

Public Disclosure Authorized

CONFORMED COPY

LOAN NUMBER 7896-BA

Loan Agreement

(First Programmatic Public Expenditure Development Policy Loan)

between

BOSNIA AND HERZEGOVINA

and

INTERNATIONAL BANK FOR RECONSTRUCTION
AND DEVELOPMENT

Dated June 3, 2010

LOAN AGREEMENT

Agreement dated June 3, 2010, entered into between BOSNIA AND HERZEGOVINA (“Borrower”) and INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (“Bank”) for the purpose of providing financing in support of the Program (as defined in the Appendix to this Agreement). The Bank has decided to provide this financing on the basis, inter alia, of: (a) the actions which the Borrower, through the Entities, has already taken under the Program and which are described in Section I of Schedule 1 to this Agreement; and (b) the Borrower’s maintenance of an appropriate macroeconomic policy framework. The Borrower and the Bank therefore hereby agree as follows:

ARTICLE I - GENERAL CONDITIONS; DEFINITIONS

- 1.01. The General Conditions (as defined in the Appendix to this Agreement) constitute an integral part of this Agreement.
- 1.02. Unless the context requires otherwise, the capitalized terms used in this Agreement have the meanings ascribed to them in the General Conditions or in the Appendix to this Agreement.

ARTICLE II - LOAN

- 2.01. The Bank agrees to lend to the Borrower, on the terms and conditions set forth or referred to in this Agreement, the amount of thirty one million three hundred thousand Euros (EUR 31,300,000), as such amount may be converted from time to time through a Currency Conversion in accordance with the provisions of Section 2.07 of this Agreement (“Loan”).
- 2.02. The Borrower may withdraw the proceeds of the Loan in support of the Program in accordance with Section II of Schedule 1 to this Agreement.
- 2.03. The Front-end Fee payable by the Borrower shall be equal to one quarter of one percent (0.25%) of the Loan amount.
- 2.04. The interest payable by the Borrower for each Interest Period shall be at a rate equal to LIBOR for the Loan Currency plus the Variable Spread; provided, that upon a Conversion of all or any portion of the principal amount of the Loan, the interest payable by the Borrower during the Conversion Period on such amount shall be determined in accordance with the relevant provisions of Article IV of

the General Conditions. Notwithstanding the foregoing, if any amount of the Withdrawn Loan Balance remains unpaid when due and such non-payment continues for a period of thirty days, then the interest payable by the Borrower shall instead be calculated as provided in Section 3.02 (d) of the General Conditions.

- 2.05. The Payment Dates are March 15 and September 15 in each year.
- 2.06. The principal amount of the Loan shall be repaid in accordance with the amortization schedule set forth in Schedule 2 to this Agreement.
- 2.07. (a) The Borrower may at any time request any of the following Conversions of the terms of the Loan in order to facilitate prudent debt management: (i) a change of the Loan Currency of all or any portion of the principal amount of the Loan, withdrawn or unwithdrawn, to an Approved Currency; (ii) a change of the interest rate basis applicable to all or any portion of the principal amount of the Loan withdrawn and outstanding from a Variable Rate to a Fixed Rate, or vice versa; and (iii) the setting of limits on the Variable Rate applicable to all or any portion of the principal amount of the Loan withdrawn and outstanding by the establishment of an Interest Rate Cap or Interest Rate Collar on the Variable Rate.
- (b) Any conversion requested pursuant to paragraph (a) of this Section that is accepted by the Bank shall be considered a “Conversion”, as defined in the General Conditions, and shall be effected in accordance with the provisions of Article IV of the General Conditions and of the Conversion Guidelines.
- (c) Promptly following the Execution Date for an Interest Rate Cap or Interest Rate Collar for which the Borrower has requested that the premium be paid out of the proceeds of the Loan, the Bank shall, on behalf of the Borrower, withdraw from the Loan Account and pay to itself the amounts required to pay any premium payable in accordance with Section 4.05 (c) of the General Conditions up to the amount allocated from time to time for the purpose in the table in Section II of Schedule 1 to this Agreement.
- 2.08. Without limitation upon the provisions of Section 5.08 of the General Conditions (renumbered as such pursuant to paragraph 4 of Section II of the Appendix to this Agreement and relating to *Cooperation and Consultation*), the Borrower shall promptly furnish to the Bank such information relating to the provisions of this Article II as the Bank may, from time to time, reasonably request.

