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CHARACTERISTICS, STRUCTURE AND SUSTAINABILITY OF DEBT OF THE REPUBLIC OF SRPSKA

КАРАКТЕРИСТИКЕ, СТРУКТУРА И ОДРЖИВОСТ ДУГА РЕПУБЛИКЕ СПСКЕ

Summary: *The aim of the research is to address the challenges that may be a constraint on economic growth and development. In the research, we used the relevant literature and acts that were in front of the delegates at the National Assembly of Republic of Srpska. The research question is: "What are the main characteristics of the Republic of Srpska's debt?" In line with this, the methods employed in this paper are the analysis and synthesis of previous researches, theoretical findings and publicly accessible documents pertaining to the debt of Republic of Srpska, and an overview of the case studies. The contribution of the paper is reflected in the explained wideness and the possibilities of using different sources of money, and the limits on which the debts can be used in order to achieve sustainability tasks. We have concluded that this year, the Republic of Srpska bill has reached the largest amount of debt – KM 858 million (755 million principal and 103 million interest). In line with the presented evidence, priority should be given to projects that would be financed by advantageous credit arrangements and to rationalize public spending. Despite the usual opinion, we have proven that the debt of the Republic of Srpska is sustainable - the average interest rate is lower than the GDP growth rate and that, although unpopular, the currency board system corresponds to the position of Republic of Srpska. However, we have pointed out the danger of stereotype that the public debt of less than 60% necessarily indicates that the country is in a good position.*

Keywords: *public debt, external debt, debt structure, indebtedness.*

JEL classification: *H61, H62, H6, H68*

Резиме: *Циљ истраживања је да се укаже на изазове који могу да представљају ограничење економском расту и развоју. У истраживању смо користили релевантну литературу и акте који су били пред посланицима у Народној скупштини Републике Српске. Истраживачко питање гласи: „Које су главне карактеристике дуга Републике Српске?“ С тим у вези, методе коришћене у раду су анализа и синтеза претходних истраживања и теоретских налаза и јавно доступних докумената који се односе на дуг Републике Српске, те преглед студија случаја, да би закључци били извучени методом дедукције. Допринос рада се огледа у томе што су објашњене ширина и могућности кориштења различитих извора за прибављање новца, те ограничења на која се дугови могу користити са циљем остварења задатака одрживости. Закључили смо да ове године, на наплату Републици Српској, пристиже до сада највећа рата дуга - 858 милиона КМ (755 милиона главнице и 103 милиона камате). У складу са презентованим доказима, потребно је извршити приоритизацију пројеката који би били финансирани кредитним аранжманима те рационализовати јавну потрошњу. Упркос увријеженом мишљењу, доказали смо да дуг Републике Српске јесте одржив - просјечна каматна стопа је мања од стопе раста БДП-а те да, иако непопуларан, систем валутног одбора одговара Републици Српској. Међутим, указали смо на опасност од стереотипа да јавни дуг мањи од 60 % нужно показује да је земља у доброј позицији.*

Кључне ријечи: *јавни дуг, спољни дуг, структура дуга, задуженост.*

ЈЕЛ класификација: *H61, H62, H6, H68*

1. INTRODUCTION

There is no specific data on the first time that the idea of debt appeared among people, but we can assume with a lot of certainty that it appeared in some form right after the first sorts of trade exchange among people had been established. What we do know from the written records, is the fact that, historically speaking, there is no doubt that debt has always played an important, often even a key role in historical and social turbulence. In fact, debt has always been above all a political matter, then a social and religious matter, and finally an economic matter that has not succeeded in establishing its primacy above the others so far.

The oldest written civilization records bear testimony on the attempts to codify debt and on the social and political implications debt had on societies three thousand years ago and four thousand years ago. The Code of Hammurabi from 18th century BC assumed periodical debt cancellations with a

clear intention of security social peace and stability. The Hellenistic world and the Old Testament world accepted debt and its existence implicitly, making the issue of whether the interest is morally justifiable and whether it should be explicitly forbidden or allowed with limitation as the focal point of their debates. Having been the representative of the former ones, he considered gaining wealth from fruits and animals always *natural*. On the other hand, he would say that there are unnatural ways to gain wealth, such as *petty trade and collection of interest, as the 'most hated' and 'unnatural' way to gain wealth, because it produces profit from the money itself* (Mijatović 2012, 484). His attitude towards interest shaped not only the attitude of the ancient cultures, but also the attitude of the Christian church for the most part.

The history of the Western civilization demonstrates that there was a series of attempts to cancel interest and pardon debt under the shroud of this doctrine, but the devastating consequences on economy made the legislators realise that there is no funding of great projects without debt (loan), and there is no loan without interest which in the end lead to involuntary evolution of the attitude toward the debt itself and involuntary acceptance of the institute of debt. However, this legislation of the debt institute has only increased the aversion of common people towards donations and donors, the aversion deeply rooted in the idea that they who make a living by lending money are some sort of parasites hooked on real economic activities such as agriculture and manufacture (Ferguson 2010, 9).

Until the end of 19th century thinkers used to put more effort into finding in theory something to back their attitude on the evil that is a result of debt and borrowing than into trying to look at the whole process from the scientific point of view and penetrating deeper into the relation between debt on one side and development and progress on the other side.

In the 20th century it finally became clear that the evolution of loan and debt was just as important as any other technological novelty in the beginning of civilization from the old Babylon to the present-day Hong Kong. Banks and securities' markets have provided a material foundation for the blossom of the Italian Renaissance. Corporative finance represented a crucial basis for the Dutch and the British empires just as the 20th century triumph of the USA can't be separated from the progress in insurance, mortgage debt and consumer credit (Ferguson 2010, 10).

It wasn't until the other half of the 20th century that the science of economics started to systematically link *clever* borrowing and management to security and progress. That period sees the first attempts to describe the quantity and quality of parameters and criteria of *wise* borrowing and debt managements, i.e. of avoiding mistakes in consumption and tax. In that period there was a development of models which contained the so-called *sensitivity measures* which dealt with total debt-to-GDP ratio, external debt-to-GDP ratio, institutional frameworks etc.

