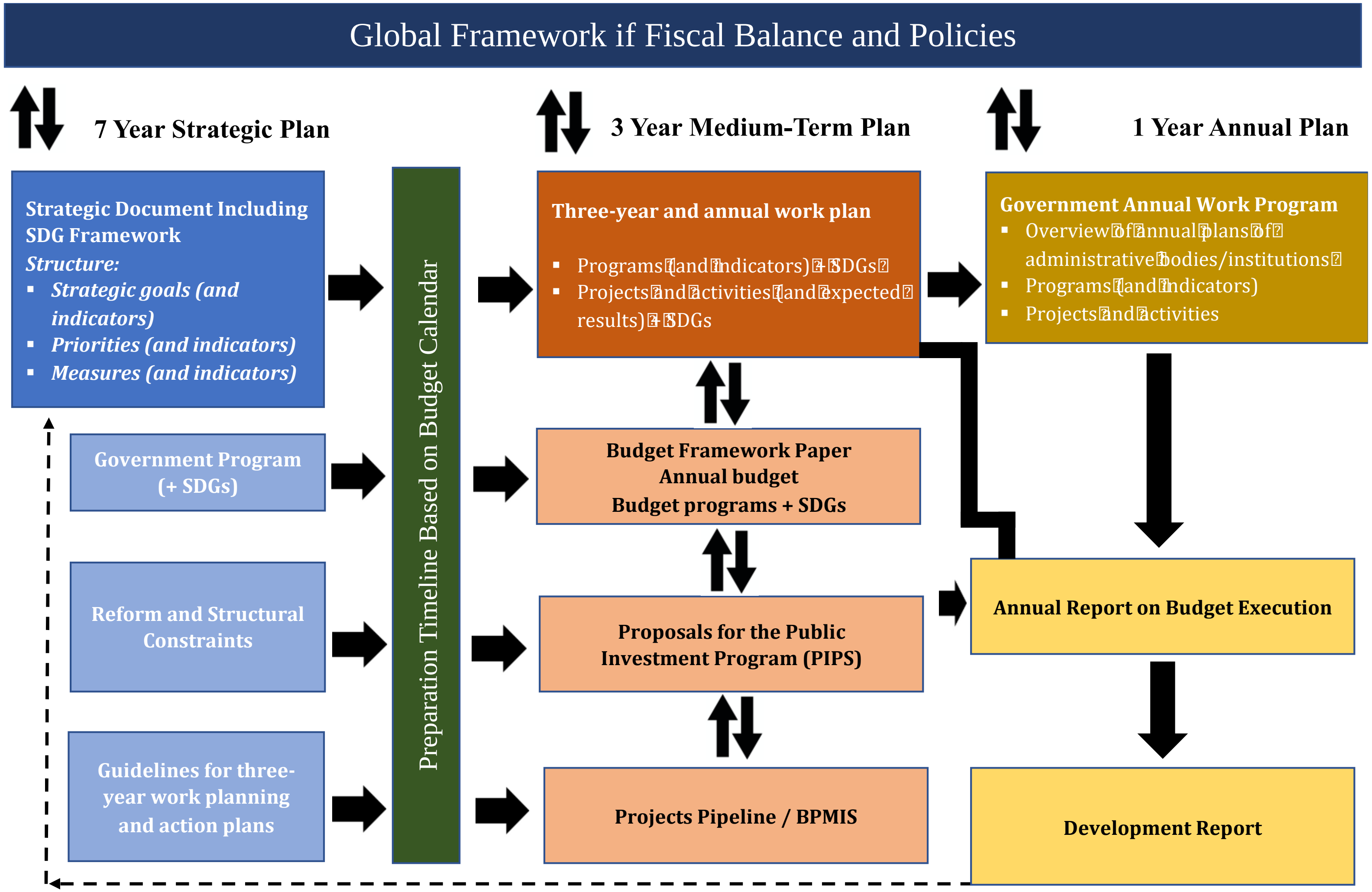
As a starting point for the SDG Financing Framework, the focus will be on (i) ***mobilizing additional resources*** for the SDG Framework (ii) ***aligning public and private resource flows*** and (iii) ***monitoring impact***.

191. Given that the SDG Financing Framework will focus on priority sectoral areas there is an opportunity to link the SDG Financing Framework with process of budget preparation, to influence the budget call circular process and guide spending units in aligning with and integrating defined priorities with budget.

192. ***Figure 4 provides an illustrative overview of the generic planning and budgeting framework in BiH that the SDG Framework and Financing Framework will need to engage to make sure that PIPs and sector investment programs are aligned and integrating the SDGs, at all four levels of budgetary administration***.

[53] While the existing PIP database is designed to match public investment proposals with the SDG Framework though integration can only happen once the SDGs are integrated into the PIPs and GAWPS. The Sector for Coordination of International Economic Assistance maintains a donor-mapping database covering donor-funded projects for BiH and this will provide a useful way to increase alignment of government spending to the SDG Framework.

Figure 4 ILLUSTRATIVE BIH PLANNING AND BUDGETING FRAMEWORK



Source: Adapted from Various Sources

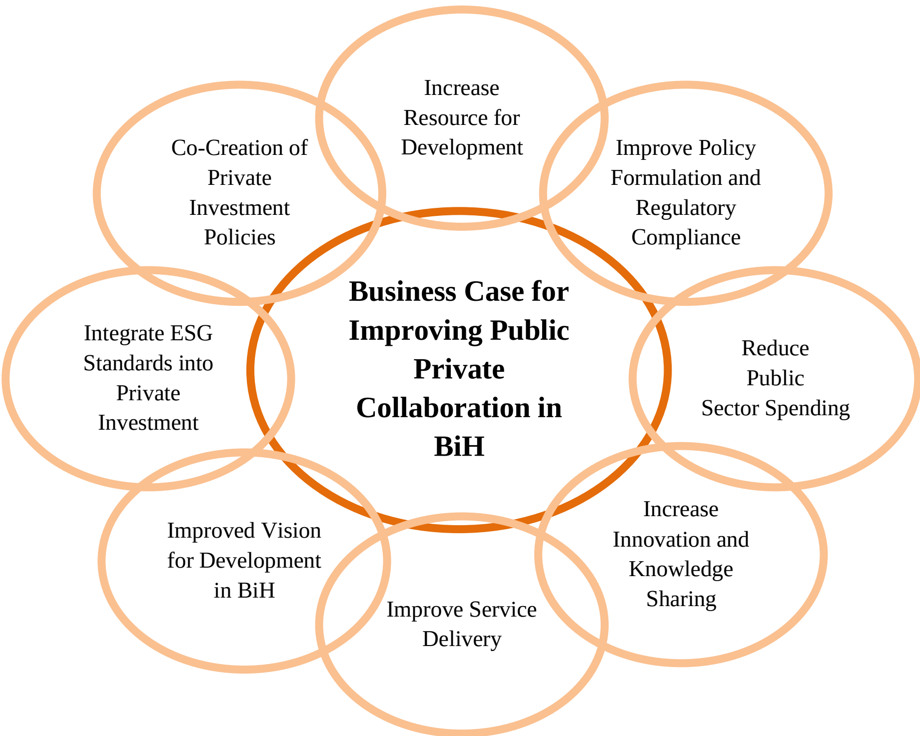
4.3 PUBLIC PRIVATE COLLABORATION AND SDG FF

193. ***In order to increase the flow of private capital into development and to increase integration of finances across public and private domains, public private collaboration becomes increasingly important***. Public private collaboration is however wider than just a focus on PPPs, given that domestic and international private investors now contribute towards the SDGs and ESGs through their own Corporate Social Responsibility CSR) policies.

194. ***Given the rise of the digital economy, the need to align private capital with meeting SDGs and adopting Environment, Social and Corporate Governance (ESG) goals and increased dependence or FDI and portfolio inflows, deepening public private dialogue and investment collaboration is necessary to identify constraints that can be resolved***.

195. While BiH has a rich history of public private dialogue Figure 5 below provides the business case for further advancing areas of collaboration, given the tangible benefits to both countrywide development and the execution of the SDG Framework.

Figure 5 BUSINESS CASE FOR IMPROVING PUBLIC PRIVATE COLLABORATION IN BIH



196. According to the IMF's paper *The Future of PPPs in the Western Balkans* (Kees et al,2023), PPPs are increasingly an important vehicle for several Western Balkan countries to increase investment. While there are benefits to well-designed and implemented PPPs, they also carry a potential for large fiscal risks and increased costs if not managed well. Countries with successful PPP programs typically benefit from a clear and well-designed PPP governance framework, which covers all stages of the PPP life cycle.

197. In addressing gaps in its PPP governance frameworks, BiH could lean upon the World Bank's experience acquired across the globe. It suggests that t**hree institutional pillars are needed to** to fully reap the potential benefits from PPPs**: (i) political will, (ii) institutions and governance and (iii) technical teams** (Flor, 2018). Firms looking to enter a PPP market like to see strong political support from the higher levels of government. Also, these firms need to know their bids will be reviewed in a timely manner using a transparent and standardized process. This standardization (contract terms related to termination, arbitration and dispute resolution, and repatriation of profits etc.) is particularly important to international investors. Another key condition is the presence of a strong technical team in government that understands the market, the potential pool of bidders, their requirements, their limitations, and ensures clarity and consistency in the process.

198. ***Barriers to increasing public private collaboration through blending can only be resolved through dialogue***. According to the Blended Finance Task Force, various barriers affect different actors in the market, but combined they limit the flow of private investment for SDG-related assets.[54] Improving public private collaboration in BiH can therefore assist in overcoming:

- ***Constraints to Private investment***: Investors are often hampered by regulatory restrictions and face a range of asset-specific risks related to their infrastructure asset exposure. They also lack reliable data on the performance of such assets in emerging markets to guide their investment decisions, and also lack an enabling legal framework and level playing field across tiers of government.

- ***Constraints to Development Banking***: Development banks often do not have strong enough incentives or business models to focus on maximizing private capital mobilization for the projects they support. Domestic commercial banks retain adequate average capital buffers, steady non-performing loan ratios and comfortable liquidity-coverage ratios, though lack of engagement with micro, small and medium enterprises is a barrier to unlocking capital to meet future investments needs.

- ***BiH Governments***: BiH lacks the necessary policy and institutional mechanisms to attract long-term capital and develop bankable project pipelines and improving public private collaboration can work to overcome this constraint. Moreover, as there are no blended financing institutions in BiH beyond the PPP space, investment policies for blending into development and sectoral strategies, PIPs and GAWPs remain weak. Moreover, the adoption of ESG standards has now so far led to increased appetite for investment.

199. ***The analysis in Chapter 3 above outlines how a number of flows from the BiH financing ecosystem can be aligned with supporting the SDGs***. These include social impact investments, domestic and international credit flows, remittances, portfolio investments and FDI, for example.[55] As a result, improving public private collaboration is likely to have a positive impact on the following investment instruments and modalities:

- ***Blended Financing***: The potential for blended financing in BiH is not yet fully explored and tapped. Blended finance, which uses public resources to mobilize financial resources from private sources, has been looked to as a means to incentivize greater investment in the SDGs (UN, 2021; OECD 2018a; Gaspar et al,, IMF, 2019). This is part of what is called the Funding to Financing (F2F) transition. The average private finance per deal mobilized in upper-middle-income countries is about US$ 60-odd million (UN, 2021), showing the potential to bridge the countrywide and SDG financing gap by investing in blended solutions..

[54] https://www.blendedfinance.earth/about
[55] Social Impact Investment (SII) are the provision of finance to organisations addressing social needs with the explicit expectation of a measurable social, as well as financial return. While there are few examples of SIA in BiH, there would appear to be considerable potential in key sectors such as education, health and social protection.

200. ***Public Private Partnerships***: Despite the potential for scaling PPPs, the overall portfolio of PPPs in BiH is limited and its contribution towards the SDGs is currently unknown. There are no PPP pipeline established in key sectors for integrating into the PIPs and GAWPs. While PPPs are not amendable to all SDGs, for those where private capital is critical to SDG attainment (i.e., infrastructure, digital economy, value chains, domestic financing, service sectors etc.) PPPs can be scaled and replicated to good effect, increasing the fiscal space for other investments. Contingent liabilities and state guarantees need to be well managed however, given knock-on risks for public debt.

- In addition, weak project appraisal and the full lack of an independent review process makes it difficult to confirm the value for- money of projects (Chaponda et al., IMF, 2018). Regardless of the financing method, but particularly in the case of PPPs it is critical to ensure that investments deliver value for money, while limiting contingent fiscal risk (Gaspar et al, IMF, 2019).

- ***Portfolio Investment***: Strengthening capital markets, public and corporate debt issuance, adopting ESG standards for publicly traded companies on the Sarajevo Stock Exchange and Banja Luka Stock Exchange will increase incoming portfolio flows in particular, and many investors have embraced both the SDGs and ESGs.

- ***Remittances***: The potential to better use remittances, strengthen remittance corridors and mobilize capital through bonds or improved bankarization can only be achieved through meaningful public private dialogue and collaboration. At 11 per cent of GDP and given the high transaction costs of remittances (i.e., 5-6 per cent against the 3 per cent SDG target), strengthening the alignment of remittances through improved collaboration seems compelling.

201. ***Many comparator countries (small Central and South-eastern European countries) have used PPPs to accelerate infrastructure development in recent years***. However, this has not been the case in BiH, where there is consequently a broad space for enhancing PPPs as they only represent about 1.5 percent of GDP, or only about 2 percent of the total public capital stock (Chaponda et al., IMF, 2018).

202. ***The*** SDG Financing Framework ***will therefore need to identify the most optimal public private collaboration model for BiH***. It will be also need to identify options for strengthening the investment climate, strengthening governance institutions and the proper legal and regulatory framework to increase blended finance and PPP investments linked to SDF Framework priorities. As part of the process, and in order to have public policies supporting a favorable investment climate for the SDGs, efforts will need to focus on strengthening market governance, building fair and predictable tax systems, efficient and transparent regulatory frameworks and rule of law (Gaspar et al., IMF, 2019) as well as the integration of new financing instruments and mechanisms into the PIPs and GAWPs.

4.4MACRO SDG FINANCING NEEDS AND PRIORITIES

203. ***While calculating the top-down macro level SDG financing needs for BiH does not inform the investment needs as the level of PIPs and sectors, it does provide an understanding of the overall level of financing flows necessary to meet BiH SDGs, as outlined in Table 14 below.*** The business case for financing the SDGs is directly linked to the business case for EU integration, as integration will lead to the adoption of a set of measures that will unify and open markets to private capital, social goals and decarbonization for example.

204. ***Due to the slow implementation of structural reforms – as not narrowing the gap in technology with developed countries clearly shows, BiH growth rates have not accelerated more than those of its comparators particularity since 2009***.

205. Instead, BIH faces a similar challenge to other middle-income countries, in a trap of structural transformation or, as widely, known, in the middle-income trap. Poorly developed investment policies, combined with reluctance in many parts of society to embrace innovation, reflected in lack of financing for Research and Development (R&D).

206. Investments in R&D were just 0.21% of GDP in 2020 or BAM 213 per capita. Such a level of investment results in very low levels of knowledge production and the low production of high-tech products (BHAS, 2022) which are need to offset import costs and to improve the balance of trade.

207. ***The knock-on effect is that BIH has lower share of manufacturing value added in the gross domestic product than its comparators, and lower exports of high-tech products up to 100-200 times*** The respective averages of exports of high-tech product (as percentage of GDP) in the World, EU member countries, high-income countries, upper middle-income countries, economic comparators, and regional comparators are higher than of BIH. ***(World Bank, 2023)***.

208. ***Economic growth depends on both population and productivity***. Population growth, and the associated increase in the labour force, stimulate economic growth through two channels: first, growing population increases the size of domestic market, and second, it means more workers that are more employable. From the perspective of smart growth and a society of equal opportunity, both national and individual productivity growth are vital.

209. ***In BiH, the population size has been decreasing for years due to two reasons: the ageing of the population and emigration***. Fertility is below the replacement level, and population growth is expected to decline in the coming decades. There were just 19 countries in the world in 2020 with lover total fertility rates (World Bank, 2023) and migration additionally exacerbates the impact of ageing of population on the population size.

210. It is inconceivable to adequately finance the SDGs without a viable, stable and prosperous economy, in line with SDG Framework development pathways two (smart growth) and three (society of equal opportunity).

SDG Financing

211. ***Based on the SDG costing model adopted (for details, see Annex 2), if BiH continues to practice a 'Business As Usual' (business as usual scenario' (i.e., continues to keep trend GDP growth rate of 2.5-3.5% and the ratio of SDG spending per cent to GDP per cent is not changed), it would be spending around BAM 79.9 billion on SDG financing over the period of 2023-2030 (see Table 15)***. This would be insufficient to meet the SDGs.

Table 15. THE 'BUSINESS AS USUAL SCENARIO' (BILLION BAM)

Variable	2022	2023	2024	2025	2026	2027	2028	2029	2030	Total (2023-30)
GDP	38.8	39.8	40.8	41.8	43.3	44.8	46.4	48.0	49.7	
GDP growth rate	2.5	2.5	2.5	2.5	3.5	3.5	3.5	3.5	3.5	
GDP per capita	11772	12,066	12,368	12,677	13,121	14,004	14,495	15,002	15,527	
SDG spending pc	2,649	2,719	2,787	2,857	2,957	3,156	3,267	3,381	3,499	
Population	3.3	3.3	3.3	3.3	3.3	3.2	3.2	3.2	3.2	
SDG spending	**8.7**	**9.0**	**9.2**	**9.4**	**9.8**	**10.1**	**10.5**	**10.8**	**11.2**	**79.9**
SDG spending / GDP	0.224	0.225	0.225	0.225	0.225	0.225	0.225	0.225	0.225	

Source: SDG DFA Experts Calculations based on Kharas and McArthur (2019) (see Annex 2 for details)

212. ***If, however, BiH builds from the 'acceleration growth scenario' investment scenario*[56] *by introducing the incremental spending necessary to meet the SDGs in the line with the comparators group of countries*** (i.e., with upper middle countries' spending on SDGs), its SDG spending would need to increase to BAM 86.1 billion over the 2023-2030 period, or from BAM10 to 10.8 billion per year in the comparison to the 'business as usual scenario' (see Table 16).