ARTICLE III - PARTICULAR COVENANTS

- 3.01. The Borrower shall: (a) relend an amount of eighteen million seven hundred eighty thousand Euros (EUR 18,780,000) out of the proceeds of the Loan to the Federation under the Federation Subsidiary Loan Agreement; and (b) relend an amount of twelve million five hundred twenty thousand Euros (EUR 12,520,000) out of the proceeds of the Loan to Republika Srpska under the RS Subsidiary Loan Agreement, all on terms and conditions satisfactory to the Bank.
- 3.02. The Borrower shall exercise its rights under the Subsidiary Loan Agreements in such a manner as to protect the interests of the Borrower and the Bank and to accomplish the purposes of the Program, and, except as the Bank shall otherwise agree, the Borrower shall not assign, amend, abrogate or waive the Subsidiary Loan Agreements or any provision thereof.

ARTICLE IV - PROGRAM

- 4.01. The Borrower, through the Entities, declares its commitment to the Program and its implementation. To this end, and further to Section 5.08 of the General Conditions:
- (a) the Borrower and the Bank shall from time to time, at the request of either party, exchange views on the Borrower's macroeconomic policy framework and the progress achieved in carrying out the Program;
 - (b) prior to each such exchange of views, the Borrower shall furnish to the Bank for its review and comment a report on the progress achieved in carrying out the Program, in such detail as the Bank shall reasonably request; and
 - (c) without limitation upon the provisions of paragraphs (a) and (b) of this Section, the Borrower shall and shall cause the Entities to promptly inform the Bank of any situation that would have the effect of materially reversing the objectives of the Program or any action taken under the Program including any action specified in Section I of Schedule 1 to this Agreement.

ARTICLE V - REMEDIES OF THE BANK

- 5.01. The Additional Event of Suspension consists of the following, namely that a situation has arisen which shall make it improbable that the Program, or a significant part of it, will be carried out.
- 5.02. The Additional Event of Acceleration consists of the following, namely that the event specified in the preceding Section 5.01 occurs and is continuing for a period of sixty (60) days after notice of the event has been given by the Bank to the Borrower.

ARTICLE VI - EFFECTIVENESS; TERMINATION

- 6.01. The Additional Conditions of Effectiveness consist of the following:
 - (a) the Bank is satisfied with the progress achieved by the Borrower and the Entities in carrying out the Program and with the adequacy of the Borrower's macroeconomic policy framework;
 - (b) the Federation Subsidiary Loan Agreement has been executed with terms and conditions satisfactory to the Bank;
 - (c) the RS Subsidiary Loan Agreement has been executed with terms and conditions satisfactory to the Bank; and
 - (d) the Financing Agreement has been executed and delivered and all conditions precedent to its effectiveness or to the right of the Borrower to make withdrawals under it (other than the effectiveness of this Agreement) have been fulfilled.
- 6.02. The Additional Legal Matters consist of the following.
 - (a) the Federation Subsidiary Loan Agreement has been duly authorized or ratified by, and is legally binding upon the Borrower and the Federation in accordance with its terms; and
 - (b) the RS Subsidiary Loan Agreement has been duly authorized or ratified by, and is legally binding upon the Borrower and RS in accordance with its terms.
- 6.03. The Effectiveness Deadline is the date one hundred twenty (120) days after the date of this Agreement.

ARTICLE VII - REPRESENTATIVE; ADDRESSES

- 7.01. The Borrower's Representative is the Minister of Finance and Treasury of Bosnia and Herzegovina.

7.02. The Borrower's Address is:

Ministry of Finance and Treasury
Trg BiH 1
71000 Sarajevo
Bosnia and Herzegovina

Facsimile:

(387-33) 202-930

7.03. The Bank's Address is:

International Bank for Reconstruction and Development
1818 H Street, N.W.
Washington, D.C. 20433
United States of America

Cable address:

Telex:

Facsimile:

INTBAFRAD
Washington, D.C.

