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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

INTERNATIONAL FINANCE CORPORATION

MULTILATERAL INVESTMENT GUARANTEE AGENCY

COUNTRY PARTNERSHIP STRATEGY

FOR

BOSNIA AND HERZEGOVINA

FOR THE PERIOD FY08-FY11

November 12, 2007

Southeast Europe Country Unit
Europe and Central Asia Region

International Finance Corporation, IFC
Southern Europe and Central Asia

Multilateral Investment Guarantee Agency, MIGA

The date of the last Country Assistance Strategy was September 16, 2004.

CURRENCY EQUIVALENTS
(Exchange Rate Effective November 7, 2007)
Currency Unit = Convertible Mark (BAM)
BAM 1.00 = US$ 0.744
US$ 1.574 = SDR 1.00

GOVERNMENT'S FISCAL YEAR
January 1 – December 31

ACRONYMS AND ABBREVATIONS

AAA	Analytical and Advisory Services
APL	Adaptable Program Lending
BAC	Business Environment Adjustment Credit
BAM	Bosnian Convertible Mark
BH	Bosnia and Herzegovina
CAB	Current Account Balance
CAS	Country Assistance Strategy
CDP	Community Development Project
CEM	Country Economic Memorandum
CIT	Corporate Income Tax
CPS	Country Partnership Strategy
DCF	Donor Coordination Forum
DFID	UK Department for International Development
DPLs	Development Policy Loans
EBF	Extra-Budgetary Fund
EBRD	European Bank for Reconstruction and Development
EC	European Commission
ECSEE	Energy Community of Southeast Europe
EIB	European Investment Bank
EMSAC	Economic Management Structural Adjustment Credit
ERP	Education Restructuring Project
ESW	Economic and Sector Work
EU	European Union
EUR	Euro
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GEF	Global Environment Facility
GNI	Gross National Income
GTZ	German Technical Cooperation
HBS	House Hold Budget Survey
HSEP	Health Sector Enhancement Project
IBRD	International Bank for Reconstruction and Development
ICT	Information Communications Technology
ICTY	International Criminal Tribunal for the Former Yugoslavia
IDA	International Development Association
IEG	Independent Evaluation Group
IFC	International Finance Corporation

IMF	International Monetary Fund
IPA	Instrument for Pre-Accession
IPARD	EU Instrument for Pre-Accession Assistance for Rural Development
ITA	Indirect Tax Authority
LPP	Law on Public Procurement
LSMS	Living Standards Measurement Survey
MDGs	Millennium Development Goals
MIGA	Multilateral Investment Guarantee Agency
MTDS	Medium-Term Development Strategy
MTEF	Medium Term Expenditure Framework
NFC	National Fiscal Council
NGOs	Nongovernmental Organizations
NOE	Non-observed Economy
NPV	Net Present Value
OHR	Office of the High Representative
OSCE	Organization for Security and Cooperation in Europe
PBA	Performance-Based Allocation
PDPC	Programmatic Development Policy Credit
PEIR	Public Expenditure and Institutional Review
PEP-SE	Private Enterprise Partnership Southeast Europe (IFC Advisory Services)
PIC	Peace Implementation Council
PIP	Public Investment Plans
PIT	Personal Income Tax
PPIAF	Public Private Infrastructure Advisory Facility
PPP	Public Private Partnership
PRSP	Poverty Reduction Strategy Paper
PTAC	Privatization Technical Assistance Credit
ROSC AA	Report on the Observance of Standards and Codes – Accounting and Auditing
RS	Republika Srpska
SAA	Stabilization and Association Agreement
SAP	Stabilization and Association Process
SDR	Special Drawing Rights
SEE	Southeast Europe
SESP	Second Employment Support Project
SIDA	Swedish International Development Cooperation Agency
SITAP	Social Insurance Technical Assistance Project
SME	Small and Medium Enterprise
SOE	State-Owned Enterprise
SOSAC II	Social Sector Adjustment Credit II
TA	Technical Assistance
UK	United Kingdom
UNDP	United Nations Development Programme
USAID	United States Agency for International Development
VAT	Value Added Tax
WBG	World Bank Group
WBI	World Bank Institute