All these efforts have resulted in certain ratios which countries shouldn't exceed if they want to avoid debt and finance crisis, however their applicability has proven to be doubtful in reality. The best-known criterion of measuring the (over)indebtedness is the one from the Maastricht Treaty, according to which Eurozone state members have the upper ratio limit fixed at 60 percent. The World Bank considers the countries with the external debt-to-GDP ratio less than 48 percent to be lowly indebted.

It is a sad fact that all these indexes haven't proven to be too reliable in reality so there is Japan with a debt-to-GDP ratio of 230 percent and so far it does not demonstrate any sign of problem with repayment and borrowing. On the contrary, Reinhart and Rogoff (2011) clearly demonstrated that in the period from 1970 to 2008 at least a quarter of cessation of debt payments took place in countries which had a debt lesser than 48 percent of GDP, and the countries that stand out are Albania, Ecuador and Turkey, which at the moment of cessation of debt payments had debts of 16.6 percent, 20 percent and 21 percent, respectively. (Reinhart and Rogoff 2011, 65-68).

Everything abovementioned indicates that every debtor should be approached with an encompassing analysis which takes into consideration not only quantity measures, such as: debt-to-GDP ratio, term structure, debt purpose, but also quality measures, such as: institutions quality, wideness of and approach to financial markets, borrower's transparency, the policy of consumption and tax. And also, one should never lose sight of the fact that coincidences and contingencies used to push countries over the edge into financial abyss on more than one occasion.

2. CONDITION OF THE REPUBLIC OF SRPSKA DEBT

This paper demonstrates the condition and the structure of the Republic Srpska debt. Analyzing the condition of the Republic of Srpska debt we have noted the difference between the old and the new debt as well as the condition of total debt and external and internal debts. In the analysis results we have noted the violation of the Law on the Budget System, the currency structure of total debt, the total debt structure from the aspect of volatility of repayment terms, the structure from the points of view of total debt repayment, term structure and type of instruments, and consumption and risk indexes of the current debt portfolio. After that, in the debate we have compared the debts of transitional countries to the Republic of Srpska debt. In relation to that, we stated the public debt controversy and the possibility of getting money in foreign markets.

According to the Information on debt as of December 31, 2016 the total debt of the Republic of Srpska in the end of 2016 is BAM 5,439.98 million, which represents 57.09 percent of GDP. The total debt is as follows: the Republic of Srpska debt (budget) in the amount of BAM 3,792.61 million, the debt of local self-government units in the amount of BAM 372.30 million, the social security funds debt in the amount of BAM 181.96 million and the debt of public enterprises and the Investment Development Bank of RS in the amount of BAM 1,093.11 million. The condition of the Republic of Srpska public debt as of December 31, 2015 is BAM 4,346.87 million, which is 45.62 percent of GDP. According to the RS Program of Economic Reforms 2017-2019 adopted by the National Assembly of the Republic of Srpska on December 24, 2016, it was anticipated that the public debt will grow in the future. It was anticipated it would rise to BAM 5,881.7 million in 2017, BAM 6,064.3 million in 2018 and BAM 6,100.9 million in 2019. As for the origin of debt, the condition of the total Republic of Srpska debt as of December 31, 2016 is as follows: the external debt in the amount of BAM 3,167.97 million, consisting of: the Republic of Srpska debt (budget) in the amount of BAM 1,988.22 million, the debt of local self-government units in the amount of BAM 86.64 million, the debt of public enterprises and the Investment Development Bank of the Republic of Srpska in the amount of BAM 1,093.11 million; and the internal debt in the amount of BAM 2,272.01 million, consisting of: the Republic of Srpska debt (budget) in the amount of BAM 1,804.39 million, the debt of local self-government units in the amount of BAM 285.66 million and the social security funds debt in the amount of BAM 181.96 million (Table 1).

Table 1. Amount and structure of total debt in relation to GDP

Category	Amount in BAM	Percentage of GDP	Debt percentage
The total debt	5,439.98	57.09%	100.00%
External debt	3,167.97	33.25%	58.23%
Debt of the Republic of Srpska (budget)	1,988.22	20.87%	36.55%
Debt of local self-government units	86.64	0.91%	1.59%
Debt of public enterprises and IRBs	1,093.11	11.47%	20.09%
Internal debt in amount	2,272.01	23.85%	41.77%
Debt budget	1,804.39	18.94%	33.17%
Debt of local self-government units	285.66	3.00%	5.25%
The total debt	181.96	1.91%	3.34%

Source: Government of Republic of Srpska. Debt information on 31/12/2016, 2017. Retrieved on 04/01/ 2018 from <http://www.narodnaskupstinars.net/?q=la/narodna-skup%C5%A1tina/sjednice/materijali-za-sjednice/materijali-za-20-sjednicu-0 p. 4>.

According to the Law on Borrowing, Debt and Guarantees the total debt of the Republic of Srpska under the Law limitation is in the amount of BAM 5,398.62 million (56.66 percent of GDP), while the public debt under the Law limitation is in the amount of BAM 4,305.51 million (45.19 percent of GDP). In accordance with the Law on Amendments to the Law on Borrowing, Debt and Guarantees of the Republic of Srpska (Official Gazette of Republic of Srpska 52/14 2014), the debt realised on the basis of borrowing with the purpose of financing damage reconstruction from the Unique Register of Damages, prescribed in the Law on the Solidarity Fund for the Reconstruction of the Republic of Srpska, is to be exempt from the limitations prescribed for the total debt (60 percent) and the public debt of the Republic of Srpska (55 percent).

