

BONDS AS SOURCE OF LONG-TERM FINANCING FOR CAPITAL PROJECTS IN THE REPUBLIC OF SRPSKA

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Abstract: Bonds are one of the most commonly used debt instruments for raising missing financial resources. They are very common in most capital markets, including in the capital market of the Republic of Srpska. By their very nature, they represent a convenient way to raise larger amounts of capital, and spread the debt over a larger period of time. Underdeveloped capital markets are typically characterized by a limited range of bond types. As such, bonds occupy a significant place on the domestic capital market due to the volume of turnover. The paper discusses some of the basic types of bonds, their adequacy for raising capital for financing capital projects of central and local governments, the return they bring to investors, and the potential risks that may arise, as well as the current level of development of the domestic capital market. By using methods of analysis and synthesis of issued bonds on the capital market of the Republic of Srpska, an attempt is made to draw conclusion about the suitability of issuing bonds for financing capital projects. Despite the underdeveloped nature of domestic capital market, the issuance of bonds represents an adequate and sustainable model for raising long-term capital to finance capital projects.

Key words: Capital market, bonds, stock exchange, municipal bonds, capital projects

JEL classification: G12

1. INTRODUCTION

There are several ways to obtain additional financial resources on the financial market. One of the most commonly used methods is through the issuance of debt instruments, namely bonds. These instruments represent a contractual obligation of

the debtor, who undertakes to pay the holder of the instrument a fixed monetary amount at agreed intervals, comprising both principal and interest, until a predetermined maturity date when the final payment is made. The maturity date of these debt instruments refers to the time until the instrument expires. An alternative method of obtaining funds is through the issuance of equity securities in joint-stock companies, such as common shares, on the basis of which investors may claim a proportional share in the realized net profit (profit after expenses and taxes), as well as in the net assets of the issuing company. The maturity of financial instruments serves as a criterion for distinguishing between financial markets, specifically between the debt market and the equity market.

Bonds are debt securities through which issuers raise financial resources, which must be repaid with interest within an agreed period. Issuers may include central or local government authorities, as well as corporations. Bonds are most commonly issued for longer periods, with fixed or variable interest rates, and are generally considered low-risk securities. The full benefits of this financing method are achieved when bonds are used specifically for financing capital projects. However, they are also frequently used to raise funds to cover budget deficits. As such, this financing method has both advantages and disadvantages.

The primary advantage lies in the possibility of securing a more favorable source of financing through bond issuance compared to borrowing from commercial banks or other financial institutions. Bond issuance requires adherence to established procedures and obligations. It also involves detailed scrutiny of reports and documentation by potential investors. An indirect effect is enhanced self-discipline and oversight of

the issuer. Bonds can be purchased on the exchange market at the time of issuance (the primary market) or from other holders after issuance (the secondary market).

The general objective of this research is to assess the adequacy of bond issuance by public sector entities for financing capital projects in the future, based on historical data and predictive analysis. An additional objective is to examine the hypothesis that issuing public sector bonds on the domestic capital market can provide all or part of the funds required for financing capital projects, thereby supporting the development of the capital market.

2. CAPITAL MARKET

The capital market in the Republic of Srpska is organized at the entity level as an independent and autonomous market, represented by the Banja Luka Stock Exchange (BLSE). According to research (Jeremić and Terzić, 2025), the capital market serves to connect entities that lack long-term financial resources for business development with investors who possess surplus funds available for investment, i.e., savings they wish to allocate in order to generate returns. The legal framework for the development of the capital market is established by the following laws: the Law on Securities, the Law on the Securities Commission, the Law on Investment Fund Management Companies and the Law on Investment Funds, the Law on the Securities Registry, and the Company Law. According to the Banja Luka Stock Exchange (BLSE, 2025), the functioning of the capital market, as well as the issuance and trading of securities, is strictly supervised by an authorized agency at the entity level. Accordingly, regulations apply specifically to the capital market of the Republic of Srpska, which operates within its own regulatory framework and institutional structure. This type of market structure is typical of developing economies. Due to a lack of high-quality investment opportunities and an unfavorable market structure, its development has been slow. According to Kumalić (2013, p. 68), the least developed segment is reflected in the limited number of instruments traded on the organized capital market. Jeremić (2012) further suggests that the capital market is primarily intended to meet the long-term financing needs of issuers.