Table 16. THE SDG ACCELERATION SCENARIO (BILLION BAM)

GDP	38.8	39.8	40.8	41.8	43.3	44.8	46.4	48.0	49.7	Total (2023-30)
GDP growth rate	2.5	2.5	2.5	2.5	3.5	3.5	3.5	3.5	3.5	
GDP per capita	11,772	12,066	12,368	12,677	13,121	14,004	14,495	15,002	15,527	
SDG spending pc	2,649	2,745	2,844	2,948	3,084	3,227	3,376	3,533	3,696	
Population	3.3	3.3	3.3	3.3	3.3	3.2	3.2	3.2	3.2	
SDG spending	**8.7**	**9.0**	**9.7**	**10.1**	**10.6**	**11.1**	**11.3**	**11.8**	**12.4**	**86.1**
SDG spending/GDP	0.224	0.226	0.238	0.241	0.246	0.249	0.244	0.246	0.249	
SDG spending % growth rate	2.5	3.63	3.63	3.63	4.63	4.63	4.63	4.63	4.63	

Source: SDG DFA Experts Calculations based on Kharas and McArthur (2019) (see Annex 2 for details)

213. ***In order to reach BAM 86.1 billion needed for the SDG spending according to the SDG acceleration scenario i.e., to keep up with upper middle-income countries, BiH needs additionally BAM 6.2 billion for the period 2023-2030 or BAM 0.8 billion per year***. This is an equivalent of 28% of actual public investments (investments from consolidated budgets of public authorities and public companies). The needed resources exist but is necessary to mobilize them by designing and deploying new financial mechanisms and instruments on one side and designing proper investment projects capable of passing the cost-benefit analysis test on the other side.

214. ***Financial resources to be mobilized include those of the EU funds for the Western Balkans, primarily for the energy transition***. The EU's energy transition master plan is backed by €270 billion euros including €9 billion for achieving Green Agenda goals in Bosna-Herzegovina and other Western Balkans in grants. So, BiH can "*dash* into *renewable energy at lightning speed*" with proper utility scale projects in solar and wind energy. Important here is to think through the most optimal composition of sector spending, to which end Table 17 below provides upper-middle income countries spending on SDGs as a per cent of overall spending.

Table 17. POTENTIAL SECTORS OUT WHICH TO SELECT BIH'S PRIORITY SECTORS (IN 2015 US$)

	Estimated SDG Spending, Total and by Sector; Upper Middle-Income Countries, 2015			**Estimated SDG Spending Needs, Total and by Sector; Upper Middle-Income Countries, 2025**	
No	***Sector***	***Amount pc***		***Amount pc***	***Sector***
1	Agriculture	127		195	Agriculture and rural development
2	Health	252		289	Health
3	Education	353		525	Education
4	Social Spending	581		799	Social Spending
5	Infrastructure	767		327	Energy

[56] See detailed "Acceleration Growth" Scenario

6	Bio Conservatism	1		7	Bio Conservatism
7	Justice	120		70	Justice
8	R&D, technology, value chains	n/a		n.a.	R&D, technology, value chains
9	Data	n/a		n.a.	Digitalization
10				32	Flood protection
11				68	Water and sanitation
12				248	Transport
13	TOTAL	2200		2559	TOTAL

Source: for sectors: Schmidt-Traub (2015) Rozenberg and Fay (2019). Manuel et al (2020), Kharas and McArthur (2019), Sachs et al (2018), Gaspar et al, IMF (2019), UNCTAD (2014 and 2021);and Kharas and McArthur (2019) for upper middle income countries' spending on SDGs.

Chapter 5

Prioritization for SDG Attainment

5. Prioritizing for SDG Attainment

215. ***In the light of the analysis presented in preceding sections, this section identifies priority sector targets for investment in the first 24-36 months of the SDG Financing Framework.*** The selection was based broadly on the criteria outlined in Box 1 below[57].

Box 1. SDG Financing Framework Priority Selection Criteria

- Target one or more SDGs that are of particularly high priority to countrywide policy.
- Be aligned to the SDG Framework.
- Be executable across all tiers of government.
- Have the potential to crowd in private capital through scaling existing and / or new instruments.
- Demonstrate quick and visible results for successful scaling.
- Be amenable to the financing instruments recommended in the Short-Term Instruments Work.
- Contribute towards EU Integration and ERP priorities.
- Address critical cross-cutting issues such as gender, climate, and environmental concerns.
- Align with the investment priorities of key anchor donor investors, and,
- Contribute towards LNOB and BBB agendas

5.1 Priority Financing Needs

216. ***The SDGs Framework informs future strategic planning processes at the level of BiH, the Republika Srpska, the Federation of Bosnia and Herzegovina and the Brčko District of Bosnia and Herzegovina***.

217. Through these processes, all levels of government will define their priorities, measures, and activities to be financed in compliance with the constitutional competencies and will ensure the contribution for implementation of Agenda 2030. All levels of government in BiH will need to support the resource mobilization drive by strengthening strategic budgeting and adopting new instruments, mechanisms and partnerships.

218. ***Bearing in mind the complexity of the administrative organization in Bosnia and Herzegovina (Forum of Federations, 2023; VM BiH, 2022), as well as the overall socio-economic condition in the country (VM BiH; IMF, 2022), each level of government is to make additional efforts towards mobilizing (domestic and external) financial sources*** (IMF, 2022).

219. With over 40 per cent of GDP distributed through the public budgets, a significant contribution to the cost of meeting the SDGs would come from the public sector. However, the areas are highly amendable to crowding in private capital and as a result, the financing gap outlined below, could be substantially met by the private sector, through various blended products and catalytic financing arrangements, especially in the five SDG areas (education, health, roads, electricity, water and sanitation) (Gaspar et al, 2019; Fay et al, 2019).

220. ***Without tracking existing SDG spending, it is of course impossible to calculate the financing gap for SDGs as a whole, or for a particular SDG or target.*** The task is made more complex by the need to localize SDGs to reflect both entity, district, and canton level. Despite this, based on the growth and revenue scenarios outlined above, it is clear that additional public and private financing is required if the indicative priorities are to be resourced to meet critical SDG financing needs.

[57] For an excellent review of SDG selection criteria see Yanga, S, Wenwu Zhaoa, W., Liua, Y , Cherubini F, Fua B, and Pereira, P., 2020. Prioritizing sustainable development goals and linking them to ecosystem services: A global expert's knowledge evaluation. Geography and Sustainability, No. 1

221. ***Table 18 below provides a summary of future SDG financing, based on the application of the international method provided in Annex 2***. It provides a summary of the total SDG spending and the assumed future priority spending needs on: (i) infrastructure and energy, (ii) research and development, and (iii) digitalization both from public and private sources.

222. **In terms of the initial priority areas, it will be necessary, as shown in Table 18, to provide an additional BAM 0.34 billion** to be invested into: (i) physical infrastructure, with a particular emphasis on investing into renewable energy resources and to build, (ii) digitalization, and (iii) research translation infrastructure.

223. ***A focus on innovation and technology and physical infrastructure investments to connect the society and the economy to the rest of the world should become priority areas of development policy in line with the SDG Framework development pathways and accelerators.***

- The '***Business-as-usual scenario'*** is the baseline scenario and it is just a continuation of current processes that keeps BiH in a middle-income trap and it does not allow it to fulfil SDG goals significantly.

- The '***Acceleration Growth Scenario'*** is 'the business-as-usual scenario plus' with an important difference. It asks for extra investments into three key priorities (R&D, physical infrastructure and energy and digitalization). The work on these priorities over the period 2023-2025, meaning introducing proper financial instruments and mechanisms, will level the field for proper investment over the period 2026-2030. At the same time, it will enable BiH in keeping abreast with upper middle-income countries in fulfilling the SGS goals.

Table 18. SPENDING TO MEET SDGS: BIH, 2023-2025 (IN BILLION BAM)

	Variable	2023	2024	2025	2023-2025	2023-2030	2026-2030
a	b	c	d	e	f	g	i
	BUSINESS AS USUAL SCENARIO						
1	SDG spending	**9.00**	**9.20**	**9.43**	**27.60**	**79.93**	**52.33**
	ACCELERATION GROWTH SCENARIO						
2 (=3+4)	SDG spending	**9.00**	**9.70**	**10.10**	**28.80**	**86.12**	**57.32**
3	*nonpriority SDGs*	6.50	6.95	7.10	20.55	61.45	40.90
4 (=5+6+7)	*priority SDGs*	2.50	2.75	3.00	8.25	24.67	16.42
5	infrastructure and energy	2.10	2.20	2.30	6.60	19.74	13.14
6	digitalisation	0.10	0.15	0.20	0.45	1.35	0.89
7	research and development	0.30	0.40	0.50	1.20	3.59	2.39
	GAPS						
8 (=2-1)	**SDG spending**	**0**	**0.50**	**0.67**	**1.20**	**6.19**	**4.99**
		gaps on SDG priorities					
9	Priority spending	0	0.14	0.19	**0.34**	1.77	1.43

Source: SDG DFA Experts Calculations

5.2PRIORITY SECTORS FOR ACCELERATED SDG FINANCING

224. ***Given the need to select priorities outlined with in the SDG Framework, including targeting SDG accelerators that can attract investment, the following priority areas and activities have been identified for form the first 36 months of execution***.

5.2.1 DIGITIZATION

225. ***Digitization Activities and SDG Alignment***: Digitization is not only essential for meeting the good governance and public sector management, smart growth, and society of equal opportunities development pathways, it is also essential for building the sustainable society of the future. The cost of financing digitization is substantial and requires considerable investment flows from the private sector.

226. Digitalization will provide BiH with access to an integrated network of unexploited big data with potential benefits for society, gender equality and the environment. Not only will the development of smart systems (connected to the internet of things) generate unique opportunities to ensure an equitable, environmentally sustainable, and healthy society, it will also lay the foundation for a FINTECH revolution, aiding competitiveness and financial inclusion, as well as reducing both gender and social inequality.

227. Digitalization activities must form an integrated approach, expanding wide adoption of digitization[58] process and laying the foundation for the entire digital transformation, covering both public and private entities.

228. Critical to the financing of digitalization efforts is the sequence of actions that need to be supported, including establishing the regulatory framework (digital services) for both official channels of public sector communication (within government as a part of government E-Government) but also E-Commerce, E-Banking and online trade (digital markets).

229. A basic law on electronic signatures, establishment of cloud centers (at the state and entity levels), tax policy incentives to leverage investments into the 5G network, development and adoption of online-trade solutions and strengthen digital and IT literacy are all critical priorities**,** with spillovers to many of the SDGs.

- ***Investment Rationale and Problems to be addressed***: In a world investing around the Forth Industrial Revolution (4iR), Industry 4.0 and the Internet of Things (IoT), if BiH remains poorly connected and digitized many economic activities will become uncompetitive, with both government services and businesses falling behind regional and European digital uptake. Moreover, the rate of return on digitization has strong direct, indirect and induced multipliers both on growth and services. There is a lack of laws, policies and strategies governing the area that are in line with relevant EU legislation. Network development requires considerable investment to broaden coverage, electronic services for all citizens are under-developed, e-government lacks financing resources and mobile and SME banking and online services has considerable growth potential, as does addressing issues related to financial inclusion and the unbanked. In spite of adopting new laws, e-signatures have not been introduced due to different

[58] As BiH embraces the digital age, digitization, digitalization and digital transformation have become an important horizontal agenda, and have been identified here as a critical investment cross-cutting all SDGs. **Digitization** refers to creating a digital representation of physical objects or attributes, and is therefore foundational to digitization and the digital transformation. **Digitalization** refers to the enabling or improving business processes by leveraging digital technologies and digitized data. Digitalization therefore assumes digitization. **Digital transformation** requires both digitization and digitalization to have occurred, and digital transformation means the transformation of both public and private sector business processes enabled by digitalization, towards new revenue and value-producing opportunities. In this DFA, digitalization therefore is implies digitization, as a contribution to longer term digital transformation

legal frameworks at different administrative levels. As a result, and to foster digitalization, the government would seek to adopt country-wide legislation on electronic identification and trust services.

- ***Current Status:*** According to the Network Readiness Index, Bosnia and Herzegovina is ranked 90th out of 131 countries in 2022[59], and compared to the countries in the region, BiH is the worst ranked country. According to access to information and communication technologies, it ranks 91st out of 134 countries and the overall assessment of network readiness is still low. The E-readiness indicator monitors the development of the information society and at the same time represents a measure of society's inclusion in international digital flows and internal digital flows. In 2020, the penetration rate of Internet users increased slightly compared to the previous year and amounted to 94.5%, which is more than 94.3% in 2019.[60] Moreover, BiH is at the very bottom of the business digitalization scale.

- ***Value-For-Money***: Digitization accelerates economic growth and facilitates job creation, and it also allows the improvement of sector service delivery in education and health, for example. It provides a huge boost to economic output and creates both formal and informal sector jobs. Digitization's impact is not uniform across economies in different stages of development, but it will aid public sector accountability and transparency improved service delivery in a wide number of sectors. In enhancing connectivity, promoting financial inclusion, and improving access to trade and public services, technology will be a great equalizer, contributing towards a society of equal opportunities.

- ***SDGs Impacted***: Digitization directly targets SDG 9 (Build resilient infrastructure, promote inclusive and sustainable industrialization and foster innovation), while it also is also referenced in the targets related to climate change (SDGs 13, 14 and 15), gender equality and women empowerment (SDG 5), private sector development (SDG 8), education (SDG 4) and health (SDG 3).

- ***SDG Accelerators***: In terms of digitization the SDG framework focuses on the following actions: (i) Digital transformation of the public sector, (ii) digitization of the economy, (iii) strengthening public digital infrastructure, and (iv) digital skills development.

- ***Investment Priorities***: BiH adopted the Information Society Development Policy 2017-2021 as well as the Information Security Management Policy in the Institutions of Bosnia and Herzegovina for the period 2017-2022. BiH has clearly defined its strategic commitment to the development of the information society and improving information security in BiH. Investments that build the infrastructure and financing modalities in order to (i) through EU aligned build BiH as a gigabit society connecting all main socio-economic drivers - such as schools, universities, research centers, transport hubs, hospitals, public administrations, and enterprises relying on digital technologies, (ii) uninterrupted 5G coverage available in all urban areas and all major terrestrial transport paths to connect people and objects, (iii) access to mobile data connectivity everywhere in all places where people live, work, travel and gather, (iv) revolutionize money and payments systems and FINTECH, and (v) digital skills development for the public and private sectors. Integrating digitization into investments into support gender equality will remain a significant priority.

- Table 19 below provides a summary of priority digitization accelerator activities. In terms of financing, using a combination of financial and non-financial measures, tax and non-tax

[59] https://networkreadinessindex.org/
[60] http://www.dep.gov.ba/naslovna/default.aspx?id=2581&langTag=en-US

incentives, blended financing based on project needs and the various strengths of collaborative financiers, new investment models will be developed.

- ***Potential Financing Instruments***: Public funding, grants, subsidies, guarantees, bonds and notes, infrastructure bonds, loans, micro-finance, SME financing and private equity funds can be mobilized, alongside social impact bonds / digitalization bonds. Apex Funds could also eventually be developed.

Table 19. DIGITALIZATION PRIORITY ACCELERATOR ACTIVITIES

#	Accelerator Action
1	Legislation aligned to EU standards (EU Digital Services and Digital Market Acts), laws on cyber security and Security of Network and Information Systems and Electronic Identification (including electronic signatures) and Trusted Services for E-transactions.
2	E-Government Development Strategy and Broadband Access Strategy and Public Administration Reform Strategic Framework
3	Implementation of 6 key pillars of Information Society Development in BiH (Single digital market, Digital Government, Trusted services and Cyber Security, Digital infrastructure, Digital skills research and development, Application of digital technologies in key development areas in Bosnia and Herzegovina)
4	Digital transformation of the public sector by implementing building blocks for transactional eServices (eDelivery, ePayment, GSB….)
5	Digitalization of the economy (including tax incentives) and financial inclusion strategy
6	Digital skills development and talent development and acquisition
7	Digital Transformation Funding to Financing Strategy, including linkages to EU Instruments for Pre-Accession Assistance (IPA) III Funds

Box 2. GENDER ENTRY POINTS FOR DIGITAL TRANSFORMATION

“The introduction of digital technologies in government systems can help in overcoming traditional barriers to women’s inclusion in governance and public participation (United Nations 2010, Huyer 2010 cited in IT for Change 2015)[16]. For example, mobile-based public information outreach services can help women avoid dependence on information brokers/middle-men in local communities; digitalization of service delivery can reduce women’s time burdens in filing entitlement-claims and tracking application status; and e-health services can reach basic health care to older women or women living with disability who face constraints on mobility. At the same time, the gender digital divide – the gap between women and men in terms of access to connectivity – can itself emerge as a new factor of gender-based exclusion in governance systems. Therefore, if the benefits of the new digitalized governance paradigm are to reach women, e-government policy and programming should rest upon the following pillars (UN Committee of Experts on Public Administration, 2010): [17]

- Special attention to women’s access to ICT.
- Design of ICT and e-governance policies and strategies to integrate gender concerns.
- Equal opportunity to both men and women with information on, and access to, government services and programs.
- E-participation of women in political and democratic processes.