According to the Information of the fiscal sustainability of Bosnia and Herzegovina for 2017 (BiH Directorate for Economic Planning 2017, 2) from the BiH Directorate for Economic Planning the Republic of Srpska borrowing in 2016 was in the amount of 57.5 percent of the Entity's GDP. For the sake of comparison, the Federation of BiH borrowing is in the amount of 36.4 percent of that Entity's GDP. The RS public debt is BAM 4.33 billion or 45.62 percent of gross domestic product. The Ministry of Finance has made an assessment that by the end of the year that debt will decrease to BAM 4.3 billion or 43.08 percent of GDP. To illustrate, approximately BAM 4.5 billion was spent only to repay the prior loans from 2008 to 2017, which is almost 50 percent of GDP or about 2.5 times bigger than the annual income to the budget. The Law on Borrowing, Debt and Guarantees has prescribed limitation to debt so that the total debt of the Republic of Srpska in the end of the fiscal year cannot exceed 60 percent of GDP, while the limitation for the public debt is 55 percent of GDP. Under the Law on Amendments to the Law on Borrowing, Debt and Guarantees of the Republic of Srpska, the debt realised on the basis of borrowing with the purpose of financing damage reconstruction from the Unique Register of Damages, prescribed in the Law on the Solidarity Fund for the Reconstruction of the Republic of Srpska, is to be exempt from the limitations prescribed for the total debt (60 percent) and the public debt of the Republic of Srpska (55 percent). Short-term debt of the Republic of Srpska cannot exceed 8 percent of the regular income amount realised in the previous fiscal year, and the total exposure of the Republic of Srpska under the issued guarantees cannot be higher than 15 percent of GDP realised in that year (Official Gazette of Republic of Srpska 52/14 2014).

As for the time the liability was created, the total external debt consists of the *old* and the *new* debt. According to the Information on debt as of December 31, 2016 (Government of the Republic of Srpska 2017, 7), in the structure of the external debt the *new* debt is in the amount of BAM 2,632.61 million or 83.10 percent, while the *old* debt is in the amount of BAM 535.36 million or 16.90 percent. In 2016 a total of BAM 257.17 million was repaid (including the indirect debt of the Republic of Srpska) on the basis of external debt (BAM 215.12 million on the principal repayment, BAM 42.05 million on repayments of interest, debt service and other expenses, and banking provisions). In 2016 loan assets in the amount of BAM 357.30 million were withdrawn, consisting of BAM 305.86 million for investment projects and BAM 51.44 million for the budget backup. The most part of the loan assets withdrawn in 2016 was the infrastructure investment at 55 percent, then public and budget consumption at 33.34 percent and economic activities at 11.67 percent (Government of the Republic of Srpska 2017, 7-39).

From the aspect of creditors, the largest item in the structure of the condition of the total external debt of the Republic of Srpska is liability to the World Bank (WB IDA, WB IBRD) in the amount of BAM 1,013.22 million, to the European Investment Bank (EIB) in the amount of BAM 906.46 million, to the International Monetary Fund (IMF) in the amount of BAM 375.75 million, to the Paris Club in the amount of BAM 242.39 million, to the European Bank for Reconstruction and Development (EBRD) in the amount of BAM 122.15 million, and to other creditors. Other creditors are as follows: the London Club, the Republic of Korea, the European Commission, the Republic of Austria, the Republic of Poland, the International Fund for Agricultural Development, the Republic of Serbia, the KfW (Reconstruction Credit Institute) Frankfurt on Main, the Government of Japan, the Kingdom of Spain and the OPEC fund in the amount of BAM 507.99 million.

The *old* debt consists of the loan assets used up to April 2, 1992. Consolidation, rescheduling and cancellation of the old debt were started after the war and finished in 2001, except for a couple of credit arrangements whose processes of consolidation and allocation to entities still go on. Consolidated liabilities of the *old* debt allocated to the Republic of Srpska (the budget) are in the amount of BAM 1,162.60 million, BAM 583.57 million was paid out on the basis of principal, and the condition of debt as of December 31, 2016 was in the amount of BAM 535.36 million. The *new* debt consists of loan assets given to the Republic of Srpska (the budget), local self-government units, public enterprises and the Investment Development Bank after the signing of the Dayton Treaty on December 14, 1995. The total of *new debt* authorised funds in this period is in the amount of BAM 5,933.36 million. Until (and including) December 31, 2016 an amount of BAM 3,708.13 million (i.e. 59.34 percent of authorized amount of the new debt) was withdrawn, BAM 1,468.66 million was cancelled, BAM 1,035.07 was paid off, and the condition of debt is in the amount of BAM 2,632.61 million.

In the end of 2016 the internal budget debt is 25.24 percent higher than the value of the same debt in the end of 2011. From the motion of the total internal debt in period from 2012 to 2016 it can

be seen that after the decline of budget debt participation in the total internal debt in 2013, there was a rise of participation in period between 2014 and 2016, as a result of obtaining funds for flood damage reconstruction in 2014, financing of investment projects and the budget consumption from domestic sources, and taking over the PIO Fund debt in 2016. For the sake of comparison, the total internal debt is 22.60 percent higher in the end of 2016 than it was in the end of 2011.

In 2016 there is a significant decrease of participation of social security funds and the RS UKC internal debt in the total internal debt, which is the result of the debt being paid off and the PIO Fund debt being included in the Republic of Srpska budget debt. The internal debt of social security funds and the RS UKC is 16.17 percent higher in the end of 2016 than it was in the end of 2011.

In 2016 BAM 403.5 million was paid on the basis of the internal debt, including the indirect debt of the Republic of Srpska. BAM 351.55 million is for the principal repayment, and BAM 51.95 million on repayments of interest, debt service and other expenses. Until (and including) November 30, 2017 a total of 21 issuance of bonds was executed for the purpose of settlement of liabilities on the basis of a projected internal debt, in the amount of BAM 928.32 million, as follows: seven issuances on the basis of settlement of the old foreign currency savings, three issuances on the basis of general liability and 11 issuances on the basis of war damage. Besides, 28 long-term bond issuances were emitted in the amount of BAM 1,068 million (Banja Luka Stock Exchange 2018). Having in mind that the Republic of Srpska did not have a way to pay out the war damage in the amount of a couple of million BAM, the issuance of the bonds to settle the old foreign currency savings and the war damage for debt settlement were the only possible solutions to clear the debt. This position is even more difficult having in mind that the Entity's alternative option was to block the accounts of their debtors. This blockage would have forced a lot of business enterprises to go bankrupt. As a result, many employees would lose their working status causing an even bigger problem to the Entity. Bond issuance caused bond owners to gain money, while tax debtor cleaned up their ledgers in a way, which made future borrowing a lot easier. At the same time, liquidity increased and new market material was created in the stock exchange (Grujić 2017).