248423(MCI) or
64145(MCI)

1-202-477-6391

AGREED at Sarajevo, Bosnia and Herzegovina, as of the day and year first above written.

BOSNIA AND HERZEGOVINA

By /s/ Dragan Vrankic

Authorized Representative

**INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT**

By /s/ Marco Mantovanelli

Authorized Representative

SCHEDULE 1**Program Actions; Availability of Loan Proceeds****Section I. Actions under the Program**

The actions taken by the Borrower, through the Entities, under the Program include the following:

1. The Parliament of RS has enacted a law, satisfactory to the Bank, on targeting of cash benefits mandating the targeting to needs.
2. The Parliament of the Federation has enacted a law, satisfactory to the Bank, with a view to: (a) targeting cash benefits by way of mandating targeting to needs; (b) introducing a coefficient mechanism for all rights-based benefit schemes; and (c) introducing the indexation of all rights-based benefits to inflation instead of wage growth.
3. The Parliament of RS has enacted a law, satisfactory to the Bank, amending the RS Law on the Rights of War Veterans and Families of Deceased Soldiers (Official Gazette No. 55/07) with a view to introducing, as of January 1, 2011, the targeting to means for the following benefits: (a) disabled war veterans with disability level 20% to and including 50%; and (b) all family benefits with the exception of children under age 27 who receive full time education.
4. The Parliament of the Federation has enacted a law, satisfactory to the Bank, amending the Federation Law on Rights of Defenders and their Families (Official Gazette No. 33/04, as amended) with a view to introducing: (a) as of January 1, 2011, the targeting to means for the following benefits: (i) disabled war veterans with disability level 20% to and including 50%; and (ii) all family benefits with the exception of children under age 27 who receive full time education; (b) a coefficient mechanism for rights-based benefit schemes under said Law; and (c) indexation of rights-based benefits under said Law to inflation instead of wage growth.
5. The Parliament of the Federation has enacted a law, satisfactory to the Bank, amending Federation Law on Special Rights of the Holders of Military Decorations (Official Gazette No. 70/05) with a view to introducing: (a) income means testing as of May 1, 2010; (b) a coefficient mechanism for rights-based benefit schemes under said Law; and (c) indexation of rights-based benefits under said Law to inflation instead of wage growth.
6. The Parliament of the Federation has enacted a law, satisfactory to the Bank, repealing the Federation Law on Rights of Demobilized Soldiers and their

Families (Official Gazette No. 61/06) and providing that benefits extended to current beneficiaries pursuant to said Law will cease on April 30, 2010.

7. The Parliament of the Federation has enacted a law, satisfactory to the Bank, mandating the carrying out of eligibility audits for right-based veterans' benefits and including a detailed plan providing for the implementation of said law based on a clear set of priorities for the carrying out of said audits, including, but not limited to, a targeted review of all disabled veterans in the disability category of 60%-80%.
8. The Government of RS has adopted an action plan, in form and substance satisfactory to the Bank, to improve the carrying out of audits of the current status and rights of disabled war veterans, including all disabled war veterans in disability categories 1 to 10 and the families of deceased soldiers.

Section II. Availability of Loan Proceeds

- A. **General.** The Borrower may withdraw the proceeds of the Loan in accordance with the provisions of this Section and such additional instructions as the Bank may specify by notice to the Borrower.
- B. **Allocation of Loan Amounts.** The Loan (except for amounts required to pay the Front-end Fee) is allocated in a single withdrawal tranche, from which the Borrower may make withdrawals of the Loan proceeds. The allocation of the amounts of the Loan to this end is set out in the table below:

Allocations	Amount of the Loan Tranche Allocated (expressed in Euros)
(1) Single Withdrawal Tranche	31,221,750
(2) Front-end Fee	78,250
(3) Premium for Caps and Collars (Amount due pursuant to Section 2.07(c) of this Agreement)	0
TOTAL AMOUNT	31,300,000

C. Withdrawal Tranche Release Conditions.

No withdrawal shall be made of the Single Withdrawal Tranche unless the Bank is satisfied: (a) with the Program being carried out by the Borrower and the Entities; and (b) with the appropriateness of the Borrower's macroeconomic policy framework.