E-government can be an effective public policy instrument for promoting women’s empowerment and gender equality, as the introduction of digital technologies in government systems can help in overcoming traditional barriers to women’s inclusion in governance and public participation. But this requires public investment to:

- Create and distribute digital resources.
- Put in place mechanisms for women’s capabilities to transact in the new language of the digital.
- Continuously assess the context for appropriate channeling of resources and design of strategies.
- Directly engage with women from different social locations to ensure desired outcomes.

Gender-based outcomes of e-government are as important as their gender-inclusive design. The three main components of e-government (service delivery, citizen uptake and connectivity architecture) could bring about gender-transformative change at the individual and systemic level, and formal and informal domains of life. To see real transformational change for women and gender equality in BiH some institutional and structural reforms have to take place, some of which can be undertake through the following Domains of Change framework:

- Enhancing individual women's access to, and control over, resources: E-government interventions can promote women's access to resources (such as digitalized information, opportunities for connecting with others and building networks) as well as material resources (such as social welfare benefits, e-learning and skill-based training, scholarships etc.).
- Shifts in legal-policy frameworks: E-government can contribute to legislative and institutional reform that strengthen women's digital citizenship. The possibilities for policy intervention are immense and the imperative, immediate. They concern not only gender equality readiness in the technical sense, (such as, connectivity; digital literacy; laws on information, data, and service guarantees; e-participation infrastructure), but also with respect to sectoral policies and strategies of all ministries. Considerations about legal reform on gender based online violence may be one important aspect in many countries. Similarly, privacy online may be another. These foundational aspects are bound to influence sectoral interventions in e-government, whether they be in health or education or agriculture or Small and Medium Enterprises (SMEs).
- Transformation of the entrenched structures that shape gender norms in a society: such as customary beliefs, traditions and practices that justify and perpetuate women's gender stereotyping, subordinate status and gender-based discrimination. This transformation is difficult to bring about. However, e-government can be a game changer in opening up new opportunities for challenging retrograde norms and ushering in progressive change. E-government policy and practice can challenge and change social practices and norms that deny women their rights, within the policy space that effectively embrace a more transformative meaning of e-government. Normative shift through e-government can be implemented in many ways
- Through a rights-based approach that enables women's access to public information and services,
- Through interventions that specifically focus on networking, community building and peer support opportunities for women (such as online communities for victims of GBV).
- Through expansion of deliberative spaces to encourage women's voice in public policy making and feedback.

5.2.2 INFRASTRUCTURE AND ENERGY

230. ***Infrastructure Activities and SDG Alignment***: Infrastructure and energy investment are central to the attainment of many SDGs, contributing to a carbon-net-zero economy, improved competitiveness and service delivery, lower transaction costs and high rates of return to growth, revenues and employment. The SDG Framework states that BiH must not only increase the investment rate but also within the investment structure increase the share of public investments in infrastructure, at least in the amount of 5-7% of Gross Domestic Product. In the context of both economic and fiscal challenges, increasing the share of public investment in infrastructure will be substantially met through PPPs and other forms of blending. Investments in infrastructure and energy support the SDG Framework accelerators. The EU Green Deal and other energy related catalytic funds will need to be mobilized to support the government in the energy transition.

- ***Investment Rationale and Problems to be addressed***: Regarding investing in physical infrastructure for growth and inclusion, according to the World Bank (2020), BiH's transportation infrastructure has been deteriorating, reducing BiH's competitiveness. Road and railway quality is poor, affected by underinvestment by financially weak state-owned companies and inefficiencies in spending. Much of BiH's energy infrastructure is obsolete. BiH's economy is the most carbon and energy intensive in the region[61], requiring rebalancing toward a diversified, low-carbon mix with a greater role for the private sector. Well-prioritized

[61] With 0.56 kt of carbon dioxide emitted per dollar of GDP, more than three times the EU average WDI, accessed June 10, 2019; latest available data are from 2014 (World Bank, 2020)

investments in enabling infrastructure will be needed to enhance connectivity and provision of public services (World Bank, 2020). Moreover, reforms in the energy sector include support for a cleaner energy mix, tariff and subsidy reform to foster private sector investments and ensure a financially viable energy sector, upgrading the transmission network, and increasing energy efficiency through sustainable financing and implementation mechanisms (World Bank, 2020). Moreover, government will need to adopt a state law to create an effective energy market and encourage greater investment in to the sector.

- Deficiencies in energy infrastructure undermine the economic potential of the country, and this damage will increase as demand grows.[62] One-quarter of companies in BiH identify deficiencies in electricity supply as a major constraint on growth. Deficiencies range from high cost and long delays to obtain connections to the network to electricity outages generating losses and costs of back-up generators; 63 percent of firms experienced more than one electricity outage per month[63] Although BiH has vast potential for renewable energy (including hydro, solar, and wind), in 2017, coal accounted for 61% of primary energy generation. The energy sector is the leading contributor to greenhouse gas emissions and a major source of air pollution[64] (World Bank, 2020). Given the need to renew infrastructure, expand the infrastructural network and move stridently towards decarbonization and a move towards the green economy, the financing deficit is considerable.

- ***Current Status:*** Transportation infrastructure is not in line with the country's needs**.** The poor state of the road infrastructure increases travel time and costs for people and firms, limiting connectivity and the country's competitiveness. Because BiH is a small economy close to the large EU market, good connectivity is essential for the economy's competitiveness, but the quality of the transportation infrastructure is much poorer than that of its peers, characterized by poor road quality, due to underinvestment, inadequate maintenance, and poor project selection and implementation (Atoyan 2018), and low road density (34 km per 100 square km of land area, versus 41 in WB6 and 111 in EU) (Eurostat).

- Priorities for investment in new highways and roads are to complete the expressway and motorway links that make up the extensions to the Trans-European Transport Network and other routes prioritized through the South-East Europe Transport Observatory. Of these, completion of corridor Vc is the most important. For the national, regional, and local road networks, the priority is selective rehabilitation of the existing network with a focus on crucial bridge and tunnel assets (World Bank, 2020).

- Railways have the potential to contribute to greater connectivity, but they need to be improved. Railways are used to transport goods much more than in the rest of the Western Balkans (Eurostat), which demonstrates their potential, but outdated rolling stock and rails and, most importantly, inefficient operations severely hamper railways, with unsustainable costs (World Bank, 2020).

- The Public water and sanitation sector need to be improved. Only 58 percent of the population in BiH is connected to the public water supply network, and only 31 percent is connected to the public sewage network. Only 15 percent of the wastewater produced in the country is treated

[62] In the period of 2023-2030, BiH needs to build at least 1600 MW of new capacities to reach energy security. That is a huge task demanding the mobilisation of internal and external financial resources.
[63] Aligning infrastructure with net zero emissions requires additional public investments in the range of 0.5 to 4.5 percent of GDP cumulatively over the next decade, with most estimates clustered around 2 percent of GDP (IMF, 2021b) "Significant decarbonisation of the economy, especially power sector, with investments of approx. BAM 17 billion in the period until 2030, which is over 5% of GDP" (CoF, 2021:5)
[64] Carbon dioxide from solid fuels is 78% of total emissions, significantly higher than in other Western Balkan countries (12-65 percent) (World Bank, 2020)

before it reaches the country's rivers. Of all the water mobilized for citizen consumption, 59 percent is lost through leaks in the network (World Bank, 2020). Many of the existing regional sanitary landfills need to start planning and designing for additional waste disposal because of inefficient use, increasing volumes of waste, and initial lack of financing to expand beyond the first cell. (World Bank, 2020).

- In the case of solid waste management, even when regional sanitary landfills are available, there is lack of enforcement to use them, and the system faces high transportation costs. Ensuring the quality, supply, and sustainability of public services will require active leadership of entity authorities. Although it makes sense to place responsibility on authorities closest to final users provision of public services is a resource-intensive task in which economies of scale are essential. Addressing deficiencies in the sector will require exploiting economies of scale across municipalities, establishing performance standards for quality-of-service provision, and eventually setting tariffs closer to the cost of the service, which will require strong support from entity authorities (World Bank, 2020).

- ***Value-For-Money***: Infrastructure investments can deliver positive rates of return on investment, and importantly, with the correct investment mix, private capital can be used as key catalytic factor, through PPPs / blending and other investment mechanisms. Maximizing both economic and social rates of return will be guaranteed through the application of investment criteria. SDG Framework accelerator investments must therefore be (i) bankable (i.e., able to attract a combination of public and private financiers) (ii) demonstrable impact on growth on the real economy (iii) have proper Project Management and Governance Arrangements in place (iv) encourage private equity participation / private sector development (v) have sufficient cash flows and positive Net Present Value (NPV) and Internal Rate of Return (IRR) above the opportunity cost of capital (vi) be implementable in 12-36 months (vii) contribute significantly to employment and revenue and (viii) have a clear risk management and mitigation plan.

- ***SDGs Impacted***: Physical infrastructure is at the centre of the delivery of the SDGs. All SDGs are underpinned by infrastructure development. Transport contributes directly to five targets on road safety (Target 3.6); energy efficiency (Target 7.3); sustainable infrastructure (Target 9.1), access to public transport[65] (Target 11.2), and fossil fuel subsidies (Target 12.c) emphasize that sustainable transport is not needed solely for its own sake, but rather is essential to facilitate the achievement of a wide variety of SDGs. At the same time it is necessary to secure access to affordable, reliable and modern energy services (Target 7.1), increase substantially the share of renewable energy in the energy mix (Target 7.2) and improve energy efficiency (Target 7.3). Physical infrastructure should be built in a way that is sustainable and resilient (Target 9.6) and strengthen resilience and adaptive capacity to climate related disasters (Target 13.1).

- ***SDG Accelerators***: In terms of infrastructure and energy, the SDG framework targets (i) Resilient and inclusive public health infrastructure and institutions (ii) smooth function of key infrastructure (iii) development of transfer infrastructure (iv) increased public investment in infrastructure (v) ensuring equal access to modern transport infrastructure and, (vi) strengthening infrastructure of service providers by introducing new models (vi) decarbonization of the energy sector and (vii) green growth and clean energy.

- ***Investment Priorities***: The government is highly interested in attracting private sector investment in renewables and FBiH for example, is preparing a law on energy efficiency[66]. Beyond strengthening public investment planning capacities for infrastructure and energy

[65] For details see Brussel et al. 2019. Access or Accessibility? A Critique of the Urban Transport SDG Indicator, International Journal of Geo-Information , January.

[66] Republika Srpska adopted its law on energy efficiency in 2013 (Official Gazette no 59/2013 and 106/2015).

investment, a primary priority is to diversify the range of financing instruments and mechanisms used, leveraging entity budget finance with private capital. While development banks, international financing institutions and multilateral and bilateral funds will be important, so will guarantees and active de-risking measures where private capital is to be incentivized. Moreover, to build necessary capacities, it is proposed to request active support from the following global infrastructure services:

- ***The Private Infrastructure Development Group (PIDG)*** mobilizes private sector investment to assist developing countries in providing infrastructure vital to boosting their economic growth and combating poverty.

- ***The Public-Private Infrastructure Advisory Facility (PPIAF)***, which is a multi-donor trust fund providing technical assistance to governments in developing countries in support of the enabling environment conducive to private investment. PPIAF also supports governments to develop specific infrastructure projects with private sector participation.

- ***World Bank Global Infrastructure Facility (GIF)***: The newly established GIF is focused on expanding the universe of infrastructure projects that have the potential to mobilize private investment, through support across the project preparation and transaction process, to include infrastructure investments in power, transport, water and sanitation.

- ***Potential Financing Instruments***: According to the 2022-2024 ERP, road infrastructure projects and energy projects, as well as the availability of funds from international financial institutions, with adequate and timely implementation, could result in an annual increase in public investment of around 10% up to 2024. Thus, in the medium term, the share of public investment in GDP in Bosnia and Herzegovina would increase to about 4% of GDP up to 2027 (IMF; 2022). Approximately €3 billion in investments will be required to modernize power generation plants, install emission control equipment, and build new capacity in the next 20 years (Nikolakakis et al. 2019, according to World Bank, 2020). In addition, total investment needed to develop the electricity transmission network is estimated to be €350 million.[67] There is considerable potential for private investment in cost-competitive renewable energy, but several factors limit private participation, including political instability, an incomplete regulatory framework, public sector influence, and a lengthy permitting process (World Bank, 2020).

    - In the context of low public spending on infrastructure, debt financing is likely to figure heavily in both infrastructure and energy investments as will PPP modalities in financing, and tapping into the EU Green Deal and other funds, to fill the investment gap.

    - PPP financing modalities will likely include Build Operate and Transfer (BOT), Design-Build-Operate (DBO), Build Transfer (BT), Build Own Operate Transfer (BOOT) and Build Own Operate (BOO) models. These are for physical infrastructure.

[67] Framework Energy Strategy of BiH until 2015, published in 2017.

- Guarantees can also be provided, alongside first loss catalytic financing[68], as well as a combination of tax and non-tax incentives, including for energy Independent Power Purchase (IPP) arrangements and Power Purchase Agreements (PPAs).

- In addition, PPP opportunities include private waste management companies that construct the large-scale infrastructure necessary to provide collection, recycling, and landfill management services and public awareness campaigns, as well as municipal solid waste conversion technologies that transform waste into valuable commodities like clean energy to be used for electricity and heating, fertilizers, building materials, and cleaner burning fuels, while cutting pollution, reducing costly imports, and generating revenue from the sale of energy created.

231. Table 20 below provided a summary of primary accelerator investment actions for the infrastructure and energy priority investments.

Table 20. INFRASTRUCTURE AND ENERGY PRIORITY ACCELERATOR ACTIVITIES

#	Accelerator Action
1	Improving the PPP legal, regulatory, operation, pipeline planning and procurement environment, as well as developing an energy services performance contracting (ESPC) support system.
2	Infrastructure and Energy PPP Pipeline Development including Climate Adaptation Design
3	Implement the Law on Entrepreneurial Infrastructure, Development of Entrepreneurial Zones and Development of entrepreneurial support institutions.
4	Strengthen Operational and Maintenance Financing for Critical Infrastructure
5	Incentive Program for Entrepreneurial Infrastructure Development
6	Engage EU Green Deal, Vertical Climate Funds
7	Partnerships with PIDG, PPIAF and GIF
8	Assessments of potentials for different technologies and projects, development of step-by-step action plan for their initiation and implementation, as well as development of feasibility studies and preliminary project designs as basis for attracting investors and investments.

5.2.3 RESEARCH AND DEVELOPMENT

232. Although R&D and innovation are one of the most important conditions for competitiveness, the growth and progress of investment in BiH in this area is still very low compared to EU countries. Insufficient funds are the most common reason for the lack of innovative activities in companies in BiH. Due to a lack of skills, a fragmented labor market and a low level of integration into global knowledge flows and value chains, foreign direct investment is not targeted at knowledge-based sectors.

233. An additional challenge is the brain drain, because in attracting talents, BiH is losing the race with countries that offer better conditions. This is confirmed by the fact that in BiH the cooperation between universities and the R&D industry is not at the appropriate level because in this respect BiH is ranked 119th out of 132 countries, which is a significant weakness in this area. In addition to this, according to the Global Innovation Index 2021 (GII 2021), Bosnia and Herzegovina is ranked 75th out of 132 countries. These are indicators of the need for reforms in this area.

234. ***Investment Rationale and Problems to be addressed***: Increased R&D spending will provide BiH with solutions to socioeconomic problems through the development of new products and services or by improving existing ones. High-income countries have traditionally invested considerably into R&D however many middle-income countries like BiH are far behind in realizing the potential benefit

[68] There are investment projects that have strong potential for social or environmental impact, but they are perceived as having high financial risk. Tools such as first-loss capital can encourage the flow of capital to these projects by improving their risk-return profiles and, thus, incentivize others to invest.

that R&D can bring to the growth of green and circular economy agendas. While there is a risk that investing in R&D in the absence of the necessary social and entrepreneurial infrastructure may yield low level results, a focus on applied research that integrated socio and cultural factors into products and services would add value to international services and products already on the market.

235. ***Current Status:*** The research and development (R&D) sector of BiH is still in a rudimentary phase. The largest number of researchers are employed in the higher education sector (84.2%), the business sector (9.1%), the public sector (6.7%), while there are no employed researchers in the non-profit sector. Gross domestic expenditures for R&D in 2021 amounted to BAM 74.5 million, of which current expenses were BAM 62.0 million (83.2%), and investment expenditures were BAM 12.5 million (16.8%) (BHAS, 2023).

236. A number of countries have developed an extremely efficient research translation infrastructure. Germany has Fraunhofer Gesellschaft, the largest in Europe, Taiwan has ITRI, South Korea ETRI, Netherlands TNO, and the Great Britain Catapult Centres etc. In the case of BIH, the OECD (2009a) found that university-business linkages are not well developed and a range of policy initiatives, typically to establish research translation infrastructure are underway. These knowledge producers have not been yet developed and their linkages with companies remain very weak with the universities and businesses continuing in largely “separate worlds”. Currently, in BIH there are 13 innovation networks and intermediaries, which tend to be stand-alone initiatives and lack systematic links with other knowledge providers and businesses (Aridi and Lopez, 2019). Strategic documents relating to research translation infrastructure at the country, entity or canton level have yet to be developed. Nevertheless, Strategy for Scientific and Technological Development 2017–2021 in RS and the Strategy for Scientific and Technological Development under the Ministry of Education and Science in FBIH have certain scattered lines on this issue (Aridi and Lopez, 2019).

237. ***Value-For-Money***: Increased resourcing of R&D is important for BiH because it can provide vital knowledge and insights into overcoming problems, also leading to improvements in existing processes where efficiency can be increased, and costs reduced. It also allows both governments and businesses to develop new products and services to allow it to survive and thrive in competitive European markets. R&D can also be positioned to identify challenges to upgrading public investment, in understanding how the diaspora can add economic value, and which sectors are likely to be the engines of growth of a competitive economy, for example. R&D is also essential for branding.