In the end of 2016 the Republic of Srpska short-term debt was in the amount of BAM 88 million, which represents 5.47 percent of the realised budget income in 2015. According to estimation from the Information on debt as of December 31, 2016 every year this debt is approximately at the same level as it was in the previous three years, which would lead to decreased participation of the Srpska short-term debt in the budget income. In the end of 2016 the exposure under the issued guarantees was BAM 346.31 million, i.e. 3.63 percent of GDP, and in the future it is estimated to stay within the range of 3.32 percent of GDP as estimated for 2017 and 2.46 percent of GDP as estimated for 2020. The external debt-to-GDP ratio had a growing tendency from 2012 to 2016, and it is estimated to decline from 2017 onward. The external debt-to-export ratio had a growing tendency until 2015, and a decline was noted in 2016, and the same is expected in the next period of time. The amount of foreign debt servicing in relation to export records growth between 2012 and 2016, and the same is expected until 2017, after which a contrary tendency is expected. The condition of the Republic of Srpska economy highly depends on foreign demand. Tomaš observes that even a slight disturbance in economies which are the most important foreign trade partners can greatly influence economic motions in the Republic of Srpska (Tomaš 2017, 246).

According to the Information on debt as of December 31, 2016 this year the Republic of Srpska is due to repay the biggest rate of a loan so far in the amount of BAM 750 million (Government of the Republic of Srpska 2017, 60-63). Therefore, there is around BAM 0.29 for debt repayment planned on every single BAM that pours into budget through regular income. The internal debt rate is significantly higher than the external debt rate reaching BAM 442.9 million, and external debt will be repaid in the amount of BAM 299 million. In this regard, economists warn that it is necessary to rationalise, that is to optimise public consumption and unburden economy.

The participation of local self-government units' debt in the total internal debt has a tendency of growth until 2013, after which its participation in the total internal debt drops between 2014 and 2016 which is, above all else, the result of its repayment. The internal self-government units' debt in the end of 2016 is 11.63 percent higher than it was in the end of 2011. The participation of the internal debts of social security funds and the University Clinical Centre of the Republic of Srpska (UKC RS) in the total internal debt in 2012-2015 reaches the level of about 14 percent (looking at the face amount, the annual change in period from 2012 to 2016 fluctuated within the range from 0.67 to 81.25 percent).

3. DETERMINING THE CHARACTERISTICS OF THE REPUBLIC OF SRPSKA DEBT

In the 2015 Report on the consolidated annual financial statement for the RS budget users it is emphasised that the Government of the Republic was breaking the Law on budget system (Supreme Office for the Republic of Srpska Public Sector Auditing 2016, 1-5). It is stated that *unsettled liabilities from the past were not planned in the position of expenditures for repayment of unsettled liabilities from past years in the least amount of BAM 78,496,625, which is not in accordance with paragraph 9 of Article 15 of the Law on Budget System of the Republic of Srpska*. The abovementioned refers to a couple of Ministries – budget users. The 2016 Report has similarities. In the 2016 Report on the consolidated annual financial statement for the RS budget users (Supreme Office for the Republic of Srpska Public Sector Auditing 2017, 5) it is emphasised that *unsettled liabilities from the past were not planned in the position of expenditures for repayment of unsettled liabilities from past years in the least amount of BAM 120,102,492, which is not in accordance with paragraph 9 of Article 15 of the Law on Budget System of the Republic of Srpska and paragraphs 3 and 4 of Article 10 of the Law on Fiscal Responsibility in the Republic of Srpska*. In accordance with it, the budget users in the amount of BAM 120,102,492 did not present expenditures on the basis of settlement of the past liabilities in the realisation of the 2016 budget, which is not in accordance with Article 108 of the Rules on budget classification, account contents and use of the chart of accounts for users of the budget income of the Republic of Srpska, municipalities, cities and funds. Based on that, expenditure on repayment of other debts were depreciated for the abovementioned amount of BAM 120,102,492. The same report's section on preparation and adoption of the budget emphasises that *unsettled liabilities from an earlier time were not planned in the position of expenditures for repayment of unsettled liabilities from past years in the least amount of BAM 120,102,492, which is not in accordance with paragraph 9 of Article 15 of the Law on Budget System of the Republic of Srpska, paragraphs 3 and 4 of Article 10 of the Law on Fiscal Responsibility in the Republic of Srpska and paragraph 8 of Article 108 of the Rules on budget classification, account contents and use of the chart of accounts for users of the budget income of the Republic of Srpska, municipalities, cities and funds*. All of it applies to a couple of Ministries – budget users.

Given the fact that the internal debt is denominated in BAM, the BAM has the greatest participation, 41.77 percent to be precise, in the currency structure of the total debt. Having in mind the fact that the Central Bank of Bosnia and Herzegovina (CB BiH) keeps the monetary stability according to the currency board arrangement, the significant participation of euro in the currency structure of almost one third of the amount (31.51 percent exactly) can be considered as favourable. What's more, even according to the Medium Term Debt Management Strategy of Bosnia and Herzegovina the currency risk is moderate (Ministry of Finance and Treasury of Bosnia and Herzegovina 2017, 15) (Table 3).