Companies or public sector institutions that raise funds from initial buyers issue new securities, such as bonds and shares, within the segment of the financial market commonly referred to as the primary market. The secondary market, on the other hand, is the financial market where previously issued securities are traded. As noted by Mishkin and Eakins (2005), primary securities

markets are less familiar to the general public, as the sale of securities to initial buyers often takes place behind closed doors. Secondary markets can be organized in two ways. One is through organized exchanges, where buyers and sellers of securities, along with their representatives—brokers and dealers—meet at a centralized location to conduct transactions. The other is through unorganized or over-the-counter (OTC) markets, where dealers located in different places maintain inventories of securities available for trading. In such markets, they stand ready to buy and sell with any party willing to accept the quoted price. It is common practice for governments to issue securities on their domestic bond markets, after which they are traded within those markets. The Jefferson Institute (2005) concludes that this financing method is most frequently used by governments of developing countries and, at the same time, provides investors with substantial returns at the lowest possible level of country-related risk.

Another way to distinguish financial markets is based on the maturity of securities. The money market is a financial market where only short-term instruments are traded, i.e., instruments with a maturity of up to one year, most commonly treasury bills. In contrast, the capital market includes all markets where securities with maturities longer than one year are traded, as well as equity instruments. In other words, the capital market refers to the segment of the financial market where financial capital (shares, bonds, certificates) is bought and sold. Ristić et al. (2012/2013) state that the capital market enables investors to access available capital, facilitates rapid restructuring of investment portfolios, transforms savers (owners of capital) into creditors, and ensures the allocation of financial resources into profitable investment projects.

Public sector bonds issued on the capital market of the Republic of Srpska represent the most liquid segment of this market. The dominant position is held by securities issued by the Republic of Srpska and its cities and municipalities.

The purpose of issuing bonds on the domestic capital market is to raise the necessary long-term funds. Since these bonds are issued on the domestic market, currency risk is eliminated and banking transaction costs are lower. In addition to traditional sources of financing, bond issuance diversifies funding sources while offering investors a more attractive return compared to savings. In this way, it directly contributes to economic development, as well as to the development of the domestic capital market and the stock exchange, while each successful issuance strengthens the issuer's reputation.

3. BONDS

Bonds are debt instruments with predetermined cash flows. Despite these known cash flows and the fact that public sector entities are often issuers, bonds should not be viewed as a form of savings, but rather as an investment in securities. Through the capital market, bond investors provide surplus financial resources to the issuer under predefined terms and for a specified period. In return for the funds received, the bond issuer pays investors interest, i.e., a coupon, at predetermined intervals, while the principal is repaid at maturity, thereby extinguishing the debt. Typically, coupon payments are made periodically, whereas the principal is repaid in a lump sum, most often at the end of the term. It is also not uncommon for bonds to include a call option, allowing the issuer to redeem them before maturity. The coupon represents the interest that the investor receives on the invested amount. It constitutes the return earned by the investor until the bond's maturity date, while for the issuer it represents the cost of borrowed funds. The coupon rate is most often determined at the time of issuance and remains unchanged until maturity. However, it may also be variable, in which case its value cannot be determined in advance, as it depends on market parameters such as movements in interest rates. The majority of bonds are issued with coupons, although zero-coupon bonds are also not uncommon. In addition to classification by coupon structure, bonds may also be categorized according to the issuer. On the capital market of the Republic of Srpska, both public sector bonds and corporate bonds are present.