238. ***SDGs Impacted***: Impacting SDG 9, BiH is pledged to build resilient infrastructure, promote inclusive and sustainable industrialization and foster innovation. Target 9.5 requires governments to encourage innovation and substantially increase the number of researchers, as well as public and private spending on research and experimental development. R&D will impact most SDGs either directly or indirectly. For example, SDG 11 aims to promote inclusive, safe, resilient, and sustainable cities and human settlements, implying a focus on managing urban development. Well-managed cities can – with incentives – be hubs of innovation and prosperity. R&D can also focus on gender (SDG 5), health and wellbeing (SDG 3), affordable and clean energy (SDG 7) and Climate Action (SDG 13), for example.

239. SDG Accelerators: In terms of research and innovation, the SDG framework focuses on (i) increasing investment in infrastructure, research, development, and innovations and, (ii) strategic investment in research-development activities of educational institutions.

240. ***Accelerator Priorities***: Developing incentives to increase public and private spending on R&D is a key priority. Encouraging cooperation of the scientific research and innovation community with the economy by financing projects that will find direct application in the economy will also be necessary, as will development of electronic platforms for connecting young scientific and research staff in the country and the diaspora, educational institutions and the economy. The adoption of the Smart Specialization Strategy of the Republika Srpska 2021–2027, establishment of the Centre for Science and Scientometrics, in cooperation with the National and University Library of the Republika Srpska and introduction of new study programs/short study programs provide examples of taking the SDG Framework and unpacking it into key accelerators.

241. ***Potential Financing Instruments***: While the formal private in most countries invest in R&D, it is assumed that the public sector will remain the anchor investor in the R&D space, entering into R&D partnerships globally and with corporations, while also encouraging international cooperation partners to provide catalytic capital for research hubs and institutes. R&D grant funding can also be developed as can venture capital fund / IFI support to finance R&D programs of high-risk and early-stage start-up businesses.

242. Table 21 below provided a summary of primary accelerator investment actions for the Research and Development Priority Accelerator Activities.

Table 21. RESEARCH AND DEVELOPMENT PRIORITY ACCELERATOR ACTIVITIES

#	Accelerator Action
1	Increased Government R&D spending
2	Strategic investment in research-development activities of educational institutions
3	Innovation Study Programs
4	Establish Research and Development Funds
5	Greater application of innovative processes or products
6	Increased R&D spending in Public Enterprises to Increase Efficiency
7	Incentivize tertiary students through scholarships for basic research, applied research and experimental development.

Chapter 6

New Financing Instruments

6. Financing Instruments and Mechanisms

6.1 Overall Enabling Financial Policy and Regulatory Needs

243. Innovations in sustainable financing have fundamentally changed the way governments are investing in sustainable development, and as many of these changes are global in nature and driven by Fintech and the digital economy, sooner or later these instruments will be available to BiH. Therefore, strengthening the regulatory regime for the next generation of instruments is important, requiring a high degree of regulatory and institutional synchronization. In this context, the following EU and global regulatory regimes and practices, taxonomies and road map examples provide proof of the ongoing transition as well as a useful reference point for strengthening the foundation for sustainable financing in Bosnia and Herzegovina:

- European Green Bond Standard.
- EU taxonomy for sustainable activities and Climate Change and Adaptation standards.
- Network of Central Banks Greening the Financing System (NGFS)
- OECD DAC Committee on Blended Finance Principles for Unlocking Commercial Finance
- UNDP SDG Standards Guideline for SDG Impact Standards for Bond Issuers
- Global ESG Disclosure Standards for Investment Products
- European rules on Corporate Sustainability Reporting
- IFC Sustainable Bonds: Bridging the Gap for Gender Equality
- UAE Sustainable Finance Framework
- EU Digital Services and Digital Market Acts
- UNDP Digital By Default to accelerate digital transformation in the public sector.

244. These examples are provided for consideration, adoption and adaptation over the life of the BiH SDG Financing Framework. Given the centrality of the EU Integration Agenda, adoption of EU standards is a priority.

6.2 Priority Financing Instruments and Mechanism

6.2.1 Digitalization Financing

245. As a primary area of investment, in line with the SDG Framework and based around the Digital-By-Default approach, the financing deficit for the evolution to a digital future is considerable, and is to be borne by the public and private sectors, based on a combination of budgetary spending, concessional loan, debt, private equity and blended financing.

246. It is necessary to balance financing of ***enabling legislation on the one hand*** (eg. EU standards, laws on cyber security, Security of Network and Information Systems, Basic Law on Electronic Signatures, Electronic Identification and Trusted Services for E-transactions) and ***strategy development***[69] ***on the other hand.***

247. As digitalization reduced costs and increases productivity, develops better products and services, supports market expansion and diversification, provides greater access to strategic resources, encourages innovation, supports an online platform economy and climate action, private sector financing has a lead role to play in resourcing. Digitalization is cross cutting to all SDGs, though it will have a particular impact on health (SDG 3), education (SDG 4), gender equality (SDG 5), reduced inequalities (SDG 10) and peace, justice and strong institutions (SDG 16).

[69] Eg. E-Government Development Strategy and Broadband Access Strategy, Public Administration Reform Strategic Framework and Financial Inclusion Strategy

248. The largest cost in the digitalization of government, society and the economy relate to the execution of the above-mentioned strategies. Creating a single digital market, digital government including eServices, eDelivery and ePayment systems, skills development and application of digital technology, as well as the digitalization of the entire economy to support financial inclusion, will take the best part of a decade to resource and implement.

249. Digital transformation[70] financing of the public sector[71] and economy and skills acquisition (pre-dominantly private equity supported by blending, de-risking and incentivizing) will ramp up once resources and anchor investors are identified in 2023.

Digitalization Financing Needs / Funding Gap:

250. The financing gap for digitalization over the short (2023-2025) and longer term (2026-2030) are BAM 18.7 million and BAM 78.05 million respectively.[72]

Financing Instruments:

251. Table 22 below provides an overview of the primary financing instruments that could be established under the digitalization priority area.

Table 22. DIGITALIZATION FINANCING INSTRUMENTS, 2023-2030

Priority Actions	Spending (In Billion BAM)	Potential Financing Sources
▪ Enabling Legislation (normative legislative and regulatory development costs	Total: 1.35 (Spending/Combined GDP=1.35/354.7=0.4%) (1.3 = 1.25 of existing spending per scenario „business as usual“ + 0.0967 of additional spending per scenario „acceleration SDGs“)	Public Budgets and ODA (i.e. EU IPA III)
▪ Strategy development		Public Budgets and ODA
▪ Implementation of 6 pillars of Information Society		Public Budgets, SOEs, Social Impact Bonds,[73] Venture Capital Funds, Catalytic First Loss Capital, ODA, Guarantees and debt instruments, Corporate Philanthropy
▪ Digital transformation of the		Public Budgets, ODA and concessional loans

[70] As BiH embraces the digital age, digitization, digitalization and digital transformation have become an important horizontal agenda, and have been identified here as a critical investment cross-cutting all SDGs. Digitization refers to creating a digital representation of physical objects or attributes, and is therefore foundational to digitalization and the digital transformation. Digitalization refers to the enabling or improving business processes by leveraging digital technologies and digitized data. Digitalization therefore assumes digitization. Digital transformation requires both digitization and digitalization to have occurred, and digital transformation means the transformation of both public and private sector business processes enabled by digitalization, towards new revenue and value-producing opportunities. In this DFA, digitalization therefore is implies digitization, as a contribution to longer term digital transformation.

[71] The EU Digital Agenda aspires to establish e-government and e-services as the dominant models of operation of public administrations of its Member States by 2020, the public administration system in Bosnia and Herzegovina should not allow overly long delays (PAR SF).

[72] Four years after the adoption of strategic framework on public administration reform (PAR SF) 2018-2022 in 2018, and the related PAR action plan 2020-2022, no systematic implementation of the PAR action plan has started yet, there is no performance-based monitoring, and there is no information on financing gap including on the public sector digitalisation (European Commission, 2022).

[73] How social impact bonds could be used for digitalization financing clearly demonstrates the following example. Since the Belgian labour market is currently experiencing a shortage of digital skills, digital training for people who are far from the labour market is organized. The program is organised and financed (2.5 million euro) via a Social Impact Bond. This means that private investors pre-finance this social intervention (the digital training programme) with a loan for 5 years. This loan is repaid by the Public Employment Services (PES) to the private investors with interest if the programme reaches its objectives. If the programme is unsuccessful (an external evaluation determines whether the project has reached its goals), the risk of the financing remains with the private investors. Either way, the operator, BeCode, receives the full budget to develop the project (for details see "Social Impact Bond (SIB)": https://ec.europa.eu/social/BlobServlet?docId=24956&langId=en).

public sector		
▪ Digitization of the economy	Until the 2030. it is necessary to ensure average yearly additional 12.09 mill. BAM (=0,0967 billion/ 8 years)	Syndicated Loans, Tax and non-tax incentives, Blockchain / Impact, Private Equity, Social Impact Bonds, SDG Bonds, Guarantees, Venture Capital Funds, Apex Financing for SMEs, Capital and Micro Finance, Crowdfunding
▪ Skills and talent development and acquisition		Public Budgets, Grants, Corporate Philanthropy and Philanthropic Funds
▪ Funding to Financing Strategy		Grants / ODA

Anchor Investors:

252. The primary anchor are the entities of the BIH in terms of digitization of the economy, in skills and talent development and acquisition in particular, bilateral (i.e., GIZ, KfW etc.), multilaterals (i.e., EU) for grants and concessional loans and the IFIs (i.e., IFC, World Bank, EBRD etc.) for concessional loans.

253. Major corporate financiers including telecoms, commercial banks and Fintech companies will make major investments in the market place. The proposed (in further text) Apex structure can provide credits to SMEs.

Mobilization Approach:

254. For legislation and regulations, support will be aligned to the funding mechanisms described in the ERP and financed from the budgets of BiH Institutions and entities.

255. For the private sector a Digital Transition Fund could be established, as has been done in Ireland, bringing together government and ODA partners funds, to be catalytic investors in the digital transition with a particular focus on investing in SME in their digital journey. The fund would help SMEs assess their state of readiness, and provide matching-grants for firms transitioning in key sectors.[74]

Potential for Blending:

256. Blended finance approaches can be important to maximize the catalytic impact of development finance by sharing risks and/or lowering costs to adjust risk-return profiles for private investors. They can create important demonstration effects that narrow the gap between actual and perceived risks of investing in these markets.

257. For instance, USAID launched Digital Invest, a new blended finance program that seeks to mobilize private capital for digital finance and internet service providers (ISPs) serving traditionally excluded consumer populations worldwide.[75]

6.2.2 Infrastructure & Energy Financing

258. The infrastructure deficits and the need to transition energy call for new ways of financing the energy transition (generation levels hover around two-thirds coal to one third hydropower) and critical infrastructure needs (including Entrepreneurial Infrastructure), though a combination of sovereign and municipal bonds, the proposed Strategic Investment Fund (with the private sector component in addition to the public sector component), syndicated loans and infrastructure bonds, PPP concessions

[74] As part of Ireland's National Recovery and Resilience Plan, the Digital Transition Fund has driven transformative digitalisation of enterprise in Ireland, particularly amongst SMEs. The programme helps companies at all stages of their digitalisation journey (see more at https://enterprise.gov.ie/en/what-we-do/supports-for-smes/digital-transition-fund/)
[75] https://www.usaid.gov/news-information/press-releases/apr-27-2022-usaid-launches-digital-invest-program-mobilize-private-capital

and Independent Power Generation (IPA) and Power Purchase Agreements (PPAs), the EU Green Deal, energy saving insurance and corporate philanthropy will be required. Subsidies, guarantees, private equity funds and SME finance all contribute.

259. Given that BiH has considerable hydropower and renewables potential, and a net exporter, the EU wide energy crisis provides a bankable investment opportunity for the country. This supports the SDGs on Energy (SDG 7), Industry, Innovation and Infrastructure (SDG 9), Sustainable Cities and Communities (SDG 11), Climate Action (SDG 13) and Partnerships for the goals (SDG 17)

260. Bearing in mind existing constraints on public sector budgets (which lead to insufficient fiscal resources for the SDGs), private capital will be very important for closing the financing gap. In particular, large investments to upscale Public Private Partnerships (PPPs)/concessions is considered an effective way of transferring life-cycle costs of infrastructure off public-sector budgets and simultaneously creating investable assets for the private sector.

261. Primary areas of engagement include strengthening the legislative and regulatory framework, developing an energy and infrastructure PPP pipeline of bankable investments, developing an energy services performance contracting (ESPC) support system and availability and need for feasibility studies.

262. The development of entrepreneurial zones and support systems, as well as incentives packages for entrepreneurs remains a priority as does developing an energy transition financing plan and strengthening infrastructure investment partnerships (i.e., PPIAF and GIF)[76] as well as strengthening entity level feasibility study capacities.

263. Given that BiH is more than four times as energy-intensive as the average in EU countries and has the highest energy intensity in the Western Balkans, with the residential sector being responsible for the highest share of total final energy consumption, energy efficiency measures are essential.

Infrastructure and Energy Financing Needs / Funding Gap:

264. The financing gap for infrastructure and energy over the short (2023-2025) and longer term (2026-2030) are BAM 274.8 and BAM 1,144.8 million respectively.

265. BiH needs to finalise and adopt the national energy and climate plan (NECP) 2021-2030, which would contain information on financial resources needed for energy transition financing and their sources.

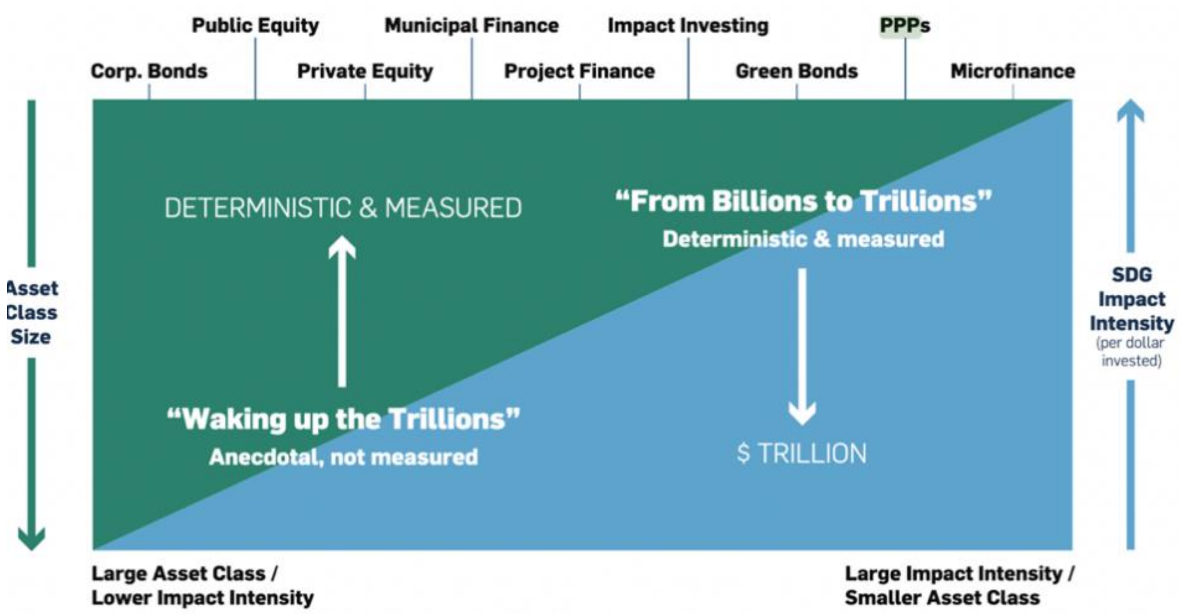
Financing Instruments:

266. The primary financing instrument would be budgets[77] from public sector companies, public guarantees, the SIF, sovereign and municipal bonds, syndicated loans, ODA catalytic finance and various kinds of insurance including EU Accession Funds and credit lines. The EU Green Deal combined with the use of climate vertical funds would support the transition to a decarbonized future. PPP concessions to private companies for both energy and infrastructure have considerable potential.

[76] The World Bank's the Public-Private Infrastructure Advisory Facility (PPIAF) helps developing-country governments strengthen policies, regulations, and institutions that enable sustainable infrastructure with private-sector participation.
The Global Innovation Fund (GIF) is social impact-first investment vehicle that works with mission-aligned development agencies, philanthropy, and other funders to find and fund evidence-based innovations with the potential to positively impact the lives of millions of the world's poorest people. The GIF is a non-profit, impact-first investment fund headquartered in London with offices in Washington, D.C., Nairobi and Singapore.
[77] Support schemes in the Federation entity are based on outdated feed-in tariffs, while the Republika Srpska entity introduced auctions (European Commission, 2022).

267. Given the size of the SDG financing gap, a critical focus will be on identifying instruments that can be deployed at scale. Figure 6 below provides a useful frame of reference in this regard, highlighting the important of mainstreaming SDG tools into both public and private markets.

Figure 6 ASSET CLASSES AND SCALING GREEN AND SUSTAINABLE INVESTMENTS



Source: SDG Bonds: Leveraging Capital Markets (UN Global Compact, UNDP), 2019

268. As a result, the Road Map would primarily focus on market-based solutions where possible, through the introduction of new and innovative instruments with a focus on large assets class size mobilization. Table 23 provides an overview of the primary instruments for key actions as outlined in the previous chapter and above.