Table 2. The currency structure of Republic of Srpska debt

Currency	Percentage
KM	41.77
EUR	31.51
SDR	19.57
USD	2.67
CPU	1.76
Other	2.72
Total	100

Source: Government of Republic of Srpska 2017

In 1999 Bosnia and Herzegovina adopted the system of currency board. To tell the truth, this move has given results in the field of country's inflation reduction representing a significant contribution to the regulation of the finance sector. The currency board implies constantly fixed exchange rate, foreign-exchange reserve in a stable currency at a level sufficient to cover the amount of money (in paper and coins) and unlimited internal convertibility, i.e. the ability to convert domestic money into the currency of the reserve and *vice-versa* at a fixed rate. In this regard the binding of the

BAM to the EUR has been an *anchor keeping the Bosnia and Herzegovina vessel from unnecessary wandering across the stormy seas of transition* (Đogo 2011).

A high participation of euro and convertible mark makes it easier to anticipate future paying of liabilities. In this respect, the Republic of Srpska is less exposed to currency risk. On the other hand, the American dollar participates with 19.57 percent, and Serbian dinar with 2.67 percent, which means that the strengthening of dollar value can increase the external debt. Should that happen, it would be necessary to extract a higher amount in convertible marks to service the external debt. In fact, the US dollar participates with more than 40 percent in this batch (International Monetary Fund 2017). To illustrate things, the external debt was increased for BAM 18.56 million in 2016 as a result of negative changes in exchange rate. In this respect, if dollar changes for one percent, the external debt changes for about 0.2 percent or BAM 6.34 million.

For small countries like Bosnia and Herzegovina, whose size and openness makes them dependent on foreign trade, the participation in processes of regional cooperation and integration represents a condition without which no further progress can be achieved (Kovač 2017, 41). Regarding that, and having in mind what was previously mentioned, it is safe to conclude that future credit loans should be agreed in convertible marks or euros. As a result of the currency board implementation, the CB BiH cannot print Fiat money in order to lend money to the state. This circumstance is viewed as being positive. In fact, it is precisely loans like this that represent the most common cause of high inflation rates in the world. On the other hand, precisely the fact that the CB BiH does not determine the amount of money assets in economy allows the possibility to turn the system's greatest advantage into its greatest disadvantage if the circumstances cease to be favourable. Foreign money flows into Bosnia and Herzegovina more often than it flows out of it but borrowing and inflow decreasing can lead Bosnia and Herzegovina in a great trap. It would mean that the constant growth or foreign money reserves has been replaced by the public debt growth and decline of foreign money reserves.

In the external debt structure, the debt being repaid under fixed conditions has a share of 53.56 percent, the debt being repaid under variable conditions has 46.16 percent and 0.29 percent of the debt still doesn't have confirmed repayment conditions (a share of the Paris club debt). In the internal debt structure, the debt being repaid under fixed conditions has a share of 69.78 percent, the debt being repaid under variable conditions has 14.83 percent and the debt not yet being repaid because it has not been verified yet (a share of projected internal debt) has 15.39 percent. According to that, the majority of debt i.e. 60.33 percent is being repaid under fixed interest rates. However, 6.59 percent of debt has not yet been verified in some way and there is no fixed repayment plan (Table 3). The structure of external debt which is being repaid under variable conditions according to the interest rate type (the analysis having included not only variable interest rates but also variable margins) is as follows: EURIBOR 44.05 percent of the debt, IMF-SDR (Special Drawing Rights) 25.4 percent, EUR LIBOR 14.69 percent, USD LIBOR 8.37 percent and others 7.5 percent.

Table 3. Structure of total debt from the aspect of volatility of the interest rate

Conditions	Percentage
Fixed conditions	60.33
Variable conditions	33.07
No repayment method is established / not verified	6.59
In total	100

Source: Government of Republic of Srpska. 2017

The debt classification according to instruments was enacted under the OECD methodology from 2002. It is important to highlight the fact that some loans are still in grace period. So, the principal of all the withdrawn loans has not yet started being repaid. Namely, 63.16 percent of the total debt is under repayment, while 36.84 percent is in grace period.

From the total external debt, 67.12 percent is under repayment. Thus, 98.31 percent of the *old* debt is under repayment, as well as 60.78 percent of the *new* debt. From the total internal debt, 57.63 percent is under repayment, and the rest is in grace period.

The marketable debt constitutes 30.19 percent of total debt, consisting of bonds and the local self-government units' debt, as well as treasury bills. According to that, debt can be considered as being almost completely long-term. Namely, the short-term total debt is only 1.67 percent of the RS total debt. According to the Information on debt in the end of 2016 the low participation of the short-

term debt in the total debt is to be preserved, under the limitation adopted in the Law on Borrowing, Debt and Guarantees.

According to its instruments, debt can be seen in the form of loan, securities, or debt which is being repaid under action plan or in cash. According to the Law on Borrowing, Debt and Guarantees of the Republic of Srpska, debt in the form of credit agreements encompasses the total external debt (except for the London Club of Creditors), long-term liabilities of the Republic of Srpska, internal borrowing of local self-government units, social security funds and public health institutions' funds (Official Gazette of Republic of Srpska 71/12 2012). In the securities structure there are bonds issued on the basis of projected internal debt (general liabilities, old foreign currency savings, war damages and executive procedural decisions), long-term bonds of the Republic of Srpska for raising money, treasury bills, the London Club bonds, and local self-government units' bonds. The share which is being repaid under action plan or in cash refers to the projected internal debt on the basis of the verified war damages, old foreign currency savings, executive procedural decisions, tombstones and tax refunds to municipalities and funds.

Weighted average interest rate of total debt is 2.34 percent, of external debt 1.22 percent and of internal debt 4.58 percent. A debt is considered sustainable when the level or growth rate of the real GDP is higher than the weighted interest being paid for debt. According to the IMF and the World Bank criteria, a country is over-indebted when debt exceeds 80 percent of the GDP. In the end of 2016 the GDP was in the amount of BAM 9.63 billion in the RS, the GDP per capita was BAM 8,321, and the real growth rate was 3.5 percent. GDP had a positive growth rate of 2.2 percent in the first trimester of 2017 in comparison to the first trimester of 2016. Taking that into account, as well as the data shown so far, debt is sustainable in the long run. Namely, the average annual inflation rate, i.e. deflation rate in the Republic of Srpska in 2016 was 1.2 percent. A year earlier it was 0.2 percent. To illustrate things, the inflation in Bosnia and Herzegovina in 2016 was -1.1 percent.