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COUNTRY PARTNERSHIP STRATEGY
FOR BOSNIA AND HERZEGOVINA

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EXECUTIVE SUMMARY

1. Bosnia and Herzegovina (BH) has made remarkable progress in post-conflict reconstruction, social integration and state building since the end of the 1992-95 war. The Dayton Peace Agreement, signed in 1995, established a complex governance structure comprising the Council of Ministers at the State-level government and two Entity Governments: the Federation of Bosnia and Herzegovina (the Federation) and Republika Srpska (the RS). An autonomous Brcko District was added to the structure in 1999.

2. With the continued support of the international community, the country has taken strides towards establishing a functioning market economy and making progress towards EU integration. The BH economy is stable. Growth has averaged five percent a year since 2000 while inflation has remained below five percent for most of the decade. Although the most recent data is scarce, there is some evidence of poverty reduction, though rural areas may be lagging. Negotiations with the European Union (EU) on a Stabilization and Association Agreement (SAA) were opened in November 2005. Technical negotiations were completed, but the SAA has not yet been signed – mainly due to an impasse on police restructuring.

3. The World Bank Group has played a significant role in this development story with commitments totaling more than $1.1 billion IDA credits and grants since 1996 and nearly $250 million original commitments from the International Finance Corporation (IFC) and about $310 million in guarantees from MIGA. This constituted one of the largest per capita assistance programs received by any post-conflict country. The vast bulk of this support came in the reconstruction phase. A review carried out by the Independent Evaluation Group (IEG) in 2004 found the BH reconstruction program to be an example of "the Bank at its best".

4. In spite of the very substantial progress in physical reconstruction, more than a decade in transition reforms has been lost to the war and reconstruction efforts. The complex institutional and political environment allows for concerted political obstruction of many reforms and frequent political gridlocks, which in turn have impeded rapid advances on economic reform. This has retarded the development of a nationwide institutional infrastructure fully supportive of a market economy and EU integration.

5. At the time of the previous Country Assistance Strategy (CAS) – endorsed by the Board in September 2004 – the World Bank Group and other donors felt considerable optimism that BH was on the threshold of a swift and significant transition from a reconstruction mode to a fully-fledged development partnership one: a national medium-term development strategy (MTDS) had been agreed; discussions with the EU on further integration had begun; and, there was some momentum in the privatization process. Hence, the CAS was centered on Development Policy Lending (DPL)[1] in support of public sector reform and private sector development. While some important reforms were achieved during the previous CAS period, with hindsight, it is clear that the degree of optimism felt at the time was unwarranted. There is now a broad consensus that the key reason for poor implementation of DPL was the lack of political commitment to reform. However, this was also compounded by the fact that some World Bank-supported programs were overly complex and ambitious.

[1] Formerly referred to as 'adjustment lending'

6. This Country Partnership Strategy (CPS) aims to focus on areas of demonstrable Government commitment and capacity to deliver on development strategies and reforms. Identifying areas of intervention that have unconditional ownership by all the Governments and which also have significant development impact has been, and will continue to be, the key challenge. The Bank's portfolio will mostly comprise of investment lending and, provided there is political commitment in a particular area, very focused DPLs.

7. A range of interventions from across the World Bank Group will be used in partnership with other donors and with communications to create an enabling environment for further reform. IFC will seek opportunities to offer debt and equity in support of BH automotive, metals, financial and tourism sectors, while also supporting SME development and providing advisory services; MIGA will be open to support foreign direct investment in BH through the provision of political risk guarantees.

8. On the World Bank side, resources under the base case of this CPS are programmed to comprise of a mix of IDA and IBRD financing. BH will begin to use IBRD finance during the first year of the CPS. It is anticipated that the country will graduate from IDA resources at the end of this CPS period. Project finance will be blended and a total of approximately US$50 million a year will be available. Should progress be made towards the high case performance benchmarks, an incremental US$20 million per annum would be available to BH. A mid-term assessment of the high case performance benchmarks will be undertaken in late 2009.