<table>
<tr><th colspan="3">Table 23. ENERGY AND INFRASTRUCTURE FINANCING INSTRUMENTS, 2023-2030</th></tr>
<tr><th>Priority Actions</th><th>Spending
(In Billion BAM)</th><th>Potential financing Sources</th></tr>
<tr><td>▪ Improve PPP Environment and Capacities</td><td rowspan="8">Total: 19.7

Spending/Combined GDP=19.7/354.7=5.6%)

(19.7 = 18.3 of existing spending per scenario „business as usual“ + 1.41 of additional spending per scenario „acceleration SDGs“)

Until the 2030. it is necessary to ensure average yearly additional 177.44 mill. BAM
(=1,41 billion/ 8 years)</td><td>Public Budgets and ODA (IPA III)</td></tr>
<tr><td>▪ PPP Pipeline Development and Climate Adaptation Design</td><td>Public Budgets, Project Finance ODA, IPA III, Energy Saving Insurance (ESI), Dedicated credit line for RE or EE, Utility consumer financing, corporate power purchase agreements
Private sector Energy and Infrastructure investments</td></tr>
<tr><td>▪ Law on Entrepreneurial Infrastructure, Development of Entrepreneurial Zones and entrepreneurial support institutions</td><td>Public Budgets, Project Finance ODA (IPA III), SIF, syndicated loans, SDG bonds and credit guarantee funds, SME financing,</td></tr>
<tr><td>▪ Strengthen Operational and Maintenance Financing</td><td>O&M Fund</td></tr>
<tr><td>▪ Program for Entrepreneurial Infrastructure Development</td><td>Development and social impact bonds</td></tr>
<tr><td>▪ EU Green Deal and Vertical Funds</td><td>Public Budgets, Vertical Climate Funds, Carbon Markets and ODA</td></tr>
<tr><td>▪ PIDG, PPIAF and GIF Partnerships</td><td>Public Budgets and ODA</td></tr>
<tr><td>▪ Feasibility Studies</td><td>Public Budgets and ODA</td></tr>
</table>

***Anchor Investors*:**

269. The public sector will remain the primary investor in energy and infrastructure though blended financing with PPPs could become the primary route for crowding in private capital. Debt financing, the SIF, syndicated loans, potentially mezzanine financing for energy buyouts and acquisitions, and support from the IFIs, bilateral and multilateral agencies could provide catalytic support and de-risking / guarantees.

***Mobilization Approach*:**

270. Working through the concession commissions and relevant ministries of finance, international cooperation partners will be encouraged to provide both financial and technical support to upgrade the legal and regulatory environment and increase legal harmonization in line with the EU acquis and OECD Principles for Public Governance of Public-Private Partnerships (in order to protect the public interest in the conduct and control of implementation of PPP projects).

271. New modalities of PPPs can provide incentives (without distorting the market) to attract potential investors, tipping the balance of risks to rewards, while maintaining transparency. PPP financing, as shown by good practices of many countries, can be mobilized by developing a full PPP pipeline of bankable energy and infrastructure investment projects, and with the use of transaction advisors and market testing to limit contingent liabilities.

***Potential for Blending*:**

272. Blending can be the important source of financing for future energy and infrastructure investments through various forms of service, management, leasing and concession contracts, build, operate, transfer (BOT) build, own, operate, transfer (BOOT), build, own, operate (BOO) and Design-Build-Finance-Operate (DBFO) models.

273. Private sector projects concessional finance—the combining of concessional funds with other types of finance, on commercial terms—is increasingly used to mobilize capital and accelerate high impact private sector investments.

274. With this model of "returnable capital" principal, interest, and other amounts are repaid to the original provider of funds (usually a donor government) on a regular basis. Because this can reduce the impact on donor government budgets, more government funds could become available for collaboration with the private sector[78].

275. At the municipal level, new models for concession for the development, modernization, expansion, energy-efficiency, operation and maintenance of the lighting networks will be considered, with a focus on value-for-money, managing risk transfers, performance standards and public assets maintenance.

6.2.3 Research and Development Financing

276. Encouraging innovation is a vital component in a strategy for improving BiH's productivity, performance and competitiveness. While increasing research and development spending is critical, the sources of financing and financing instruments remain rather limited, with public sector financing expected to provide over two thirds of total support. It is indispensable to increase government spending

[78] Karlin, A. and Kruskaia, S-E., 2019. Blended Concessional Finance : The Rise of Returnable Capital Contributions. EMCompass,no. 72;. International Finance Corporation, Washington, DC.

on R&D, though support from ODA partners and corporate philanthropy will be incentivized, alongside direct financing by the larger private sector.

277. Strategic investment in research-development activities of educational institutions, innovation study programs, encouraging greater innovation processes and products, innovation funds to increase the efficiency of public enterprises, establish scientific innovation funds and incentivize tertiary students through scholarships will reduce the outflow of talent, and encourage greater innovation and competitiveness.

278. R&D financing will impact industry, innovation and infrastructure (SDG 9), sustainable cities (SDG 11), gender (SDG 5), health and wellbeing (SDG 3), affordable and clean energy (SDG 7) and Climate Action (SDG 13).

***Research and Development Financing Needs / Funding Gap*:**

279. The financing gap for research and development over the short (2023-2025) and longer term (2026-2030) are BAM 50.0 and BAM 208.4 millions respectively.[79]

***Financing Instruments*:**

280. In increasing government-financed gross expenditure in R&D (GERD), both entity and canton levels need to lead the process. R&D funding involves direct transfers from government (entity, canton etc.) in the form of contracts, grants or donations (excluding repayable loans to enterprises for conducting R&D) for the coverage of current costs (mainly R&D personnel labor costs and non-capital expenditures on materials, supplies, etc.), and capital expenditures (investment in fixed assets) for performing R&D.[80]

281. As noted above, public sector financing is key to increased R&D spending, and in addition to financing grants and scholarships, instruments such as R&D tax credits can be used to increase private sector innovation financing.

282. Innovation and Development Funds (as a blended instrument funded by government and private sector) could be established and developed[81] alongside a Voucher Scheme to include R&D incentives for both SMEs and large companies to enhance, encourage and reward greater innovation.

283. R&D tax credits can target key areas of growth, and investments can develop common meeting places where academics, investors (including venture capitalist etc.), economists and investment experts can meet, as a locus for action[82]. Allocation modalities will need to be considered, for final instruments adopted. Table 24 provides a summary of the primary financing instruments for actions proposed.

Table 24. RESEARCH AND DEVELOPMENT FINANCING INSTRUMENTS, 2023-2030		
Priority Actions	**Spending (In Billion BAM)**	**Potential Financing Sources**
▪ Increased Government R&D spending	Total: 3.59 (Spending/Combined GDP=3.6/354.7=1%)	Budget reallocation to increase from 0.2% of GDP to around 0.4% by 2025 and at least 1.0% in 2030 at entity and canton levels. Partnerships with philanthropic and EU regional research funds is necessary.

[79] On research and innovation policy, no action plan was in place from 2017 till 2022. BiH needs to develop and adopt a new strategy and action plan for scientific development (2022 – 2028) (European Commission, 2022).
[80] Public Financing Research Taxonomy of public research-funding apparatuses
[81] In 2023, BiH should in particular adopt the roadmap for research infrastructure (European Commission, 2022).
[82] The collaboration of SMEs and research institutions is not sufficiently developed to create conditions for the application of innovative financing models like innovation vouchers or collaborative grants. The needed amendment to the patent law could improve both collaboration and financing of innovation activities for higher value-added business (European Commission, 2022)

<table>
<tr><td>▪ Strategic investment in research-development activities of educational institutions</td><td rowspan="6">(The African Union strongly urged member States to promote R&D by allocating at least 1% of GDP while the EU target is 3%)

(3.59 = 3.33 of existing spending per scenario „business as usual“ + 0.2581 of additional spending per scenario „acceleration SDGs“)

Until the 2030. it is necessary to ensure average yearly additional 32.26 mill. BAM
(=0.2581 billion/ 8 years)</td><td>Public R&D grants, philanthropic organizations. Innovation and Development Fund (public and private matching grants)</td></tr>
<tr><td>▪ Innovation Study Programs</td><td>Public R&D grants</td></tr>
<tr><td>▪ Establish Scientific Innovation Funds and Scientific and Research Parks, as centers of excellence</td><td>Public Grants, ODA support and philanthropic organizations</td></tr>
<tr><td>▪ Greater application of innovative processes or products</td><td>Program and Project funding grants, R&D tax credits and Performer funding grants, Apex Fund</td></tr>
<tr><td>▪ Increased R&D spending in Public Enterprises to Increase Efficiency</td><td>R&D tax credits, accelerated amortization</td></tr>
<tr><td>▪ Incentivize tertiary students through scholarships for basic research, applied research and experimental development.</td><td>Scholarships and tuition waivers, and R&D tax credits, corporate philanthropy</td></tr>
</table>

***Anchor Investors*:**

284. Public investment in R&D will need to increase to at least 1 per cent by 2030 requiring strengthening the public research-funding apparatus and its structured instruments of funding. Through R&D tax credits private (including SMEs) R&D funds can be incentivized, and the EU institutions could be providing technical assistance to support the process.

285. Charitable and philanthropic organizations such as the Berlin Institute of Health at Charité (BIH) provide an example of private support to R&D that should be expanded through incentives.[83] Remittances can also be incentivized to support R&D, as is encouraged under PARE 1+1.[84]

***Mobilization Approach*:**

286. It is necessary to adopt science and innovation strategies and action plans showing how financial resources can be mobilised for the development of the entire public research-funding apparatus and its structured instruments, allowing a funding and financing strategy to link to new resourcing targets. This would link funding and financing to key areas where innovation is needed, in line with the SDG Framework. A Joint Research Center could be established, with public and private philanthropy and linkages with the European Research Council, European Innovation Council and European Institute of Innovation and Technology would be made.

***Potential for Blending*:**

287. There is limited potential for blending instruments, though PPP allowances for R&D can be considered and tax credits can incentivize private research into services, industry and products. The Israeli government Innovation Authority – for example – provides income-linked R&D grants.[85]

---

[83] https://www.bihealth.org/en/research/funding
[84] The Pare 1+1 is the Government of Moldova's Program on Attracting Remittances into the Economy (PARE 1+1) that aims at channelling remittances into micro, small, and medium enterprise development. The program is intended for migrant workers and / or their first-degree relatives who wish to invest in launching and / or developing their own business.
[85] https://forskningsradet.pameldingssystem.no/blended-finance

6.2.4 OVERVIEW OF SHORT- AND LONG-TERM INSTRUMENTS

288. Table 25 below provides an illustrative overview of the projected financial value for the key and complementary instrument that can be placed in the function. For different instruments proposed here, the size depends on the fiscal space, liquidity and incentives of different financiers.

Table 25. INDICATIVE FINANCING INSTRUMENT SIZE, 2023-2030

PROPOSED FINANCING MECHANISMS /INSTRUMENTS	The projected financial value for the instrument to be put into the function (in million BAM)	Potential for additional mobilization from the public sector and crowding-in from the private sector (in million BAM)
(Main) Mechanisms / Instruments		
Strategic Investment Fund (SIF)	500	2500
Syndicated Loans	300	3600
Apex SME Financing	100	1000
SDG Bonds	100	500
Complementary Mechanisms / Instruments that could be imposed also in the short term	**Priority areas**	
Digital Transition Fund	Digitalization	
State Guarantees	Digitalization Research and Development	
Credit Guarantees for SMEs	Digitalization, Research and Development	
O&M Fund[86]	Digitalization, Research and Development	
R&D Tax Credits	Digitalization, Research and Development	
PARE 1+1 & PARE 1+2	Digitalization, Research and Development	
Corporate Philanthropy	Digitalization, Research and Development	
Vertical Funds	Digitalization, Research and Development	
Social Impact Bonds	Digitalization, Research and Development	
IFI Concessional Loans	Infrastructure and energy, Digitalization, Research and Development	
Long Term Mechanisms / Instruments	**Priority areas**	
Central Bank Digital Currency (CBDC)	Digitalization	
Crowdfunding (donations and equity financing)	Digitalization, Research and Development	
Equity investment	Digitalization, Research and Development	
Catalytic Fist Loss Finance	Digitalization, Research and Development	
Double-leveraged Mezzanine Finance	Digitalization, Infrastructure and energy	
Energy Saving Insurance (ESI)	Infrastructure and energy	
Energy Cooperative	Infrastructure and energy	
Carbon Markets	Infrastructure and energy	
National Property Catastrophe Insurance Pool	Infrastructure and energy	
Commercial Bonds	Infrastructure and energy, Digitalization	
Trade finance	Infrastructure and energy, Digitalization, Research and Development	
Public equity fund and crowdfunding (including equity crowdfunding)	Infrastructure and energy, Digitalization, Research and Development	
PPPs Funds	Infrastructure and energy, Digitalization, Research and Development	
Cross Border Infrastructure PPPs	Infrastructure and energy, Digitalization, Research and Development	
Gender Bonds	Infrastructure and energy, Digitalization, Research and Development	
Project Bonds	Infrastructure and energy, Digitalization, Research and Development	

[86] Operations and Maintenance Funds are stand-alone funds funded by government, partners and perhaps revenue offtake at a specific percentage and later to invest into current and investment maintenance to maintain functionality and values of built assets and used capital equipment.

6.3 Proposed Short-Term Financing Mechanisms and Instruments

289. This section provides a high-level summary of the four major instruments to be prioritized as short-term instruments, covering the SIF, bonds, syndicated loans and Apex Financing Structure for SMEs[87]. Individual concept notes and a taxonomy of sustainable financing instruments has been developed to support this exercise and these can be used during the execution phase.

6.3.1 Strategic Investment Fund (SIF)

290. SIFs are strategic investment funds that can be established as different administrative levels, including at the state, entity or canton level, for example, or even incorporated into existing entity level development bank / bank driven funds. Once established any SIF would provide a significant source of financing energy and infrastructure priorities in particular.

291. Incorporating sustainable development principles (and ESG standards) into SIFs – and issuing green and sustainable financing instruments – SIFs could lead the charge in pioneering new and innovative ways of financing to support accelerated SDG achievement and building back better.

Rationale and Objective:

292. Unlike many other Strategic Investment Funds (SIFs), any SIF initiated in BiH will not only re-invest domestic funds, it could also seek to attract foreign co-investors to help fund economic development.

293. While the primary function of any SIF would be to support a number of growth-related Sustainable Development Goals (SDGs) SIFs could also generate wealth for future generations, by soliciting catalytic financing partners and adding value by signaling to the market that BiH is open for investment.

294. The mission of any SIF – established at state, entity or sub-entity levels - could be to develop strategic investments and help narrow the gap between the domestic funding capacity and the need for development programs, in support of the resourcing of the SDG Framework.

Expected Benefits:

295. Any SIF would allow both public and private funds to be integrated in the support of various blended financing instruments, to pioneer new ways of investing as foreseen by the global integrated financing framework approach.

296. SIFs would help increase market integration and financial deepening to support BiH's EU Membership, and as a mixed capital fund, in addition to public entities the fund would be invested in by commercial entities to strengthen the emergence of a Common Regional Market and EU Single Market.

297. SIFs would also work to strengthen the regulatory and corporate governance environment to ease doing business and increase market competitiveness.

Policy and Regulatory Requirements:

298. No additional policy or regulatory requirements are needed though agreement between the entities/cantons/municipalities on funding contributions would be required, supported by fund governance rules.

Financing:

[87] For details see Tabel 32.

299. With a starting capital of BAM 300 million, the BiH public sector institutions (municipalities, cantons, entities, district, BiH institutions and public companies) interested in establishing a SIF leading to an initial endowment of BAM 500 million with the additional capital from the domestic private sector (banks and LSEs) in the amount of BAM 200 million. Co-investors from abroad would provide matching funds equaling BAM 500 million.

300. As the SIF would envision to have total liabilities and capital of BAM 3 billon for the period 2023-2025, an additional BAM 2 billion could be mobilized by issuing SDG/Green bonds (primarily for the citizens and other the private sectors' actors) and having credit lines extended by international or national development banks.

301. Properly structured and managed the SIF could become an effective vehicle for crowding in private investors to priority investments, thus magnifying the impact of public capital.

Target Areas:

302. New instruments emerging from the SDG Financing Framework Road Map could be pioneered by the SIF, including introducing thematic bonds, new public private partnership modalities, new climate and energy financing instruments, for example.

303. SIFs would help lead the necessary project financing revolution, carrying out specific analysis (cost-benefit analysis, investment pipeline development etc.) and investing in large-scale bankable infrastructure projects.

304. SIFs would change the entire investment landscape, deepening financial markets and acting as a draw for foreign direct investment, while aligning with and executing the European Green Bond Standard, EU taxonomy for sustainable activities and Climate Change and Adaptation standards, while also promoting corporate sustainability reporting, sustainability preferences and fiduciary duties.

305. SIFs would also invest in or provide financing to companies on a commercial basis, to help expand and develop the economy in prioritized sectors such as renewable energy in the first phase (large scale utility solar and wind farms). In accordance with that, at whatever level established, SIFs could also provide long-term patient capital as equity, quasi equity and debt.[88]

306. Possible target sectors and sub-sectors of any SIF fund are outlined in Table 26 below.

Table 26. SIF's Target Sectors and Subsectors

Renewable Energy	Resource Efficiency	Environmental Industries	Rationale
Solar, Wind, Biomass, Sustainable biofuels, Hydro, Waste to energy, Geothermal, Hybrid power systems, Energy Storage and switching to renewable fuels	Energy Service Companies, Energy Efficiency, Advanced materials, Transmission lines, Smart Grid, Combined heat and power, Storage, Green Buildings, Transportation improvements	Process technologies and Equipment manufacturing, assembly and distribution for industries within target sectors	Boost the country's renewable energy mix through use of first loss catalytic financing. Promote clean energy sources and use Increase grid-connected renewable energy Projects.