D. Deposits of Loan Amounts. Except as the Bank may otherwise agree:

1. all withdrawals from the Loan Account shall be deposited by the Bank into an account designated by the Borrower and acceptable to the Bank for on-lending by the Borrower to the Entities pursuant to Article III of this Agreement; and
2. the Borrower shall ensure that upon deposit of an amount of the Loan into this account, an equivalent amount is accounted for in the Borrower's budget management system, in a manner acceptable to the Bank.

E. Excluded Expenditures. The Borrower undertakes and shall cause the Entities to undertake that the proceeds of the Loan shall not be used to finance Excluded Expenditures. If the Bank determines at any time that an amount of the Loan was used to make a payment for an Excluded Expenditure, the Borrower shall, promptly upon notice from the Bank, refund an amount equal to the amount of such payment to the Bank. Amounts refunded to the Bank upon such request shall be cancelled.

F. Closing Date. The Closing Date is December 31, 2010.

SCHEDULE 2**Amortization Schedule**

1. The following table sets forth the Principal Payment Dates of the Loan and the percentage of the total principal amount of the Loan payable on each Principal Payment Date (“Installment Share”). If the proceeds of the Loan have been fully withdrawn as of the first Principal Payment Date, the principal amount of the Loan repayable by the Borrower on each Principal Payment Date shall be determined by the Bank by multiplying: (a) Withdrawn Loan Balance as of the first Principal Payment Date; by (b) the Installment Share for each Principal Payment Date, such repayable amount to be adjusted, as necessary, to deduct any amounts referred to in paragraph 4 of this Schedule, to which a Currency Conversion applies.

Principal Payment Date	Installment Share (Expressed as a Percentage)
On each March 15 and September 15, Beginning September 15, 2020, to and including September 15, 2034	3.33 %
On March 15, 2035	3.43 %

2. If the proceeds of the Loan have not been fully withdrawn as of the first Principal Payment Date, the principal amount of the Loan repayable by the Borrower on each Principal Payment Date shall be determined as follows:
- (a) To the extent that any proceeds of the Loan have been withdrawn as of the first Principal Payment Date, the Borrower shall repay the Withdrawn Loan Balance as of such date in accordance with paragraph 1 of this Schedule.
 - (b) Any amount withdrawn after the first Principal Payment Date shall be repaid on each Principal Payment Date falling after the date of such withdrawal in amounts determined by the Bank by multiplying the amount of each such withdrawal by a fraction, the numerator of which is the original Installment Share specified in the table in paragraph 1 of this Schedule for said Principal Payment Date (“Original Installment Share”) and the denominator of which is the sum of all remaining Original Installment Shares for Principal Payment Dates falling on or after such date, such amounts repayable to be adjusted, as necessary, to deduct any

amounts referred to in paragraph 4 of this Schedule, to which a Currency Conversion applies.

3. (a) Amounts of the Loan withdrawn within two calendar months prior to any Principal Payment Date shall, for the purposes solely of calculating the principal amounts payable on any Principal Payment Date, be treated as withdrawn and outstanding on the second Principal Payment Date following the date of withdrawal and shall be repayable on each Principal Payment Date commencing with the second Principal Payment Date following the date of withdrawal.
 - (b) Notwithstanding the provisions of sub-paragraph (a) of this paragraph, if at any time the Bank adopts a due date billing system under which invoices are issued on or after the respective Principal Payment Date, the provisions of such sub-paragraph shall no longer apply to any withdrawals made after the adoption of such billing system.
4. Notwithstanding the provisions of paragraphs 1 and 2 of this Schedule, upon a Currency Conversion of all or any portion of the Withdrawn Loan Balance to an Approved Currency, the amount so converted in the Approved Currency that is repayable on any Principal Payment Date occurring during the Conversion Period, shall be determined by the Bank by multiplying such amount in its currency of denomination immediately prior to the Conversion by either: (i) the exchange rate that reflects the amounts of principal in the Approved Currency payable by the Bank under the Currency Hedge Transaction relating to the Conversion; or (ii) if the Bank so determines in accordance with the Conversion Guidelines, the exchange rate component of the Screen Rate.
5. If the Withdrawn Loan Balance is denominated in more than one Loan Currency, the provisions of this Schedule shall apply separately to the amount denominated in each Loan Currency, so as to produce a separate amortization schedule for each such amount.