9. Despite strong economic performance and a reasonably healthy portfolio, the level of risk in the BH program is substantial. The greatest internal risk to implementation of the BH program is political obstruction of economic reforms and a deterioration in the quality of the political dialogue. Meanwhile, local and regional political tensions risk distracting policy makers from the economic reform program.

10. Executive Directors may wish to consider:

i) Whether the lessons learned from the previous CAS period have been adequately reflected in the CPS;

ii) Whether the financial resources, terms and performance benchmarks are appropriately matched to BH's level of development;

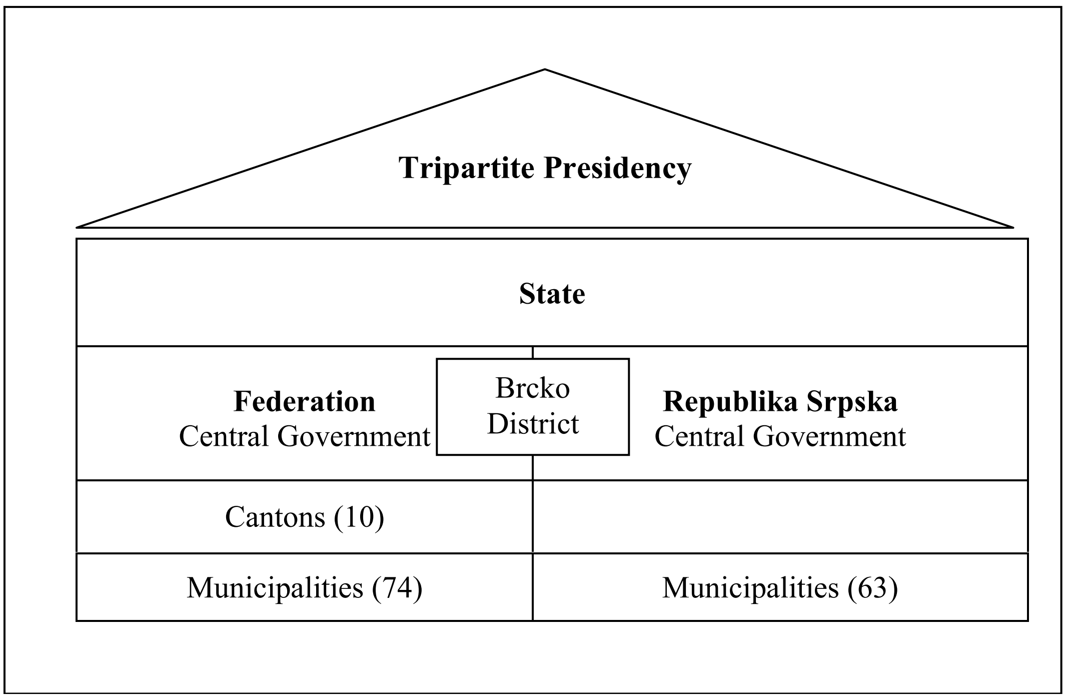
iii) Whether the program is adequately tailored to make the best use of World Bank Group resources in order to respond to BH's needs.

I. COUNTRY CONTEXT

A. Political Economy and Social Context

1. **Bosnia and Herzegovina (BH) has a complex governance structure.** Since the Dayton Peace Agreement was signed in 1995, peace has been maintained in BH and the country has achieved remarkable progress in reconstruction and economic development. The Dayton Peace Agreement, signed in 1995, established a complex governance structure comprising the Council of Ministers at the State-level government and two Entity Governments: the Federation of Bosnia and Herzegovina (the Federation) and Republika Srpska (the RS). An autonomous Brcko District was added to the structure in 1999. The Federation is divided into ten cantons and 74 municipalities. The Republika Srpska is divided into 63 municipalities (see Box 1).

Box 1: The Constitutional Structure of Bosnia and Herzegovina.