Source: FONSIS

Responsible Actors and Structure:

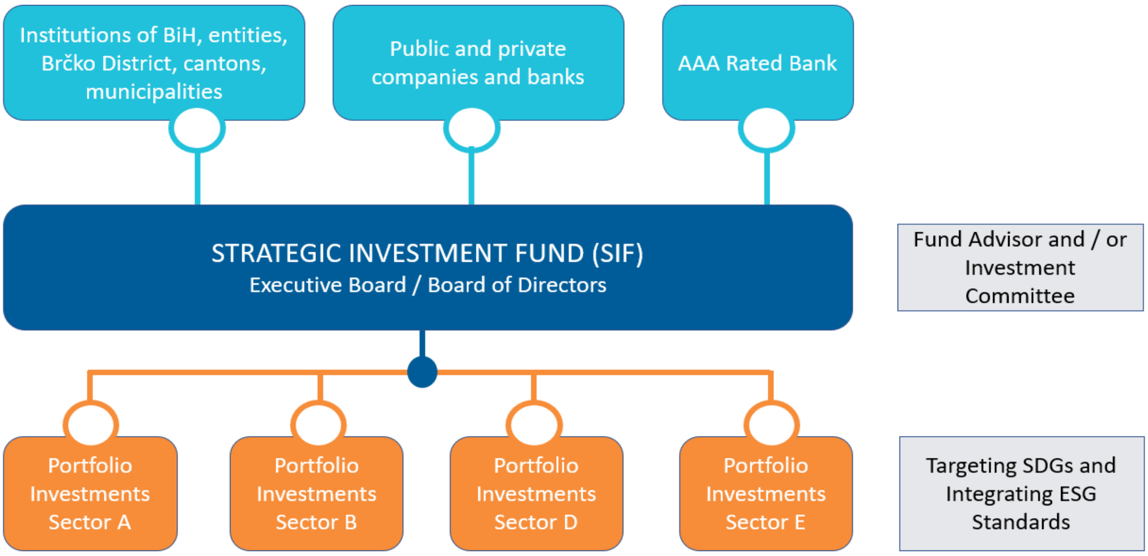
[88] The patient capital is a specific type of long term capital, characterized by (i) willingness to forgo maximum financial returns for social impact, and an unwillingness to sacrifice the interests of the end customer for the sake of shareholders, (ii) greater tolerance for risk than traditional investment capital, (iii) longer time horizons for return of capital, and (iv) intensive support of management as they grow their enterprise

307. While the SIF outline provided below would be for a countrywide SIF, it is acknowledged that a single or multiple SIFs could be established at any administrative level, and that a unified approach may not be possible or ultimately desirable. **The state and each entity and Brčko District will need to deliberate over the best administrative level for such an instrument**.

308. A simplified governance structure shows how equity shareholders would capitalize the SIF. Fund Governance would be provided by an Executive Board, Board of Directors, and be supported by a Fund Advisor and / or investment committee. The fund would support SDG acceleration, within a sustainable investment framework.

309. In terms of fund development, a team tasked by the leading public sector's institution would be appointed. Afterwards, a member team tasked by the equity shareholders would be responsible for SIF establishment. Figure 7 below provides an illustrative governance structure for a unified SIF, though should this be developed at the entity or sub-entity level, ownership arrangements would change.

Figure 7 **ILLUSTRATIVE SIF GOVERNANCE STRUCTURE**



Risks:

310. The SIFs investment and safeguards policy would set target returns to provide visibility, hold the SIF accountable to its investors, and discipline the manager's search for deal opportunities. Gender, environmental fiduciary and other safeguards would be established.

311. SIFs would operate like the private equity funds (limited fund life and focus on one specific layer of the capital structure, such as equity or loans), with a minimum of 5 percent annual return on investment.

Next Steps:

312. Beyond building consensus on the establishment of any SIF at the respective political and administrative level, the following additional key decision points are required: [89]

- The identification of entities serving as the SIF's legal owners; the B-H institutions of public and private sector and a foreign triple-A bank.

[89] Divakaran, S, Halland, H, Lorenzato, G, Rose, and Sarmiento-Saher, S. 2022. Strategic Investment Funds - Establishment and Operations. Washington, D.C.: World Bank.

- The identifications the fund's oversight mechanism; i.e., a board of directors to closely monitor the SIF's adherence to the triple bottom line mandate, while buffering the manager from too much interference by the owners.[90]
- The selection of board members according to clearly outlined criteria, with emphasis on professional experience and fit and proper assessments.
- The board would be chaired by an independent director and board members would be independent (unaffiliated with owners);
- The identification of the SIFs management model; signaling the SIFs commercial orientation by employing a well-reputed manager selected by a competitive process or by ensuring that the SIFs chief executive officer and staff have strong private sector investment backgrounds, and,
- Agenda 2030 SDGs and ESG Standards would need to be closely aligned with the governance and regulatory arrangements for the fund.

Among the founders' first responsibilities – at whatever administrative level SIFs would be established - will be:

- Determine how to balance potentially conflicting financial and socio-economic goals.
- Articulate the additionality the SIF would bring to the market and to government infrastructure, and,
- Validate the SIF s viability and its coherence with SDGs / ESG and development policies by submitting the proposed idea to the rigor of a feasibility study.

6.3.2 SYNDICATED LOANS

313. Syndicated loans (debt financing) arise when a project (for example in energy or infrastructure) requires too large a loan for a single lender or when a project needs a specialized lender with expertise in a specific asset class.

314. Given that the borrower can be a corporation, a large project, or a governments, there is both a need and considerable potential for scaling this instrument to support the digitalization and energy transitions, and to invest in key infrastructure investments.

Rationale and Objective:

315. The interest and resources to promote commercial solutions that can close important financing gaps in infrastructure, climate change and social services are growing. Most financing mobilized from the private sectors such as guarantees, syndicated loans, credit lines, direct investment in companies and shares in collective investment vehicles in areas with clear commercial opportunities (such as energy, industry, and mining and construction) are been achieved through syndicated loans and credit lines (OECD, 2018).

Expected Benefits:

316. The borrower only needs to meet with the agent of the arranging bank, and as a syndicated loan is contributed to by multiple lenders, the loan can be structured in different types of loans and securities. The varying loan types also offer different types of interest, such as fixed or floating interest rates, which makes it flexible vis a vis use cases to support the SDG Framework. Moreover, borrowing in different currencies protects the borrower from currency risks resulting from external factors such as inflation and government laws and policies.

---

[90] The triple bottom line is a business concept that posits firms should commit to measuring their social and environmental impact—in addition to their financial performance—rather than solely focusing on generating profit, or the standard "bottom line."

317. Mobilizing syndicated loans for SDG 8 (decent work and economic growth), SDG 12 (responsible consumption and production) and SDG 13 (climate action) have emerged as priority investment areas.

Policy and Regulatory Requirements:

318. Syndicated loans have been provided in BiH before and there are no regulatory or legal impediments to scaling. According to the IMF, between 1994 and 2014 there were some 28 cross-border syndicated loan deals. [91]

Financing:

319. Financing will be driven by the private sector, corporations, government and ODA partners, depending on demand and the nature of the project investment to be financed. The commercial viability of the project (Net present value, financial rate of return, discount rates etc.), project management arrangements and safeguards, sector, cost and risk structure will determine the syndicate structure.

320. IFIs actively partner with commercial banks, impact investors, institutional investors, and development finance institutions to co-finance investments as syndicated loans. There is also scope for developing cross-border syndicated bank lending.

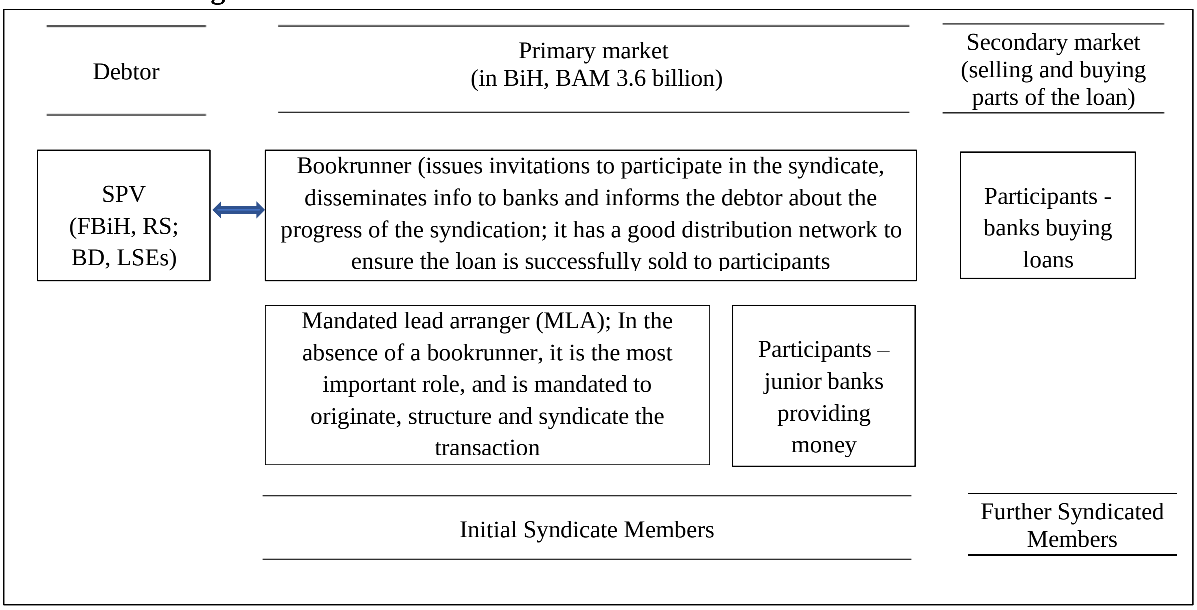
Target Areas:

321. Syndicate loans would be used to provide debt financing for key energy, digitalization and infrastructure investments as outlined above, though the private sector, corporation and potentially government will determine the exact sectors, given cost of borrowing and rate of return determination.

Responsible Actors and Structure:

322. Syndicated loans are driven by the borrower and the arranging bank, though given lack of issuance of syndicated loans in BiH for key sectors, financial intermediation will need to be provided combined with greater financial literacy about how syndicated loans can be accessed. Figure 8 provides an illustrative structure of a syndicated loan set of actors for BiH.

Figure 8 **ILLUSTRATIVE STRUCTURE OF A SYNDICATED LOAN**



Source: DFA Consultants

[91] IMF, Daniel Gurara, Andrea F. Presbitero and Miguel Sarmiento (December 2018) Borrowing costs and the role of multilateral development banks: Evidence from cross-border syndicated bank lending.

Risks:

323. Default risk is the likelihood of a borrower's defaulting on making timely principal and/or interest payments on the loan i.e., a borrower's being unable to pay interest or principal on time.

324. Default risk could, in most cases, be most visibly expressed by a public rating from ratings agency which reflect their opinions regarding the loan's collateral coverage, seniority in the company's capital structure (typically senior secured), industry trends and company management, among other factors (S&P, 2017)

Next Steps:

325. Syndicated loans can be mobilized as a potential financing tool by the private sector, corporations of government once demand for such debt instruments emerges, based on the opportunities developed in the three sectors.

326. This a market-based demand-driven instrument, though engagement with the IFIs (i.e., EBRD for example) would help identify potential financing for projects not being financed by commercial or investment banks.

6.3.3 Apex Micro Financing for MSMEs

327. An apex is a second-tier (or "wholesale") fund that channels public resources to multiple retail financial providers—typically lenders—in a single financial market. Apex financing facilities provide mainly local currency loans, but may also offer loan guarantees, equity investment, grants for operational cost support, and technical assistance. An apex is not always a standalone institution and it may be housed within a larger organization, such as a development bank.

328. An apex for BiH could provide financing facilities to support institutions delivering retail financial services to poor and low-income clients, with a particular focus on targeting SMEs.

Rationale and Objective:

329. According to the World Bank Small and medium enterprises (SMEs) are the economic backbone of virtually every economy in the world and as well in BiH. They account for more than 50% of jobs, and contribute more than 35% of Gross Domestic Product (GDP) in many emerging markets.

330. Strengthening financing for SMEs – including micro enterprises – is also a priority of the BiH SDG Framework. Lack of dedicated financing for SMEs has often been described as the 'missing middle' in financial markets, given the size of the credit gap.

331. Most SMEs struggle to get access to affordable financing and dedicated products from commercial banks and at the same time Micro-Finance Institutions (MFIs) have insufficient capital to extend collateralized loans, and they are by definition risk averse.

Expected Benefits:

332. Expected benefits include that participating banks and MFIs would benefit from capital to expand borrowing on normal market terms, de-risked, to encourage participating banks to on-lend to SMEs for priority sectors. The potential uptake by SMEs would be in the US$ hundreds of millions over the medium term, providing a sustainable source of capitalization.

Policy and Regulatory Requirements:

333. There are no policy or regulatory impediments to such an Apex structure and as a result all that is required is consensus among anchor investors, and deliberation over the exact focus on the Apex fund in terms of target activities and fund governance.

Financing:

334. Given the size of the BiH SME community, an initial fund capitalization of BAM 100 million would be easily achievable, if linked to the SDG Framework, Paris Declaration, EU Green Deal and EU market integration.

335. Most funds start with a market capitalization sufficient to secure the interest of Private Finance Institutions (PFIs), from which Apex growth will be determined by market performance. Apex financing structures have received considerable support from EU institutions, World Bank / IFC, KfW, USAID, bilateral agencies and the Consultative Group for the Poor (CGPA). EIB is also an active investor in the SME Apex Financing space.

336. The fund would on-lend funds to eligible PFIs and PFI management would then be free to make the decision on granting loans to the enterprises on a commercial basis.

Target Areas:

337. The Apex is intended to financing / de-risk SME projects, small and medium scale infrastructure projects promoted by local markets and authorities and any size industrial / service industry investment in the fields of the knowledge-economy, energy, agriculture and environmental protection.

338. The Apex facility would directly target priorities identified under the BiH SDG Framework, both directly addressing the needs for a society of equal opportunities / increased financial inclusion, but also showing linkages to good governance and the smart growth agenda, as outlined in Table 27 below.

Table 27. TARGET SDG FRAMEWORK ACCELERATORS

Good Governance	Smart Growth	Society of Equal Opportunities
Improved financial sector governance, deeper financial markets, strong gender inclusion in financial markets. Pioneering new innovative blended financing solutions and bridging the capital gap, or the missing middle in financial markets. Incentivizing on-lending to SMEs.	Strengthen the enabling environment for entrepreneurship and innovations for production of high value export-oriented goods. Accelerating green growth and energy including addressing energy poverty reduction. Improve market and SME risk management.	Activation and employment focusing on vulnerable categories. Financial inclusion.

Source: BiH SDG Framework

Responsible Actors and Structure:

339. The Apex structure would be incorporated either as an independent structure or established through law as a Limited Liability Company (LLC) fully owned by the Governments. The Apex would be overseen by a board of directors drawn from the BiH investors and anchor financiers. A management director / or CEO would report to the Board, and be supported by a risk committee and audit committee, and have units related to legality and compliance, credit and operational risk, financial and internal operations and portfolio and relations officers.

Risks:

340. Working with a major donor such as the EU or USAID, as has been successfully scaled in Kosovo, a BiH Credit Guarantee Fund (CGF) combined with capital for on-lending could be established in BiH as an apex institution that issues loan guarantees to financial institutions to cover up to 50 percent of the risk for loans to BiH businesses.

341. Participating banks and MFIs could also benefit from capital to expand borrowing on normal market terms, with risks being borne by the Apex. ODA partner anchor investment would constitute catalytic first loss capital to support SME development.

Next Steps:

342. BiH and UNDP working together can invite the Consultative Group for the Poor (CGAP) to support the establishment of the facility. A Concept Note needs to be agreed, formation agreement signed, marketing undertaken for anchor investors, outreach to CGAP followed by the drafting of Apex Policies (Code of Conduct CSR, ESG standards, Social Management Framework and Draft Apex Charter on Fund Establishment and Capitalization.

6.3.4 SDG Bonds

343. Consensus on the need for SDG bonds needs to be established, though with SDG bonds issued in Indonesia and Uzbekistan valued at over BAM 4.1 billion (US$ 2 billion) and in Serbia over BAM 1.95 billion (1 billion eur), all of which were substantially over-subscribed, there is likely to be considerable demand.

344. SDG bonds (debt and fixed income instruments) and other thematic bonds (i.e., for gender, digital transformation, blockchain, climate, green and ecosystem development) have become an increasing source of finance that can be piloted and scaled in BiH, targeting a number of SDGs within the digital, energy and infrastructure priority areas.

345. There is potential to establish a broad portfolio of fixed-Income SDG investments including corporate SDG Bonds (Non-Financial), SDG Bonds by Banks and Financial Institutions, Asset-Backed and Project SDG Bonds and Sovereign and Municipal SDG Bonds.[92]

Rationale and Objective:

346. SDG bonds can provide considerable new financial flows for digitalization, energy and critical infrastructure needs in BiH. Bond investments can also offset contraction in FDI and portfolio inflows, with recent issuances heavily subscribed by overseas investors.

347. The focus on the bonds on specific and measurable SDG goals, targets and indicators, secures direct alignment between the finance and expected outcomes.

Expected Benefits:

348. SDG bonds would provide the government with a direct source of financing to support meeting the SDGs, increasing fiscal resources to target key goals, while also supporting a new approach to sustainable financing that can benefit the introduction of other instruments. In this way, the Bond would facilitate the transfer of resources from private funds to finance public SDG-oriented programs. From an investors point of view, SDG bonds provide a predictable income stream, with bonds normally paying interest twice a year.

349. If the bonds are held to maturity, bondholders get back the entire principal, so bonds are a way to preserve capital while also investing, and bonds can assist in offsetting exposure to more volatile stock holdings.

Policy and Regulatory Requirements:

350. SDG Impact Standard for Bond Issuers have been established to guide and govern SDG bond issuance and execution.[93] As bonds are already issued on BiH markets, there are no policy or regulatory

[92] https://d306pr3pise04h.cloudfront.net/docs/publications%2FSDG-Bonds-and-Corporate-Finance.pdf
[93] https://sdgimpact.undp.org/sdg-bonds.html

changes required, though adoption of the bond issuance guidelines would be useful to guarantee transparency and accountability.