According to the Republic of Srpska Institute of Statistics data in 2016, trade sector has the biggest participation in the GDP structure (11.1 percent), followed by the processing industry (10.8 percent) with agriculture, hunting and forestry (9.3 percent) in the third place. It is here where we emphasise that these sectors should have a greater participation in GDP. With that in mind, a negative tendency should not be overlooked. In 2008 the introduction of the VAT and tax reforms resulted in high growth rate of salaries in health care system (83.3 percent), education (67.83 percent), service industry (58.1 percent) and public administration (14.8 percent). On the other hand, the average net wages in real sector did not follow this growth. Wages in the processing industry grew at a rate of 12.6 percent, in construction industry 9.5 percent, in agriculture 23 percent, in ore and stone extraction 22.8 percent and so on. This tendency along with constant employment in public sector caused a paradox of increase in rates of taxes and contribution during the economic crisis, instead of decrease of these rates.

Future projections show the repayments of the internal and external debts shall increase in the next couple of years. This is of the utmost importance for 2018 – when sizeable liabilities on the basis of internal debt in the form of medium-term bonds and long-term credits are due to be repaid. Also, the increase in the external debt repayment refers to the maturity of debt on the basis of the stand-by arrangement with the IMF. Still, according to the relevant documents into which we had an insight, the risk of refinancing is also assessed as moderate.

It was demonstrated that debt is characterised by favourable risk indexes. It is a result of significant participation of concessional financial sources, and bonds of unsettled liabilities on the basis of the internal debt with low expenditures and a long maturity (Bosnia and Herzegovina Ministry of Finance and Treasury 2017, 18). In relation to that, keeping expenditures and risk indexes at a relatively low level is challenging for the Republic of Srpska, keeping in mind the changed structure of financial sources. Namely, having in mind the fact that these, concessional financial sources shall be less available in the future, it is necessary to find other external and/or domestic sources paying attention that the growth of expenditures and risk indexes stays within acceptable limits.

4. DISCUSSION

Experiences of the countries with debt crises point to the fact that depending too much on foreign capital and borrowing at foreign markets leads to the collapse of the financial system. For developing countries, like ours, the problem lies in the abrupt termination of fixed foreign exchange

rate. In the case of Bosnia and Herzegovina, the termination of the currency board regime would lead to devaluation of convertible mark in respect to other currencies. All the debts not denominated in convertible marks would at that point rise compared to their current amount in convertible marks. In other words, the debt-to-GDP ratio would grow, too. Argentina experiences a similar collapse in 2001. After abandoning of fixed foreign exchange rate, the value of peso per dollar decreased by about 70 percent. Depreciation caused the public debt and GDP to rise from 51.5 percent to 122 percent a year later.

According to abovementioned data, the RS is more indebted than most European countries which are more successful during transition. There are two exceptions: Hungary with 74.1 percent and Slovenia with 79.7 percent of debt-to-GDP ratio.

According to the Eurostat statistics, it is obvious that the Maastricht criteria are overlooked in a great deal of cases. The state debt-to-GDP ratio of the EU-28 member states decreased from 84.9 percent in the end of 2015 to 83.5 in the end of 2016, while it decreased from 90.3 percent to 89.2 percent in EA-19 (Eurostat 2017). In the end of 2016, 16 member states had a debt-to-GDP ratio higher than 60 percent. The highest ratio was recorded in Greece (179,0 percent), then Italy (132.6 percent), Portugal (130.4 percent), Cyprus (107.8 percent) and Belgium (105.8 percent). The lowest participation of the state debt in GDP was recorded in Estonia (9.5 percent), Luxembourg (20.0 percent) and Bulgaria (29.5 percent) (Eurostat 2017).

The countries which have experienced the greatest difficulties while balancing the budget are Spain, with -4.5 percent deficit, France with -3.4 percent and Romania with the United Kingdom with -3.0 percent.

Based on the Stability and Growth Pact, the EU member states are under obligation to keep deficit and debt under certain limits. For example, the state deficit of a member state cannot exceed three percent of the gross domestic product (GDP), and its debt cannot exceed 60 percent of GDP. Therefore, if a certain member state does not operate under these limitations, a so-called Excessive Deficit Procedure shall be activated. After the 2008 financial crisis the European Union indebtedness rose from 60 percent of GDP to over 80 percent of GDP in 2010. From the Eurostat date it can be seen that most member states are still struggling with balancing the budget, and state debt is already alarmingly high in some member states. Therefore, it is only right to ask up to which point the European Union is willing to tolerate deviations from its basic founding principles and where the limit to pre-determined flexibility lies.

Political elites often misuse the debt-to-GDP ratio. The conditions, deadlines and reason for borrowing should be in the focus of debates. Reasons for borrowing, as well as conditions are often overlooked. For example, Japan has the greatest debt-to-GDP ratio in the world with over 230 percent. At the same time, the budget deficit in Japan is more than seven percent of GDP. What's even more interesting, all the anticipations based on relevant strategies and documents are showing that in the near future this ratio will grow even higher – in the favour of debt. Besides, half of the money Japan collects through taxes is allocated to servicing of public debt – mostly interest. Japanese public debt is largely caused by the catastrophic earthquake, but it is also caused by overestimated yen and reduced export, and by deflation. For a developing country these indexes would have been devastating, but interest on Japanese state bonds is still less than 0 percent, in spite of over-indebtedness (Bloomberg 2017).