2. **The complex institutional structure permits concerted political obstruction of reforms and frequent political gridlocks which, in turn, have impeded rapid advances in economic reforms**. Despite progress in creating new State-level institutions after 1995, opposing views on the role of the State in BH, combined with attempts to preserve as high a degree as possible of Entity autonomy, has retarded the development of a nationwide institutional infrastructure fully supportive of a market economy and EU integration. A single economic space and a common vision of the country as a framework for guiding economic policy-making have been slow to emerge: it was only in 2004 that the Medium-Term Development Strategy (MTDS), the first nationwide, locally conceived document of such a kind, was adopted.

3. **There is still a significant international presence in BH.** BH operates under the supervision of a High Representative/EU Special Representative to BH, supported by the Office of the High Representative (OHR). This position was created to oversee implementation of the civilian

aspects of the Dayton Peace Agreement and it carries extensive powers to legislate and remove public officials. The High Representative is supervised by the Peace Implementation Council (PIC), comprising representatives of countries and agencies that support the peace process in different ways. A contingent of EUFOR troops continues to oversee the security situation, and while concerns over personal security have greatly diminished, societal divisions persist. During the national elections in 2006 nationalist rhetoric increased, further compounding the reform gridlock since then.

4. **Negotiations with the EU on a Stabilization and Association Agreement (SAA) were opened in 2005; the technical negotiations have been completed, but the Agreement has not yet been signed.** The SAA has been held back mainly through a lack of agreement on police restructuring, the last remaining major benchmark to be met (although reforms of public broadcasting and full cooperation with the ICTY are also needed for the signing of the SAA, see Annex 5). The October 2007 PIC concluded that the lack of progress with the delivery of the SAA required reforms is a grave disappointment and a source of concern for the international community. However, they welcomed the Mostar Declaration[2] of October 28, as a starting point for a positive reengagement of the government coalition parties.

5. **Joining the EU remains a key goal for BH, but governance reform is needed.** Accelerating the EU integration process – something public opinion polls indicate the majority of the population supports – would require a renewed government willingness to deal with problem areas, including dealing with vested interests that reap benefits from the rigidities and complexities of the multilayered government structure. An attempt to reform the constitution in April 2006 was not successful. The fragile consensus for reform broke down between those who prefer incremental changes to the *status quo*, no matter how modest, and those who prefer a more radical restructuring. The prospects for a new constitutional agreement are uncertain in the current political climate.

6. **In addition to internal factors, the political climate in BH during the past year has been affected by regional developments.** Discussion of the potential links between the resolution of the status of Kosovo and of the integrity of BH as a sovereign nation has had a negative effect on the political environment in BH and has increased opposition to strengthening of State-level institutions. Calls have been made in the RS for a referendum on self-determination.

7. **However, even in the current environment, progress on key reforms is possible and necessary.** The October 2007 signing of a Platform for Action (Annex 1) on key structural reforms that could help boost BH economy's potential is encouraging. The Platform for Action aims at accelerating the implementation of urgent reforms to attract investment, accelerate job creation and improve living standards in the country. The signatories agreed that urgent economic reform cannot be put on hold until major political disputes are resolved. It supports actions to: (i) improve fiscal coordination and stability; (ii) create a more conducive business environment; and, (iii) promote other reforms which ensure sustainable development. A successful and swift implementation of these commitments would be in the interest of all BH citizens.

[2] On October 28 the leaders of the six main parties met in Mostar and agreed on the general principles that could support a positive move forward on the pending SAA agenda

B. Recent Economic Developments and Outstanding Challenges

Output, inflation and employment

8. **BH has made substantial progress in economic reconstruction since the end of the war and economic expansion has remained robust.** Driven in large part by a jump in international metal prices, earlier reforms, new metal-processing capacity and significant remittance inflows, economic expansion has remained robust over the last few years. Real GDP growth, which averaged five percent a year since 2000 and is likely to rise to about six percent in 2007, helping return the level of GDP to near its pre-war level.[3] A lot more remains to be done, however, to create conditions for sustained growth and to reduce risks to hard-won fiscal stability.

9. **Inflation has remained low in general.** Anchored in the currency board arrangement, inflation is set to average two percent in 2007, after a one-off surge to 7.5 percent in 2006 as a consequence of the introduction of the Value Added Tax (VAT).