Financing:

351. SDG bonds can be issued by government as a source of debt financing to meet the needs for high rate of return investments outlined in the SDG framework. The value of bond issuance depends on the SDG goals to be targeted (i.e., gender, climate action, renewable energy,) but issuance would allow entities to tap into the private global capital markets to finance SDG-related programs to improve lives and livelihoods. As SDG bond development requires a credible SDG impact theory to be established, though as a fixed coupon and fixed maturity date, demand for bonds is likely to be high.

352. Given that the total size of the thematic bond market is about US$2.8 trillion (See Table 28 below), with the green bonds, accounting for about 57 percent of the total thematic market, BiH could look to finance green investments in the energy sector, infrastructure and the digital economy through such instruments.

Table 28. TOTAL SIZE OF THEMATIC MARKETS AS OF 31 DECEMBER, 2021(IN BN US$)

	Green	Sustainability	Social	Sustainability-linked	Transition
Total size of market	1.6 tn	520.5	538.8	135.0	9.6
Number of issuers	2045	425	861	225	15
Number of instruments	9886	2323	3471	317	32
Number of countries	80	51	44	37	12
Number of currencies	47	38	33	16	7

Source: Climate Bonds Initiative (2022)

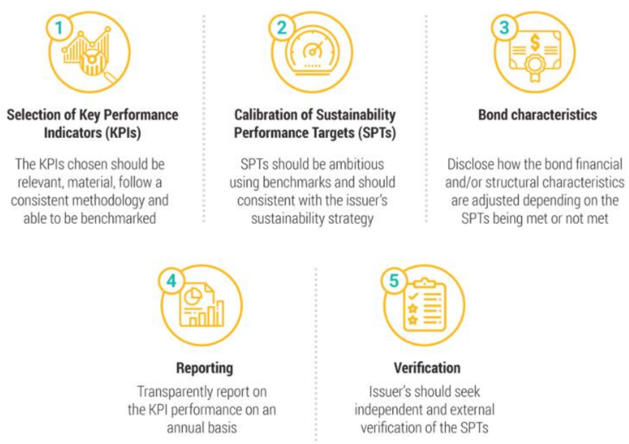
Target Areas:

353. As noted above, the primary targets for SDG bonds would be in green energy (SDG 7), Green Transportation (SDG 9 and SDG 11), Pollution Control (SDG 11) and the Management of Natural Resources (SDG 13 and 15).

Responsible Actors and Structure:

354. The various ministries of finance would lead the SDG bond development process with the Central Bank. A “second party opinion” would be required by a company such as “Sustainalytics Ltd.” (UK), applying guaranteeing that the SDG Bond Framework is credible and impactful and aligns with the Sustainability Bond Guidelines 2021, Green Bond Principles 2021, and Social Bond Principles 2021. Figure 9 provides an overview of the sustainability link bond characteristics to be reviewed.

Figure 9 SUSTAINABILITY LINKED BONDS CHARACTERISTICS [94]



[94] https://www.sustainalytics.com/esg-research/resource/corporate-esg-blog/sustainability-linked-bonds

Risks:

355. Sovereign bond risk depends on the government debt sustainability ranking as determined by the IMF and rating agencies. As sovereign risk is typically low, but can cause losses for investors in bonds whose issuers are experiencing economic woes leading to a sovereign debt crisis, a level of risk would be carried with this instrument, and depends on the annual coupon rate.

Next Steps:

356. SDG Bonds Stages for issuing thematic bonds in the feasibility stage, pre-launch and launch state. The feasibility stage includes considering the reasons for issuance, project selection, gathering information for analysis, and beginning of stakeholder coordination. The pre-launch stage includes appointing key advisors, selecting the bond framework, risk management, and investor outreach. The launch stage includes the actual launch, marketing and the roadshow, and finally pricing and closing the bond issue. The post issuance stage includes monitoring and reporting the project impact, and preparing for future transition.[95]

357. According to the Sustainability-linked Bond Principles (SLBP), Sustainability-linked Bonds are bond instruments with financial and/or structural characteristics that depend on whether the issuer achieves predefined sustainability/environmental, social, and governance (ESG) objectives, and that align with the five core components of the SLBP: (i) selection of Key Performance Indicators (KPIs); (ii) calibration of Sustainability Performance Targets (SPTs); (iii) bond characteristics; (iv) reporting; and, (v) verification. With these bonds, issuers commit, explicitly, to improve sustainability outcome(s) by a predefined deadline. The proceeds from SLBs are intended for general purposes, and, hence, the use of proceeds is not a determinant in its categorization.

6.3.5 Blended Solutions and Other Hybrids

358. The instruments outlined for the three priority areas, and the four short term instruments outlined above, can all be issued within the existing policy and regulatory environment. However, as financial markets are not very deep and capital markets are under-developed, it is suggested to scale existing instruments (IFI concessional loans, state guaranties, etc.) and align them with the SDG Framework first, building greater complexity in instruments over time. In addition, some short term instruments such as Pare 1+1 and R&D tax credits could be designed and introduced.

6.4Proposed Long-Term Financing Mechanisms and Instruments

359. As noted above, the immediate priorities for the three sectors – and the instruments proposed – would be introduced and scaled up over the period 2023-2025. In the meantime, after strengthening of the overall sustainable finance regulatory environment many of the longer-term instruments summarized below can be brought on stream.

6.4.1 Market Development Sequencing

360. The rather under-developed nature of financial and capital markets combined with lack of guidance on new and innovative sustainable and green financing instruments, slows the pace for potential acceleration of emerging instruments. The adopted BiH law on public procurement[96] in line

[95] Martin, P, 2021. Sustainability and SDG Bonds. ESCAP, 5th NCA Subregional SDG Forum, October 7.
[96] The Law on Public Procurement of Bosnia and Hercegovina ("Official Gazette of Bosnia and Herzegovina", no. 39/2014 and 59/2022).

with EU recommendations will aid PPP development, and improving oversight of public entities would increase market efficiency and potentially open up areas of the economy. As capital markets are under-developed (there are two stock exchanges but they are not a significant funding source for companies) and corporate bond markets therefore operate at a low level

361. Key steps in market development sequencing include (i) introducing new taxonomies and bond standards and sustainable financing taxonomies (ii) actively promoting digitalization as key enabler for private sector development and efficiency gains in the banking sector (iii) prioritize building core PPP capacities in all three priority sectors and (iv) establishing the working team for sustainable development that will work on green and climate bonds standards (v) strengthen strategic budgeting (vi) prepare the ground for carbon markets (vii) support business and capital markets environment, FDI investment and integration of local companies into regional and global value chains and (viii) improve corporate governance. Unless such measures are undertaken, the public sector will remain the dominant source of finance, and the SDG financing gap will remain as it is.

6.4.2 EXISTING INSTRUMENTS FOR SCALING

362. There are four instruments identified as having potential over the long term with their main characteristics presented in Table 32 (provided in the annex);

- Commercial bonds
- Trade finance
- Equity investment
- Public equity fund and crowdfunding (including equity crowdfunding)

363. In terms of potential SDG impact however, only trade financing has the potential for considerable impact, and for this collateralized transaction regulations need to be strengthened and the court system needs to facilitate easy foreclose on collateral. Strengthening the country's legal system to work well for the resolution of international commercial disputes is vital, but will take time.

364. Crowdfunding has only modest potential and necessary regulations need to be established and a cultural transformation encouraged to allow crowdfunding skills to come to the fore, in particular as a channel for diaspora flows.

6.4.3 NEW AND INNOVATIVE INSTRUMENTS

365. Assuming that policies, strategies, regulations, taxonomies and other capital market deepening measures are undertaken, a number of additional instruments deployable within future market regulatory conditions can be imagined, as listed below.

366. Their main characteristics presented in Table 33 (provided in the annex):

- Cross Border Infrastructure PPPs
- PPPs Funds
- Energy Saving Performance Contracting
- Gender Bonds
- Project Bond
- Double-leveraged Mezzanine Finance
- Central Bank Digital Currency (CBDC)
- Energy Cooperatives

REFERENCE

Agencija za statistiku Bosne i Hercegovina (BHAS), 2023. Research and development (R&D). 12 January 2023.

Agencija za bankarstvo Federacije Bosne i Hercegovine (FBA), 2022.Informacija o subjektima bankarskog sistema Federacije Bosne i Hercegovine sa stanjem na dan 30.09.2022. godine. Sarajevo: FBA.

Agencija za bankarstvo RS (ABRS). 2022. *Izvještaj o stanju u bankarskom sistemu Republike Srpske* 30.09.2022. Banja Luka: ABRS.

Agencija za osiguranje u Bosni i Hercegovini (AZOBIH),2022. Pregled osnovnih statističkih pokazatelja za 2021. godinu u sektoru osiguranja BiH.

Amović, G., Maksimović, R and Bunčić, S., 2020. Critical Success Factors for Sustainable Public-Private Partnership (PPP) In Transition Conditions: An Empirical Study in Bosnia and Herzegovina. *Sustainability*, 2020, vol. 12, issue 17, 1-29.

Centralna banka Bosne i Hercegovine (CBBiH), 2022. Izvještaj o finacijskoj stabilnosti-Financial Stability Report. Sarajevo: Centralna banka.

Centralna banka Bosne i Hercegovine (CBBiH), 2023. Statistics. Available at (Accessed February 2023). Avaliable at http://statistics.cbbh.ba/Panorama/novaview/SimpleLogin_en_html.aspx

Commission on Growth and Development, 2008. *The Growth Report – Strategies for Sustained Growth and Inclusive Development*, World Bank, Washington, D.C.

Cegar, B. and Parodi, J. F., 2019. State-Owned Enterprises in Bosnia and Herzegovina: Assessing Performance and Oversight. IMF WP/19/201.

European Banking Authority (EBA), 2019. ANNEX – Republic of Bosnia and Herzegovina.

Ernst & Young Global Limited (EYGM), 2016. EY Poland, Economic Analysis Team.

European Union (EU), 2023. Report from the Commission to the European Parliament, The Council and the European Economic and Social Committee Alert Mechanism Report 2023.

European Commission (EU), 2022. Bosnia and Herzegovina 2022 Report.

Felipe, J., Kumar, U. and Galope R., *2014.* Middle-Income Transitions: Trap or Myth? ADB Economics Working Paper Series no. 421.

Fay, M, Il Lee, H. Mastruzzi, M., Han, S. and Cho, M., 2019. Hitting the Trillion Mark - A Look at How Much Countries are Spending on Infrastructure, Policy Research Working Paper 8730.

Flor, L., 2018.Three ways governments can create the conditions for successful PPPs. The World Bank blogs, August, 16. Available at https://blogs.worldbank.org/transport/three-ways-governments-can-create-conditions-successful-ppps

Forum of Federation, 2023. Federal Countries –Bosnia and Herzegovina. Available at:https://forumfed.org/countries/bosnia-and-herzegovina/

Gaspar, V. Amaglobeli, D, Carcia Escribano, M, Prady, D. and Soto, M., 2019. Fiscal Policy and Development: Human, Social, and Physical Investment for the SDGs. IMF Staff Discussion Note SDN/19/03.

Gill, I. and Kharas, H., 2016. The Middle-Income Trap Turns Ten. World Bank Policy Research Working Paper 7403.

Gill, I., Kharas, H. et al. 2007. An East Asian Renaissance: Ideas for Economic Growth. World Bank, Washington, DC.

International Labour Organisation (ILO), 2020. Overview of the informal economy in Bosnia and Herzegovina.

International Monetary Fund, 2022. IMF Country Report No. 22/167.

International Monetary Fund, 2021. WEO Database. Available at: (Accessed December. 2021).

International Monetary Fund, (2019), World Economic Outlook. Washington, D.C.: IMF.

Hunziker, L. And Dejonghe, C.,2019. Local and Regional Democracy in Bosnia and Herzegovina. Strasbourg: Congress of Local and Regional Democracy in Bosnia and Herzegovina.

Kees Martijn, J., Sun Y, Khachatryan, A., Lindquist, W, Mooi Y., Ozturk, E. and Selim, H., 2023. The Future of PPPs in the Western Balkans, IMF WP WP/23/31.

Krugman, P., Obstfeld M. And Melitz J. M. 2016. International Economics – Theory and Policy. Harlow: Pearson.

Larson, G., Loayza N. and Woolcock, M, 2016. The Middle-Income Trap: Myth or Reality? Research Policy Briefs From the World Bank Malaysia Hub No. 1.

Lin, J. Y., 2012. *New Structural Economics - A Framework for Rethinking Development and Policy* World Bank, Washington, D.C.

Medina, L and Schneider, F. 2018. Shadow Economies Around the World: What Did We Learn Over the Last 20 Years? IMF WP/18/17.Mitra, P., 2016. Addition by Subtraction: How Diasporas Can Boost Home-Country Growth.iMFdirect – The IMF Blog, May 18.

OECD, 2022. SME Policy Index: Western Balkans and Turkey 2022 Assessing The Implementation of The Small Business Act for Europe. Paris: OECD.

OECD, 2012.OECD R&D tax incentives database, 2021 edition. Paris: OECD.

Rodrik, D. and Stantcheva, S. 2020. The Post-Pandemic Social Contract. Project Syndicate. June11, 2020 .Available at https://www.project-syndicate.org/commentary/new-social-contract-must-target-good-job-creation-by-dani-rodrik-and-stefanie-stantcheva-2020-0.

Torgler, B. and Schneider, F., 2007. The Impact of Tax Morale and Institutional Quality on the Shadow Economy. CESifo working paper no. 1899.

Torgler, B., 2011. Tax Morale and Compliance Review of Evidence and Case Studies for Europ. Policy Research Working Paper 5922. World Bank.

United Nations Department of Economic and Social Affairs, Population Division (2020). International Migrant Stock 2020.

Vijeće ministara Bosne i Hercegovine (VM BiH), 2022. Program ekonomskih reformi 2022-2024.

Yanga, S, Wenwu Zhaoa, W., Liua, Y , Cherubini F, Fua B. and Pereira, P., 2020. Prioritizing sustainable development goals and linking them to ecosystem services: A global expert's knowledge evaluation. Geography and Sustainability, No. 1

World Bank. 2023. World Development Indicators. Available at: https://databank.worldbank.org/source/world-development-indicators# (Accessed in February, 2023).
World Bank. 2022. Systematic Country Diagnostic Update. Washington, D.C.: The World Bank Group.

World Bank, 2015. Rebalancing Bosnia and Herzegovina: A Systematic Country Diagnostic.
Washington, D.C.: The World Bank Group.

ANNEX 1: SELECTED TERMS

Selected Terms

Backward Linkages:
Backward Linkages describe and measure the response of sectors in the economy that are affected by an increase in demand in the tourism sector.

Blended Finance or Blended Capital
Blended finance occurs when development finance in the form of grants, loan guarantees, or philanthropic funds are used to attract or leverage private capital into developing countries. The term derives its name from the mix of types of capital. Blended finance is typically used to de-risk investments or bring returns in line with what investors are seeking. Blended finance may have the potential to bring in new sources of funding to development challenges. But development finance institutions warn that blended finance deals have to be put together carefully, with the different types of financing used at the appropriate stages to ensure that any concessional financing doesn't distort markets.

Catalytic First-Loss Finance
Catalytic first loss finance — or first loss capital — refers to socially and environmentally driven credit enhancement provided by an investor or grant-maker who agrees to bear first losses in an investment in order to catalyze the participation of co-investors that otherwise would not have entered the deal. For example, donors have so far been funding the development of conservancy lodges, which improves long term viability and cash flows, and increases the dividends going to conservancy members.

Concessional Loan
Concessional loans offer better than market-rate terms, either through longer repayment times, low interest rates, or both. Development finance institutions often use these loans to de-risk or encourage certain investments.

Development Finance
Development finance is the efforts to support, encourage, and catalyze expansion through public and private investment in physical development, redevelopment and/or business and industry. It is the act of contributing to a project or deal that causes that project or deal to materialize in a manner that benefits the long-term health of the community.

Development Impact Bonds
Development impact bonds are results-based contracts in which private investors pay up front for the costs of a proven intervention, which is implemented, typically by an NGO, and measured by clear, predetermined metrics. If the intervention succeeds in achieving the goals, the outcome payor — typically a donor agency, foundation or perhaps a company — will pay the investor back based on the performance or success of the interventions.

Direct, Indirect, and Induced Impacts
Common direct impacts include financial transactions, such as payments of wages, taxes, and dividends, and the distribution of philanthropic grants and cash contributions. Indirect impacts are often harder to quantify, but include jobs created by suppliers and increases in productivity. Induced effects are the results of increased personal income caused by the direct and indirect effects (e.g. the increased spending power of people employed in the tourist industry).

Economic Multipliers
The Economic Multiplier Effect describes the fact that an increase in spending produces an increase in national income and consumption that is greater than the initial amount spent. The multiplier effect (for example) describes the fact that investment not only creates jobs in the economy it also encourages growth in many primary and secondary sectors of industry (e.g., agriculture, transport, finance, etc.). Simply stated, well committed investment circulates many times through a country's economy.

Forward Linkages
Forward linkages describe and measure the increase in the supply of one sector in response to a uniform increase in demand spread over all sectors. It quantifies the relative dependence of each sector on a general increase in the activity level of all other sectors. In the case of tourism, it measures the extent to which tourism benefits from a boost in the demand of other sectors (e.g., the airline industry). The greater the link between tourism and that sector, the greater the benefit to tourism if demand for that sector increases.

Gross Domestic Product

A measure of economic activity in a country. It is calculated by adding the total value of a country's annual output of goods and services. GDP = private consumption + investment + public spending + the change in inventories + (exports - imports).