Greece, as expected, holds the second place among the biggest debtors. On the one hand, Japanese economy keeps growing, despite the constant borrowing, and unemployment can be ignored. On the other hand, Greek public finance is in dire straits. Besides, Japan has a high A credit rating (AAA being the highest, AA being the next, and so on), while Greece is already in the category of partial bankruptcy. Mathematically, investors underestimate the risk of Japan declaring bankruptcy. Japan is the world's third economy. If, due to a quick decline of number of citizens, Japan becomes the new Greece it would represent a financial tsunami on a global scale. Such a scenario would show that financial markets have been blind for years with Japan still servicing the debt. However, one of the advantages of Japan is the large assets it can sell quickly and repay a part of debt with the money it receives. On the other hand, Greece does not own a great deal of valuable asset it could quickly sell. Besides, Japan borrows mostly from – its citizens, with even 95 percent of the money being borrowed on the basis of the Japanese people making deposits in the Japanese banks. Basically, Japan holds its position thanks to the fact that, unlike Greece, it succeeds to repay accruals, no matter how big they may be. Greece has been borrowing mostly abroad, under much less favourable conditions – with higher interest and hasn't been repaying accruals regularly.

As the world's greatest economy, the USA has an excellent credit rating and a high public debt. Also, unlike the countries with equal or lesser public debt – investors still eagerly buy the USA bonds, despite the fact that yield on the US long-term bonds is higher than 2.3 percent. Financial markets, however, place much more trust in Japan than in the USA market. According to estimations of the US Congressional Budget Office, American debt might rise up to 200 percent of GDP, which is more than Greece and Japan, in the next twenty years. The next biggest debtor is Italy, with debt at about 132.6 percent of GDP. Portugal holds the fifth place, with public debt at 130.4 percent of GDP. Belgium is next, with public debt at 105.8 percent of GDP. In order to draw the attention to the moves which a country like ours should not make, we will demonstrate the history of Belgium's debt. In the end of the last century public debt was about 130 percent of GDP. Until the beginning of the 2008 world's economy crisis it decreased to less than 85 percent. After that, during the crisis, it grew just like in other countries. Debt grew as a result of the reaction to the 1973 oil crisis and another crisis six years later. The said crises resulted in many layoffs and many workers occupied work positions in public sector not due to their competence, but due to their political or family ties. At the same time, Belgium used incentives to prop domestic industry whose competitiveness was shrinking. Textile, coal, steel and shipbuilding industry were given the biggest incentives. Here we perceive the same mistake that the SFRY made when it employed about a third of extra workers in industries that were making losses. These movements are basically financing of social peace by borrowing and enlarging public debt.

Among the countries that have GDP higher than in our country are Singapore, with public debt over 90 percent of GDP, France with 96.5 percent, Ireland with 77.9 percent of GDP etc. Therefore, public debt lower than 60 percent does not say much about the level of development of that country. However, such countries are able to overcome their problems, because of the investors' trust and also their wealth and marketable assets. Besides, developed countries are ranked better in rating agencies. In accordance with that, they can borrow under much more favourable conditions.

Economic crises of the last couple of years have shown that insisting on keeping public debt within *acceptable limits*, in order to preserve social, financial and fiscal stability, along with ignoring experience of others and irrational borrowing can lead to many misconceptions. Chasing new opportunities, American investment funds and financial institutions were lending loans in dollars in the Far East. As a consequence of such behavior, GDP was growing at rates between eight and ten percent. Such growth created an illusion of the Asian economic miracle. By converting dollar into domestic currencies, and by neglecting any risks, local banks were lending loans at high interest rates. In that way they were making profits on the account of the difference between the lent credits and the interest rates under which they were borrowing abroad. In the end of 1996, a year prior to the 1997 Southeast Asia crisis, debt-to-GDP ratio was 35 percent in Malesia, 26 percent in Indonesia, 15 percent in Thailand and 9 percent in South Korea. After depreciation of Asian currencies and a decline in the inflow of credits from abroad during 1997 foreign capital started leaving the country, despite the interventional politics of the said countries. The withdrawing of American creditors caused bankruptcy of banks and companies, and later even states. As a result, foreign institutional investors took over a lot of Asian companies at low prices. A similar pattern was seen in Ireland ten years later. So, excessive borrowing in public sector has triggered financial crisis. The described behaviour pattern disregarded the warnings saying that a healthy GDP growth happens as a result of increased productivity, and not as a result of money importation (Krugman 1998). Tanzi (2010) reminds of the fact that transformation of market economy is not complete until operating fiscal institutions and reasonable and accessible expenditure programs, including the basic social welfare networks for the unemployed, sick and aging people are established. These expenditure programs should be financed from public revenues which are generated – through taxing – without overburdening the private sector. With that in mind, keeping the public debt within *acceptable limits* according to the Maastricht criteria, in order to maintain social, financial and fiscal stability, along with irrational borrowing is a safe way to collapse the system.

The BiH Ministry of Finance and Treasury has agreed upon the creation and monitoring of sovereign BiH credit rating with international rating agencies of Moody's Investors Service and Standard & Poors, on the behalf of the Bosnia and Herzegovina and pursuant to a decision of the Council of Ministers (Central Bank of Bosnia and Herzegovina 2017). The Standard & Poors rating agency confirmed sovereign credit rating of Bosnia and Herzegovina at *B with stable outlook* on September 8, 2017 (Central Bank of BiH 2017). In February 2016 the Moody's Investors Service agency confirmed the BiH sovereign credit rating at *B3 with stable outlook*. The Moody's Investors

Service credit rating agency confirmed the Republic of Srpska credit rating at *B3 with stable outlook* (Central Bank of BiH 2017). Given the methodology of credit rating, ranges between the levels and the state of the country, it is highly unlikely that the Republic of Srpska would have a different credit rating than Bosnia and Herzegovina.

According to the Standard and Poor's agency, other countries with sovereign credit rating at *B with stable outlook* are Nigeria, Pakistan and Uganda. 10-year bond yield of these countries is 14.8 percent, 7.9 percent and 14.2 percent, respectively. This credit rating is one notch above Greece. Cameroon, Ecuador, Ethiopia, Jamaica, Nigeria, Pakistan, Rwanda, Uganda, Egypt, Ghana and Moldova all have the same rating. According to the Moody's agency countries at *B3 with stable outlook* are Egypt and Pakistan, too. Currently, 10-year bond yield of these countries is 16.21 percent and 7.9 percent. Countries like Honduras and Sri Lanka have a better credit rating than BiH. Looking at these indicators only, one might believe that borrowing 10-year bonds in foreign markets with 8 percent interest rate would be a pleasant surprise. Such appraisal of credit rating shows that bonds issued by a country with such rating do not have investment, but speculative rating. And that is why interest rates are so high.