APPENDIX**Section I. Definitions**

1. “Entity” means either the Federation or RS, as the case may be, and “Entities” means the Federation and RS, collectively.
2. “Excluded Expenditure” means any expenditure:
 - (a) for goods or services supplied under a contract which any national or international financing institution or agency other than the Bank or the Association has financed or agreed to finance, or which the Bank or the Association has financed or agreed to finance under another loan, credit, or grant;
 - (b) for goods included in the following groups or sub-groups of the Standard International Trade Classification, Revision 3 (SITC, Rev.3), published by the United Nations in Statistical Papers, Series M, No. 34/Rev.3 (1986) (the SITC), or any successor groups or subgroups under future revisions to the SITC, as designated by the Bank by notice to the Borrower:

Group	Sub-group	Description of Item
112		Alcoholic beverages
121		Tobacco, un-manufactured, tobacco refuse
122		Tobacco, manufactured (whether or not containing tobacco substitutes)
525		Radioactive and associated materials
667		Pearls, precious and semiprecious stones, unworked or worked
718	718.7	Nuclear reactors, and parts thereof; fuel elements (cartridges), non-irradiated, for nuclear reactors
728	728.43	Tobacco processing machinery

Group	Sub-group	Description of Item
897	897.3	Jewelry of gold, silver or platinum group metals (except watches and watch cases) and goldsmiths' or silversmiths' wares (including set gems)
971		Gold, non-monetary (excluding gold ores and concentrates)

- (c) for goods intended for a military or paramilitary purpose or for luxury consumption;
 - (d) for environmentally hazardous goods, the manufacture, use or import of which is prohibited under the laws of the Borrower or international agreements to which the Borrower is a party;
 - (e) on account of any payment prohibited by a decision of the United Nations Security Council taken under Chapter VII of the Charter of the United Nations; and
 - (f) with respect to which the Bank determines that corrupt, fraudulent, collusive or coercive practices were engaged in by representatives of the Borrower or other recipient of the Loan proceeds, without the Borrower (or other such recipient) having taken timely and appropriate action satisfactory to the Bank to address such practices when they occur.
3. "Federation" means the Federation of Bosnia and Herzegovina, a constitutive part of the Borrower, and includes any successor or successors thereto.
 4. "Federation Subsidiary Loan Agreement" means the agreement entered into between the Borrower and the Federation, pursuant to Section 6.01 (b) of this Agreement, as the same agreement may be amended from time to time with the Bank's prior approval, and such term includes all schedules supplemental to the Federation Subsidiary Loan Agreement.
 5. "Financing Agreement" means the agreement between the Borrower and the Association in support of the Program, of the same date as this Agreement, as such agreement may be amended from time to time. "Financing Agreement" includes all appendices, schedules and agreements supplemental to the Financing Agreement.
 6. "General Conditions" means the "International Bank for Reconstruction and Development General Conditions for Loans", dated July 1, 2005 (as amended

through February 12, 2008) with the modifications set forth in Section II of this Appendix.

7. “Program” means the program of actions, objectives and policies designed to: (i) increase social assistance to the poor, while reducing the fiscal deficit and creating fiscal space for poverty-reducing growth; (ii) improve the structure and efficiency of public expenditures; and (iii) reduce social contribution rates and pressures on private sector wages from faster wage growth in the public sector, thereby enhancing private sector competitiveness, set forth or referred to in the letter dated March 2, 2010 from the Borrower to the Bank declaring the Borrower’s and the Entities’ commitment to the execution of the Program, and requesting assistance from the Bank in support of the Program during its execution.
8. “Republika Srpska” or “RS” means Republika Srpska, a constitutive part of the Borrower, and includes any successor or successors thereto.
9. “RS Subsidiary Loan Agreement” means the agreement entered into between the Borrower and RS, pursuant to Section 6.01 (c) of this Agreement, as the same agreement may be amended from time to time with the Bank’s prior approval, and such term includes all schedules supplemental to the RS Subsidiary Loan Agreement.
10. “Single Withdrawal Tranche” means the amount of the Loan allocated to the category entitled “Single Withdrawal Tranche” in the table set forth in Part B of Section II of Schedule 1 to this Agreement.
11. “Subsidiary Loan Agreement” means either the Federation Subsidiary Loan Agreement or the RS Subsidiary Loan Agreement, as such agreement may be amended from time to time with the Bank’s prior approval, and such term includes all schedules supplemental to the Subsidiary Loan Agreement, and “Subsidiary Loan Agreements” means the Federation Subsidiary Loan Agreement and the RS Subsidiary Loan Agreement, collectively.