Impact Investing
Impact investments are made in companies, organizations, or funds that intend to generate social and environmental impact along with a financial return. Impact investing includes a spectrum of investment types, including those seeking market-rate returns and those that are looking only recoup capital. The field continues to grow, and there is a push to track some investments to the Sustainable Development Goals, though this still represents a small fraction of total investments. Impact investing is sometimes equated with socially responsible investing or investing based on environmental, social, and governance standards, but the two differ. Impact investments don't merely screen out investments that have a negative impact or consider potential impacts; rather, they have the express purpose of creating impact.

Loan Guarantee
A loan guarantee is a promise by the guarantor, often a development finance institution, to pay back a borrower's debt if a borrower defaults on a loan. Guarantees can cover all or part of the debt and are often used to de-risk investments for conventional or commercial investors.

Multiplier Effects
Multipliers are measures by which the multiplier effect is estimated. They are computed through the analysis of Input-Output (I-O) framework, which serves to analyze the interdependence of industries in an economy. Input-output analysis ("I-O") is a form of macroeconomic analysis based on the interdependencies between economic sectors or industries. This method is commonly used for estimating the impacts of positive or negative economic shocks and analyzing the ripple effects throughout an economy. A key output from this analysis is the production of multipliers.

Results or Performance-Based Financing, or Pay-for-Success
This type of financing ties funding to specific performance or results that are typically agreed upon in advance. In many cases, funding — or incentives — is contingent on meeting those goals. Results-based financing can take the form of contracts or deals, including social and development impact bonds. Traditionally, contracts or grants are based either on the inputs (the number of services delivered) or on short-term outputs. But these mechanisms require clear, measurable results and outcomes, thus pushing those involved to build robust data systems and closely monitor their work.

Right-Financing
The right-financing approach to development maintains that financing an investment alone does not make it successful in achieving its objective. Right-Financing highlights the importance of adopting the appropriate policy, fiscal, institutional and financial support mechanisms in order to maximize sustainable returns on both public and private investments over time. The term goes beyond the public sector restructuring concept of right-sizing in that it looks to assess the policy mandate and size of an institutional entity, its functions and their discharge, its financing, as well as the staffing structure and establishment with regard meeting investment and development objectives. Its application as a conceptual framework is important for sustainable development finance because it encourages a focus on financial integration, crowding in private capital and integrated national financing frameworks.

Social Impact Bonds
Social impact bonds are partnerships or contracts between governments, NGOs and investors to fund interventions that address pressing challenges. They are designed to bring in new funding for programs, typically to address social issues with preventative interventions that could save government dollars.

Value for Money (VfM)
A utility derived from every purchase or every sum of money spent. Value for money is based not only on the minimum purchase price (economy / efficiency) but also on the maximum efficiency and effectiveness of the purchase. Value for Money assessments are useful tools for donors to assess the opportunity cost of one investment over another.

Value Chain
Value Chain is the full range of business activities needed to bring a product or service from conception to delivery.

ANNEX 2: SDG COSTING METHODOLOGIES

According to United Nations, Economic and Social Council (2021:18): "„There is no single correct methodology to cost the SDGs".

Several approaches have been employed to cost the SDGs, including (ESCAP, 2020; ESCWA, 22021)

- **incremental capital-output ratios (ICOR**) that link a certain level of fixed investments to the achievement of certain target variables such as per capita GDP growth rate, which is applied in this paper;
- **unit cost,** the most commonly used approach, is simply the cost incurred to produce a single unit of output -it takes the total cost to deliver a service and divides it by the number of units (number of children, households etc.).
- **input-output elasticities** that furnish cost estimates based on trend analysis;
- **frontier analysis** that derives the costs of pursuing SDG targets based on similar actions taken by comparable income economies or geographical areas;
- **intervention-based needs assessment that** refers to the cost of specific intervention, eg. provision of fertilizers to farmers - the approach applies unit costs for each of the specific interventions;
- **computable general equilibrium (CGE)** that uses the underlying behavioral relationship characterized by cost minimization by firms and utility maximization by households to incorporate links between the sector of assessment and the rest of the economy, and accordingly it can be used to estimate investment needs for different policy options;
- **impact costing** that considers calculating the cost of the socio-economic impact of a given problem or intervention. It shows the costs or adverse impacts of taking or not carrying out specific actions to address an issue.

Each of these methodologies have their advantages and disadvantages, main of which are listed in the following Table 29.

Table 29. SDG COSTING METHODOLOGIES

Methodologies	Advantage	Disadvantage
Incremental capital-output (ICOR) and other growth models	-Simple to calculate	- Simply extrapolate the past into the future - Obtaining ICORs is prone to error as it is based on cross-country regressions - Cannot yield investment needs at a disaggregated level
Unit cost estimates or input-output elasticities	- Simple to calculate - Can be applied to a large group of countries	- Simply extrapolate the past into the future - Results are sensitive to unit costs - Cannot take into account synergies, trade-offs and economy-wide effect of SDG investment
Intervention-based needs assessment	- Simple to calculate - Can be highly disaggregated (e.g. rural/urban populations)	- Cannot take into account synergies, trade-offs and economy-wide effect of SDG investment
Computable General Equilibrium	- Take into account synergies, trade-offs and economy-wide effect of SDG investment	- Computational complexity - Data requirements

Source: Compiled from Schmidt-Traub (2015) and ESCAP (2020)

Homi Kharas and John McArtur of Brookings Institution identified sectors and forms of public spending that could be considered SDG-related: (i) social spending, (ii) agriculture spending, (iii) health spending, (iv) education spending, (v) infrastructure spending, (vi) biodiversity conservation spending and (vii) justice spending.

Then they identified relevant data sources (ILO, FAOSTAT and IFPRI, WHO, World Bank, IMF, Waldron et al and UNStats).

They found the tight linkage between SDG spending and income pc. The slop of the trend line is approximately 1.13 meaning that for every 10 percent higher income pc countries show an 11.3 percent higher level of average SDG spending.

They found that as of 2015 low-income countries governments spent around $115 p.c. per year on SDGs, that total SDG spending rises considerable to an estimated $267 p.c. in lower-middle-income countries, to $2200 p.c. in upper-middle-income countries to 12,753 p.c. in high-income countries.

Since BiH is an upper-middle-income country according to the World Bank's classification, the estimate of $2200 pc is considered as a benchmark for its spending on SDGs.
However, the gross national income (GNI) of BiH is significantly lower than of the average GNI of upper-middle-income's countries (US$4730 vs. US$8156). Additionally, it is necessary to take into the consideration that the buying power of the US dollar changed from 2015 to 2022 (1,2 times or 20%), to convert the US$ figures into the BAM figures and multiply the figure of SDG spending per capita with the number of inhabitants of BiH. Finally, the figure of the SDG spending of BAM 8.7 billion for 2022 is obtained (2200 x 0.5799 x 1,2x 1,74 x 3,3=8,74). To validate it the latest available data on SDP spending are collected and presented in Table 31.

For the period of 2023-2030, the incremental capital-output ratios (ICOR) method is applied. Its advantages and disadvantages are shown in Table 30 while its results are presented in the Chapter 4.

Table 30. SDG SPENDING; BIH, 2019

No.	Spending	% of GDP	Amount (in billion BAM)	Source
1	**Social protection**	**3,4**	**1,2**	ILO & Eurostat (2022)
	-family and children, including maternity	0,5		ILO & Eurostat (2022)
	-means-tested social assistance	0,4		ILO & Eurostat (2022)
	-war veterans and civilian victims	1,5	0,5	ILO & Eurostat (2022)
	-other	1,0		ILO & Eurostat (2022)
2	**Health**	**9,1**	**3,2**	BHAS (2021)
	-public sources		2,2	
	-private sources		0,9	
3	**Justice (police services, law courts, prisons)**	**1,4e**	**0.5e(*)**	SDG DFA Expert Estimations based on data provided by World Bank (2022) Central Bank of BiH (2022) and Agency for Statistics of BiH (2022)
4	**Subsidies (agriculture, transport)**	**1,1e**	**0,4e**	SDG DFA Expert Estimations based on data provided by World Bank (2022) Central Bank of BiH (2022) and Agency for Statistics of BiH (2022)
5	**Education**	**4,5**	**1,6**	BHAS (2021)
	-public sources		1,4	
	-private sources		0,1	
6	**Public investment (infrastructure etc.)**	**4,5e**	**1,5e**	SDG DFA Expert Estimations based on data provided by IMF (2021)
7	**R&D**		**0.1e**	SDG DFA Expert Calculations based on data provided by BHAS (2022)
8	**Spending on SDGs**	**24,1**	**8,5**	
9	GDP	100	35,3	CBBiH (2022)

(*)e-estimation

ANNEX 3:

Table 31. MAIN SHORT-TERM FINANCIAL INSTRUMENTS FOR SDGS

Name of the financial instrument/mechanism	*Description of the financial instrument/mechanism*	*Key stakeholders*	*Additional regulatory requirements (if any)*	*Implementation requirements (if any)*	*SDG financing potential*	*So that the instruments could be strengthened/optimized*
Strategic Investment Fund (SIF)	SIFs serve to finance projects of strategic importance for the country, region or municipality. Their establishment is supported by the IMF and the World Bank. They usually have a threefold task: economic and social return and international contribution (to attract as many foreign funds as possible). The management of SIF is based on imitating the operation of a private investment fund.	Public sector institutions (BiH institutions, entities, cantons, municipalities and public companies) and private sector institutions (banks and large companies)	Non existing	Non existing	High	The leading shareholder should be the entity government, which would bring together domestic financially generous public and private sector institutions. It is extremely important to secure a foreign AAA bank as a shareholder - this would increase the success of issuing bonds, acquire credit lines and develop project finance, and improve corporate governance. The SIF could collect three billion BAM in the period 2023-2025, which would finance the medium-term gap in SDG financing, with the condition that the development of project finance takes place in parallel (e.g. 3 wind power plants and six solar power plants with an individual power of 200 MW); thus, BiH would be much more prepared to meet the EU measures planned for 2026.
		Domestic commercial banks	Non existing	Non existing	High	Certain development projects would be realized

Table 31. MAIN SHORT-TERM FINANCIAL INSTRUMENTS FOR SDGS						
Name of the financial instrument/mechanism	***Description of the financial instrument/mechanism***	***Key stakeholders***	***Additional regulatory requirements (if any)***	***Implementation requirements (if any)***	***SDG financing potential***	***So that the instruments could be strengthened/optimized***
Syndicated loans	Syndicated loans are used when a project, e.g. infrastructural, required too much credit exposure for one bank, but not for several of them, which therefore join together to implement a large investment project.					through the cooperation of entity and cantonal governments as project promoters on the one hand and banks as financiers on the other. The financial potential of this instrument is over three billion BAM, which is the amount of surplus funds of the banks at the Central Bank above the required reserves.
Financial instrument Apex	Apex is a "wholesale" fund that directs public funds to multiple retail financial service providers - usually lenders - in a single financial market.	Entity governments	Law on the establishment of the APEX institution	Non existing	Relatively high	Apex would offer credit guarantees, equity investments, grants to support operational costs and technical assistance to special categories of SMEs (startups etc.) and special sectors (knowledge economy, energy, agriculture, environmental protection, etc.). Apex is not always an independent institution and may be located within another organization. Apex could mobilize around 200 million BAM.
SDG	SDG bonds are fixed income debt instruments which are becoming an increasing source of funds	Entity governments	Non existing	Non existing	Relatively high	The Ministries of Finance would lead the development process of SDG bonds.

Table 31. MAIN SHORT-TERM FINANCIAL INSTRUMENTS FOR SDGS

Name of the financial instrument/mechanism	Description of the financial instrument/mechanism	Key stakeholders	Additional regulatory requirements (if any)	Implementation requirements (if any)	SDG financing potential	So that the instruments could be strengthened/optimized
bonds	for financing several goals of sustainable development in priority areas (e.g. digitization, and infrastructure, etc.)					Using government guarantees could remove the obligation to reserve regulatory capital and thus encourage the use of this instrument. Firms like Sustainalytics Ltd. (UK) would ensure that the bond framework for the SDGs is credible, effective and aligned with the Sustainable Bond Guidelines 2021, Green/Social Bond Principles, etc. The development of the interbank market and the repo market can support the development of this market. The financial potential of this instrument is BAM 0.2 billion per year

ANNEX 4:

Table 32. EXISTING FINANCIAL MECHANISMS / INSTRUMENTS

Financial instrument/mechanism Name	*Description of financial instrument/mechanism*	*Key stakeholders*	*Regulatory Requirements (If any)*	*Implementation Requirements (If any)*	*SDGs Financing Potential*	*How The Instruments Could Be Strengthened/Optimized*
Commercial Bonds	Also known as business bonds and commercial surety bonds, commercial bonds are agreements that protect businesses.	Business, financial institutions, individuals,	No	No	Low	It is necessary to develop a business environment conducive to private investment, which creates private sector employment that supports the growth of both small and medium-sized enterprises and larger companies.
Trade Finance	The following trade finance financial instruments are used in BiH to make payments abroad: documentary collections, checks, and letters of credit.	Firms, SMEs, banks, exporters, importers	Strengthening collateralized transaction regulations and the court system make it easy to foreclose on the collateral. Strengthening the country's legal system to work well for the resolution of international commercial disputes.	No	High	Strengthening collateralized transaction regulations
Equity Investment and Public Equity Funds	An equity investment is money that is invested in a company by purchasing shares of that company in the stock market. Public equity funds are investment funds that raise money via an initial public offering (IPO) in order to invest in securities according to a specified investment strategy.	Stock Exchange, Companies, financial institutions	No	No	Low	Strengthening shareholder protection laws
Crowdfunding	Crowdfunding is the practice of funding a project or venture by raising money from a large number of people, in modern times typically via the Internet.	Fund demanders and suppliers	Making necessary regulations for crowdfunding	No	Medium	Making necessary regulations for crowdfunding

ANNEX 5:

Table 33. FUTURE INNOVATIVE FINANCIAL MECHANISM AND INSTRUMENTS

Financial instrument/mechanism Name	*Description of financial instrument/mechanism*	*Key stakeholders*	*Regulatory Requirements (If any)*	*Implementation Requirements (If any)*	*SDGs Financing Potential*	*Basic Conditions Necessary For The Establishment Of The Mechanism*
Cross Border Infrastructure PPPs	Mobilizing international private or public sector resources to other countries through PPPs	International private sectors, governments, international and local financial institutions	No	A type of loan-grant blending facility could be designed to encourage cross border PPPs	High	Enabling business environment
PPPs Funds	PPPs funds help finance their PPPs programs. International experience shows that PPP funds should be built on an understanding of the appropriate role of government.	Owner of the PPPs projects and PPPs funds	Fund establishment law	No	High	Establishing operationally independent in the foundation law of the fund.
Energy Saving Performance Contracting	Performance contracting is frequently used to finance and implement EE projects. A performance contract refers to the execution of energy-saving implementation services under energy saving performance contracts (ESPC).97	Energy Service Providers, Firms	No	Dedicated saving energy funds should be established to promote the use of this contract.	High	Enabling the banking sector to gain experience in energy-saving projects Strengthening the energy services distribution infrastructure
Gender Bonds	Gender Bonds can be broadly defined as bonds that support women's empowerment and gender equality	Those who supply and demand the bond. Financial Institutions	Preparing a taxonomy regulation related to gender equality	Issuing bonds in accordance with the Social Bond Principles	High	Having a developed capital market to issue these bonds in the local market

[97] UNDER ESPC energy service providers provide a full range of services through the implementation of EE projects. Energy service providers undertake the technical and performance risk with ESPC while performing these services. Service-related payments depend on whether energy service providers meet the performance targets set in the ESPC. Often the payments to the energy service providers are less than the cost savings from implementing the EE project.

Table 33. FUTURE INNOVATIVE FINANCIAL MECHANISM AND INSTRUMENTS						
Financial instrument/mechanism Name	***Description of financial instrument/mechanism***	***Key stakeholders***	***Regulatory Requirements (If any)***	***Implementation Requirements (If any)***	***SDGs Financing Potential***	***Basic Conditions Necessary For The Establishment Of The Mechanism***
Project Bond	Project bonds provide an alternative to bank loans for projects that have characteristics allowing them to be financed by the private sector	Those who supply and demand the bond. Financial Institutions	No	No	High	Having a developed capital market to issue these bonds in the local market
Double-leveraged Mezzanine Finance	Mezzanine financing is a hybrid of debt and equity financing. In the event of contractually specified conditions, a debt-like financial instrument is converted to an equity instrument. For this, trigger points are determined in the contract.	Those who supply and demand the hybrid of debt and equity instruments	No	A Public-Private mezzanine fund should be established	High	Increase the financial literacy of SME owners to understand this form of financing
Central Bank Digital Currency (CBDC)	CBDCs are digital coins issued by central banks that use distributed ledger technology like cryptocurrencies.	Central Bank, those who demand CBDC	Central Bank law change is needed for CBDC.	No	High	A new Financial infrastructure is needed
Energy Cooperative	Energy Cooperatives are established for the purpose of producing and distributing energy, mostly from renewable resources such as wind, solar power, or biomass. The remaining profits from cooperative activities are invested in the infrastructure of the cooperative or distributed to its members as dividends.	Local People, companies that sell energy efficiency or renewable energy equipment.	No	A Cooperative needs to be established	Medium	Political and local commitment support is a must

„Development Finanace Assesment (DFA)“ preparation is supported through the Joint Program „Towards the SDG Financing Ecosystem in Bosnia and Herzegovina“, which is financed by Joint SDG Fund, and implemented by United nations in Bosnia and Herzegovina.

JOINT SDG FUND

Council of ministers of BiH

Government of Federation of BiH

Government of Republika Srpska

Government of Brčko District BiH

UJEDINJENE NACIJE BOSNA I HERCEGOVINA