10. **Formal employment is low, but is now rising.** After several years of labor shedding, hiring has increased and overall employment is reported to have risen five percent in 2006. Unemployment has eased to 29 percent in early 2007 from 31 percent in 2006. Sustained improvements in employment will require structural changes in the pattern of productive activity.

External developments

11. **The current account deficit remains large and represents a key macroeconomic challenge, despite evidence that the shortfall is smaller than officially estimated.** The officially estimated current account deficit narrowed from about 20 percent of GDP in 2005 to 10.7 percent of GDP in 2006 due to an across-the-board export growth and improved statistical reporting. Preliminary data suggest that the external shortfall is set to widen again in 2007 to as much as 17 percent of GDP. However, there is substantial evidence that the current account deficit may be much smaller than is officially estimated due to the underestimation of remittance inflows and other current transfers.

12. **Net capital inflows have consistently exceeded the current account deficit, boosting foreign exchange reserves.** Reserves rose to $3.5 billion as of the end of September 2007 (or 5.2 months' worth of import cover). Foreign direct investment inflows also rose to about 11 percent of GDP in 2007, reflecting substantial progress on privatization in the RS.

13. **BH's gross external debt fell from 60.3 percent of GDP in 2003 to about 50 percent of GDP in late 2007, thanks to a rapid reduction in public external indebtedness.** Public external debt amounted to just below one-half of total external debt and is dominated by obligations to multilateral and bilateral creditors. The World Bank is the country's largest single creditor with outstanding debt balance of $1.4 billion as of the end of June 2007 - equivalent to 10.3 percent of GDP. BH's World Bank debt accounted for about 20.5 percent of the country's overall external debt. More than one-half of BH's external debt is denominated in Euros and about one-half of

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[3] The statistics agency has revised national accounts data to reflect some of the sizable non-observed economy (NOE), bringing BH in line with most other countries in the region. As a result of adjustments in 2005 and 2006, nominal GDP is now larger by about 17 percent. Third-party estimates of the NOE in BH suggest that it may be as large as 40-50 percent of GDP.

external debt is contracted at floating interest rates, resulting in substantial exposure to changing global market conditions.

Fiscal Developments

Table 1: Bosnia and Herzegovina: Macroeconomic Framework, 2005-11

	2005 Act.	2006 Est.	2007 Proj.	2008 Proj.	2009 Proj.	2010 Proj.	2011 Proj.
			Percent change				
Real GDP growth	5.0	6.3	6.0	6.5	5.5	4.5	4.5
Consumer prices (average)	3.6	7.5	2.0	2.0	2.0	2.0	2.0
Nominal GDP (in millions of BAM)	16,928	19,106	20,758	22,528	24,195	25,738	27,381
GNI per capita (Atlas method)	2,950	3,240	3,540	3,960	4,330	4,590	4,870
			In percent of GDP 1/				
Consumption	116.3	113.2	116.9	113.7	111.0	108.0	105.7
Investment	22.0	16.2	18.6	19.8	20.6	21.2	21.2
Foreign savings	19.8	10.7	16.9	16.2	15.4	13.7	12.7
Current account balance	-19.8	-10.7	-16.9	-16.2	-15.4	-13.7	-12.7
Import of goods and services	74.7	66.5	74.3	74.6	74.4	73.6	72.5
Exports of goods and services	33.0	36.6	38.9	41.0	42.6	44.4	45.5
Foreign reserves (in months of imports)	4.0	5.0	5.3	5.7	5.7	5.7	5.5
General government revenues	46.6	47.0	46.3	46.1	45.2	44.9	44.1
General government expenditures	49.5	44.2	46.5	46.9	46.5	46.4	46.1
o/w: Capital expenditures	9.1	5.9	6.3	6.8	6.5	6.4	6.1
Fiscal balance	0.0	2.8	-0.2	-0.8	-1.3	-1.5	-2.0
Public debt 2/	23.5	21.7	19.5	33.3	32.0	42.0	40.6
			Percent change				
Domestic credit to non-government	44.3	48.4	50.3	49.5	52.3	56.4	62.7
Broad money	18.2	24.7	21.2	15.3	14.6	14.0	14.6
External debt (in percent of GDP)	47.5	52.1	50.1	47.4	48.5	49.0	47.8
Debt service 3/	11.6	7.9	9.0	13.4	9.2	10.1	10.6

1/ Relative to GDP adjusted by 8 percent for imputed rent and later by additional 7 percent for non-observed economy.