Government and municipal bonds are largely similar. The primary difference lies in the issuer: government bonds are issued by the central level of authority, whereas municipal bonds are issued by lower levels of government, i.e., cities and municipalities. Unlike central governments, local authorities must comply with more complex issuance procedures when issuing municipal bonds. Furthermore, the purpose of funds raised differs between central and local government bonds. Funds raised through municipal bond issuance may only be used for the specific purposes for which they were issued. Consequently, they are most often used to finance infrastructure projects of significant importance to local communities, which may not be a priority for central authorities. As noted by Brborović (2023), bond issues by local governments are generally significantly smaller than government bond issues and are issued under less favorable conditions. Essentially, the distinction between government and municipal bonds lies solely in the identity of the issuer. According to Selak (2016), municipal

bonds are debt securities issued by lower levels of government with the aim of raising the necessary financial resources. They are generally considered relatively safe investments, as they are typically backed by the overall assets of the issuer or by the local government budget. Forcan (2013) suggests that it is not uncommon for central governments to guarantee such issuances, while Stamenković (2015) emphasizes that, for an issuance to be successful, investment in bonds must be attractive to investors. This is achieved through higher interest rates, the possibility of profit participation, or by offering returns that exceed those on other government bonds or bank deposits. According to Golić (2012), in many countries there are tax incentives for purchasers of municipal bonds.

Although public sector bond issuers include the state and local government units, investment in bonds is not without risk. These risks primarily depend on the type of bonds in which the investment is made. The most common risks include:

- Interest rate risk, which is particularly relevant for bondholders who may need to sell their bonds before maturity. Bond prices move inversely to market interest rates.
- Inflation risk, where rising inflation reduces the real return on bond investments, and vice versa.
- Political and legal risks, typically related to decisions concerning the tax treatment of income generated from bond investments.
- Liquidity risk, which refers to the possibility that bondholders may be unable to sell their bonds on the capital market before maturity.
- Currency risk, arising from fluctuations in exchange rates relative to the rate at the time of investment in foreign-currency-denominated bonds.

In addition to these, other risks may arise, such as credit risk, sector-specific risk, and volatility risk. A comprehensive overview of all potential risks can be found in the bond prospectus or by reviewing the terms and conditions under which the bonds are issued.

4. BONDS TRADING ON THE RS CAPITAL MARKET

The Law on Borrowing, Debt and Guarantees of the Republic of Srpska (Official Gazette of the Republic of Srpska, No. 30/07) regulates the procedures and methods of borrowing, issuing guarantees and securities by the Republic of Srpska and its municipalities, ensuring funds for debt repayment, maintaining records of debt, guarantees and securities, as well as other matters related to debt, guarantees and securities of the Republic of Srpska and its municipalities. Based on this law, on March 7, 2008, bonds of the

Republic of Srpska issued for the settlement of obligations arising from verified claims of old foreign currency savings were listed on the official market of the Banja Luka Stock Exchange. The first trading of these bonds took place three weeks later. Đogo et al. (2021) point out that bond trading effectively began only in 2009, while treasury bills and long-term securities issued by entity governments appeared from 2011 onwards. Today, the Banja Luka Stock Exchange trades bonds issued by the Republic of Srpska, as well as by its cities and municipalities, which are issued to secure funding for capital projects.

The conducted research indicates that municipal bonds have been issued with coupon payments (monthly, quarterly, semi-annual, or annual), with or without a grace period, and with possible changes in coupon rates after a specified period (Table 1). All municipal bonds, including those issued by their public enterprises, have been issued with a nominal value of 100 convertible marks.

In addition, bonds of the Republic of Srpska issued for budgetary purposes have been listed on the Banja Luka Stock Exchange in 48 series, with a nominal value of 1,000 convertible marks, interest rates ranging from 2.30% to 6.10%, annual coupon payments, and maturities most commonly between 5 and 10 years. The exchange also trades bonds issued by the Republic of Srpska for financing war damage costs in 12 issuances. These bonds were issued with a nominal value of one convertible mark, an interest rate of 1.50%, and a maturity of 13 years, six of which included a three-year grace period. Furthermore, bonds issued in three series for financing obligations related to verified foreign currency savings are also traded. These bonds have a nominal value of one convertible mark, an interest rate of 2.50%, semi-annual coupon payments, and a maturity of five years.