Other interesting phenomena are present in this area. For example, yield to 5-year bonds of the Federation of BiH issued on December 27, 2017 was 1.2 percent. At the same time, yield to 5-year bonds of the USA was 2.23 percent. Looking at these indicators only, one might say that the BiH Federation is less likely to go bankrupt than the USA. When the issuance in foreign market occurs, foreign investors shall definitely be looking at success and amount of recent issuances.

Countries with the *B with stable outlook* credit rating have a low credit rating showing that the bonds they issue have a high credit risk. One notch above there is *B plus*. This level, too, marks a very high credit risk. One notch below there is *B minus*. Precisely B minus is the borderline separating a country from it declaring it is not able to service its foreign debt. Each of the next ratings below that one represents a country which is not able to settle all its liabilities.

Downgrading of rating may be a result of the IMF support deprivation or termination of cooperation with other international financial institutions. It would mean that borrowing abroad would cost BiH even more. Besides, simply negotiating an arrangement with the IMF, i.e. asking the IMF for help is a signal to major-league investors that the country's situation is not positive.

5. CONCLUSION

This paper demonstrates that indebtedness indexes have been staying within their legal limitations lately. It is shown that the Republic of Srpska debt is characterized by favourable risk indicators, which is the result of many factors. The first factor is a significant participation of concessional financial sources. The second, participation of bonds of unsettled liabilities on the basis of the internal debt with low expenditures and a long maturity. And the third, the moderate risk from the aspect of volatility of repayment terms, and from the points of view of total debt repayment, term structure and type of instruments. Related to that, keeping expenditures and risk indexes at a relatively low level is a challenge for the Republic of Srpska. Namely, having in mind the fact that concessional financial sources shall be less available in the future, it is necessary to find other external and/or domestic sources paying attention that the growth of expenditures and risk indexes stays within acceptable limits.

It is advisable to keep a steady course of keeping fiscal stability and adopt the decisions on borrowing while respecting the guidelines under the Republic of Srpska Debt Management Strategy. With that in mind, it is necessary to respect the golden rule of borrowing and look for long-term financial sources when funding long-term projects which provide profits. Therefore, only the projects which contribute to the enlargement of the economic growth or employment should be supported. In accordance with it, the projects which are not profitable and/or carry high costs and risks should not be further funded.

So far, the Banja Luka Stock Exchange has issued bonds at interest rate within the range from 3.2 percent to 6 percent. On the one hand, it is advisable that the Republic of Srpska makes its appearance in the international market, in order to gain international creditworthiness and credibility. With that in mind, the state's borrowing is recommended, because otherwise there would be a financial collapse due to excessive liquidity. In fact, banks keep record amounts beyond the obligatory required reserves, and the state cannot compete with these funds in any way; it even pays bigger yield

than some companies do. On the other hand, gaining favourable interest rate by issuance of bonds outside BiH would compromise reports from credit rating agencies and declarations from Bloomberg, Forbs, the World Bank and others on the state of the country.

Despite the fact that it is unpopular, the currency board system suits the Republic of Srpska well. In the case the board was cancelled, there would be depreciation of the domestic currency in relation to euro and dollar. There are many negative effects of abrupt depreciation to a small and open country. For example, credit repayment of people, companies and the Government would rise, import prices would rise which would lead to inflation, but the savings in marks and real income of people would drop. Besides, securities in marks would no longer be so appealing and that would additionally decrease the role of the domestic stock exchange. Even worse, counter value of external debt as a part of GDP would increase, and value of loans of companies that export goods and services would decrease. All of it together would make investors trust less in the ability debt repaying. On the other hand, exporters would gain in the case of depreciation because their products are cheaper abroad. Similarly, depreciation suits foreign tourists.

The average interest rate of the Republic of Srpska debt was 2.34 percent in 2016, and the average GDP growth in 2016 was 4.62 percent, nominally. GDP in the Republic of Srpska is expected to vary from 2 percent to 4 percent. The debt whose average interest rate is lower than the GDP growth rate is considered sustainable at a long-term.

The gross financing needs for financing internal and external debt, based on the projections from the Information on debt as of December 31, 2016, are BAM 849.68 million, or 8.81 percent of GDP. In the case of markets like the Republic of Srpska (emerging markets), it is supposed that any amount between 10 and 15 percent of gross financing needs does not jeopardise the operating of public finances. Therefore, debt is sustainable. However, it is necessary to take measures to elongate the average debt duration, currently it is 6.32 years. A longer debt deadline means lower annual burden and more money for other purposes. Also, Srpska should implement the Debt Management Performance Assessment (DEMPA), the World Bank's methodology in debt management to raise effectiveness in debt management and lower future risks, but notwithstanding the fact that the level of gross financing needs does not jeopardise the public finances operating, it is necessary to do a detailed analysis of the Republic of Srpska debt sustainability in order to support the debt management strategy. Having all the said in mind, it is necessary to stipulate the future credit agreements in convertible marks or euros.

Finally, it is not possible to compare the debts of the Republic of Srpska and the BiH Federation, due to different debt definitions and reasons for borrowing, and estimating only on the basis of the 2007 fiscal collapse the difference between the Federation and the Republic of Srpska is BAM 400 million. Also, debt has been affected by the payout of retirement savings on the basis of unrealised rights creating a loss in the amount of BAM 1 billion, which is the amount that the Pension and Disability Fund of the Republic of Srpska (Fond PIO) claims from the Federal Fund. Besides, it's the fact that the Republic of Srpska increased its debt by BAM 2.4 billion from 2008 to 2016 on the basis of international borrowing. Infrastructural projects received 1.6 billion from that amount. Fiscal collapses can be felt, but they need to be controlled, anticipated and their management should be more effective.

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