Section II. Modifications to the General Conditions

The modifications to the General Conditions are as follows:

1. The last sentence of paragraph (a) of Section 2.03 (relating to Applications for Withdrawal) is deleted in its entirety.
2. Sections 2.04 (*Designated Accounts*) and 2.05 (*Eligible Expenditures*) are deleted in their entirety, and the remaining Sections in Article II are renumbered accordingly.

3. Paragraph (a) of Section 2.05 (renumbered as such pursuant to paragraph 2 above) is modified to read as follows:

“Section 2.05. Refinancing Preparation Advance; Capitalizing Front-end Fee and Interest

(a) If the Loan Agreement provides for the repayment out of the proceeds of the Loan of an advance made by the Bank or the Association (“Preparation Advance”), the Bank shall, on behalf of such Loan Party, withdraw from the Loan Account on or after the Effective Date the amount required to repay the withdrawn and outstanding balance of the advance as at the date of such withdrawal from the Loan Account and to pay all accrued and unpaid charges, if any, on the advance as at such date. The Bank shall pay the amount so withdrawn to itself or the Association, as the case may be, and shall cancel the remaining unwithdrawn amount of the advance.”

4. Sections 5.01 (*Project Execution Generally*), and 5.09 (*Financial Management; Financial Statements; Audits*) are deleted in their entirety, and the remaining Sections in Article V are renumbered accordingly.
5. Paragraph (a) of Section 5.05 (renumbered as such pursuant to paragraph 4 above and relating to *Use of Goods, Works and Services*) is deleted in its entirety.
6. Paragraph (c) of Section 5.06 (renumbered as such pursuant to paragraph 4 above) is modified to read as follows:

“Section 5.06. Plans; Documents; Records

... (c) The Borrower shall retain all records (contracts, orders, invoices, bills, receipts and other documents) evidencing expenditures under the Loan until two years after the Closing Date. The Borrower shall enable the Bank’s representatives to examine such records.”

7. Paragraph (c) of Section 5.07 (renumbered as such pursuant to paragraph 4 above) is modified to read as follows:

Section 5.07. Program Monitoring and Evaluation

... (c) The Borrower shall prepare, or cause to be prepared, and furnish to the Bank not later than six months after the Closing Date, a report of such scope and in such detail as the Bank shall reasonably request, on the execution of the Program, the performance by the Loan Parties and the Bank of their respective obligations under the Legal Agreements and the accomplishment of the purposes of the Loan.

8. The following terms and definitions set forth in the Appendix are modified or deleted as follows, and the following new terms and definitions are added in alphabetical order to the Appendix as follows, with the terms being renumbered accordingly:
- (a) The definition of the term “Conversion Date” is modified to read as follows:

“‘Conversion Date’ means, in respect of a Conversion, the Execution Date (as herein defined) or such other date as requested by the Borrower and accepted by the Bank, on which the Conversion enters into effect, and as further specified in the Conversion Guidelines.”
 - (b) The definition of the term “Eligible Expenditure” is modified to read as follows:

“‘Eligible Expenditure’ means any use to which the Loan is put in support of the Program, other than to finance expenditures excluded pursuant to the Loan Agreement.”
 - (c) The term “Financial Statements” and its definition are deleted in their entirety.
 - (d) The term “Project” is modified to read “Program” and its definition is modified to read as follows (and all references to “Project” throughout these General Conditions are deemed to be references to “Program”):

“‘Program’ means the program referred to in the Loan Agreement in support of which the Loan is made.”
 - (e) The term “Program Preparation Advance” (renamed as such pursuant to subparagraph 8 (d) above) is modified to read “Preparation Advance” and its definition is modified to read as follows:

“‘Preparation Advance’ means the advance referred to in the Loan Agreement and repayable in accordance with Section 2.05.”