In order to manage capital investments more efficiently, the Government and its institutions

adopted a Public Investment Program. This document is prepared for a three-year period and analyzes existing capital investments, thereby providing a basis for more effective planning and management of future capital needs.

The legal foundation of the program is contained in the provisions of the Law on the Budget System of the Republic of Srpska (Official Gazette of the Republic of Srpska, Nos. 121/12, 52/14, 103/15, and 15/16). Its preparation involves all ministries and institutions, which submit individual project-related information, while the Ministry of Finance consolidates and analyzes the submitted data. The program has been developed since 2004 and has undergone various methodological changes, gaining formal recognition within the Law on the Budget System of the Republic of Srpska in 2012. It includes an overview of ongoing capital projects for which funding has been secured or is likely, as well as a list of priority projects that do not yet have secured financing at the time of preparation. The projects included in the program are categorized accordingly. Socio-economic development projects, which relate to investments aimed at increasing the value of non-financial assets of the Republic of Srpska, include infrastructure of general importance, local infrastructure, facilities, land, and equipment. Projects aimed at building administrative and technical capacities involve investments in improving the knowledge, skills, and capabilities of human resources. Capital investments encompass all projects primarily focused on investments in capital goods such as facilities, equipment, and operational assets. Finally, institutional investments refer to projects primarily aimed at strengthening the capacities of institutions.

Table 1 Municipal bonds issued on the Banja Luka Stock Exchange

Issuer	Number of bonds	Maturity	Nominal value	Issue value
Banja Luka	120,000	10	100	12,000,000
Prijedor	55,000	10	100	5,500,000
Istočno Novo Sarajevo	50,000	15	100	5,000,000
Kozarska Dubica	105,000	12	100	10,500,000
Kostajnica I	10,800	15	100	1,080,000
Kostajnica II	7,200	14	100	720,000

Novi Grad	20,000	15	100	2,000,000
Kneževo	56,000	20	100	5,600,000
Kotor Varoš II	50,000	10	100	5,000,000
Bileća	43,000	10	100	4,300,000
Istočni Stari Grad	18,000	10	100	1,800,000
Foča	15,000	9	100	1,500,000
Srbac IV	12,000	12	100	1,200,000
Modriča	40,000	10	100	4,000,000
Srbac III	35,000	14	100	3,500,000
Pelagićevo	12,000	10	100	1,200,000
Šekovići	12,000	15	100	1,200,000
Vlasenica	18,000	12	100	1,800,000
Trnovo	8,500	15	100	850,000
Rogatica	9,000	10	100	900,000
Sokolac	55,000	15	100	5,500,000

Source: Author's calculation

The Public Investment Program of the Republic of Srpska (Government of the Republic of Srpska, Ministry of Finance, 2025) was adopted for the period 2025–2027. During this period, the implementation of investment projects is planned, including those whose execution began in previous years. There are also projects whose implementation will continue beyond 2027. The largest investments are planned in the sectors of energy and mining, transport and communications, health and social protection, as well as agriculture, forestry, and water management, with the competent ministries acting as project holders. Significant investment projects in the Republic of Srpska are financed through concession models and are therefore not included in this program. Investment expenditures encompass investments in

socio-economic development as well as investments aimed at strengthening administrative and technical capacities. The total planned investment for the period 2025–2027 amounts to 2,540.94 million convertible marks. The program envisages that financing will be secured from domestic sources included in the participants' budget plans, donations from domestic and international financial institutions, as well as foreign funding obtained through loans and grants. According to project proponents, priority projects without secured sources of financing have been proposed by the Ministry of Transport and Communications and the Ministry of Energy and Mining, respectively. As such, these projects are categorized as capital goods, facilities, equipment, and operational assets.

Table 2 Planned investments by type and category of projects in the Republic of Srpska (in million BAM)

Project type	Project category	Investment plan			Total
		2025	2026	2027	
Administrative and technical capacity building	Capital	4.62	2.90	3.10	10.62
	Institutional	2.38	2.26	1.75	6.39
	Total:	7.00	5.16	4.85	17.01
Socio-economic development	Capital	942.04	852.03	672.72	2,466.78
	Institutional	19.05	19.03	19.05	57.15
	Total:	961.09	871.08	691.77	2,523.93

TOTAL:		968.09	876.23	696.62	2,540.94
Type of financing	Financing method	Investment plan			Total
		2025	2026	2027	
Domestic funds		471.72	333.17	122.80	927.69
Foreign funds	Loans	496.50	559.50	573.37	1629.38
	Grants	15.51	9.49	0.45	25.45
Total:		512.01	568.99	573.82	1,684.83
TOTAL:		983.73	902.16	696.62	2,582.52

Source: Author's calculation

Based on the analysis of previously issued bonds by issuer, issue value, and maturity, it can be concluded that part or the entirety of the funds required to finance capital projects of importance to the public sector can be secured through bond issuance.

CONCLUSION

Empirical research conducted for the purposes of this paper has shown that the capital market of the Republic of Srpska is underdeveloped and exhibits characteristics typical of capital markets in developing and less developed countries. Since its establishment, its development has gone through several phases. Due to the lack of high-quality investments and an unfavorable structure, market development has been slow, accompanied by a limited number of instruments available for trading on the organized market. From the establishment and commencement of operations of the stock exchange until 2009, trading was conducted exclusively in shares, i.e., equity securities, primarily arising from the privatization process, while bond trading began only thereafter. Since then, trading in debt securities has accounted for an increasingly significant share, both through regular market turnover and public bond offerings. Additional growth was achieved with the introduction of treasury bills trading, which was well received by market participants.

Compared to raising funds through borrowing, bond issuance for financing capital projects offers significant advantages. By issuing bonds to obtain the necessary financial resources, all levels of government in the Republic of Srpska retain full control over the use of funds, without external supervision or conditionality, which is typical of grants approved by the International Monetary Fund. In addition to the reform requirements often associated with such financing, borrowing from other financial institutions is generally more expensive than bond issuance. On the other hand, raising funds through bond issuance also entails certain limitations. The first limitation lies on the issuer's side. Several months typically pass from the moment the decision is made to raise funds in this manner until the approval of issuance and

commencement of trading. Furthermore, the ability to raise the required amount of funds depends on the success of the issuance, which necessitates thorough and efficient assessment of all relevant elements and information required by investors to make investment decisions regarding the issued securities. This limitation is largely mitigated in the case of borrowing, as loan applications specify a predetermined amount of funds to be obtained. On the side of institutional investors, certain constraints must also be considered. Domestic financial institutions are subject to a legal exposure limit of 10% to a single counterparty.

The analysis of the capital market in the Republic of Srpska indicates that trading in debt securities accounts for a significant share of the total turnover on the Banja Luka Stock Exchange. Given that the market is characterized by a limited number of tradable instruments, bond issuance for financing capital projects is expected to contribute to maintaining the level of market turnover and capitalization. By issuing bonds on the domestic capital market, authorities can stimulate the inflow of capital from foreign investors and mobilize the savings of domestic investors and the general population. Achieving this requires capital market institutions to invest efforts in developing new and innovative financial instruments and trading mechanisms.

The Public Investment Program envisages that part of the required funding will be secured from domestic sources. Considering the characteristics of bonds as a debt instrument, the time required for issuance procedures, repayment terms and structures, as well as the advantages of bond issuance over alternative financing sources, it can be concluded that bonds represent an appropriate mechanism for securing the necessary funds. This approach supports the development of the domestic capital market by introducing new securities. At the same time, it diversifies funding sources and extends the repayment period of principal into the future, when the effects of financed capital projects are expected to materialize.

Opportunities for new instruments should be sought in the implementation of projects in environmental, socio-economic, social, and ecological fields through the issuance of so-called green, social, or sustainable bonds. Additional opportunities lie in mobilizing household savings through instruments such as retail savings bonds issued on the Banja Luka Stock Exchange exclusively for individuals, with favorable transaction costs and repayment structures adapted to the average small investor. Finally, the long-term maturity of bonds aligns with the time horizon over which the benefits of investments in capital projects are expected to be realized.

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