2/ Starting in 2008, includes formalization of domestic claims, potential property restitution and conversion of debt warrants into debt.

3/ In percent of exports of goods and services

Sources: National authorities, IMF and World Bank staff estimates.

14. **Progress in fiscal consolidation has been substantial since the fiscal deficit peaked in 1999 but Government spending is still high.** The general government deficit was reduced from about six percent in 1999 to two percent in 2004, before shifting to a surplus of about three percent in 2006. Through mid-2007, the general government surplus amounted to about four percent of GDP. Budget revisions in both Entities should bring the general government outcome to near balance for 2007 as a whole. Fiscal consolidation since 1999 has been accompanied by a reduction in the size of government, with general government spending down from about 51 percent in 2003 to about 44 percent of GDP in 2006. Nonetheless, the government burden on the economy expressed as a percentage of GDP is 4-5 percent higher than that of countries with similar levels of per capita income.

15. **Government debt is low, amounting to about 20 percent of GDP in late 2007, down from about 24 percent in 2004.** Even after the planned issuance of government bonds to finance the settlement of domestic claims, government debt should remain limited to about 42 percent of GDP by 2011 and be substantially lower in Net Present Value (NPV) terms (about 35 percent of GDP)[4] reflecting the fact that the newly issued debt will be highly concessional, as is a substantial share of the existing government obligations.

Structural Reforms

16. **Some structural reform has been undertaken in BH.** Reforms of the financial sector, trade policy and public finance have advanced reasonably well. In public finance, key accomplishments to date include successful harmonization of indirect taxation, culminating in the establishment of the Indirect Tax Authority (ITA) at the beginning of 2004 and the introduction of a state-wide single-rate VAT from the start of 2006. Modernized and harmonized corporate income tax (CIT) and personal income tax (PIT) laws were enacted in 2006 in the RS and in late 2007 in the Federation, setting the respective CIT rate at 10 percent and the PIT rates at 10 percent and 15 percent, a major improvement over previous legislation.

17. **However, implementation of other key reforms has been slow and uneven.** The National Fiscal Council (NFC), comprising the presiding member of the BH Council of Ministers and the two Entity Prime Ministers, was formally established in 2005 and a draft law has recently been agreed after substantial delays. However, the NFC is not yet functional. Enacting the law will be a crucial step toward ensuring effective coordination of the setting, executing and monitoring of fiscal policy in BH. Progress in advancing non-bank privatization and other corporate restructuring has also been slow, particularly in the Federation.

C. Poverty Profile

18. **About 18 percent of the population lives in poverty, according to the most recent data available.[5]** About 80 percent of the poor live in rural areas and many of the poor are in large households. The heads of poor households tend to be among the least educated and are typically inactive or unemployed. The overall poverty numbers conceal movements into and out of poverty

[4] These domestic claims were accumulated as a result of the 1992-95 war and the fiscal pressures in its wake. The claims are composed of three groups: government spending arrears (almost fully repaid), liabilities for frozen currency deposits and liabilities for war damages. After settling in cash a small portion of the deposits upon verification, the authorities plan to settle the remaining claims for such deposits by issuing bonds in 2008 with maturity of nine years and a fixed interest rate of 2.5 percent. The claims for war claims are planned to be settled with bonds with longer-term to be issued in 2009. Current legislation in the RS allows for maturities up to 35 years, grace period of 25 years and an interest rate of 1.5 percent. In the Federation, the grace period is 13 years and the interest rate 1.5 percent

[5] The most recent data on poverty is from the 2004 Living Standards Measurement Survey (LSMS).

and differences in the evolution of poverty rates at disaggregated levels. The poverty headcount was reduced only slightly between 2001 and 2004, although many individuals moved both in to and out of poverty. These movements reflect outcomes in the labor market and wage developments. Many workers who moved out of poverty also moved from inactivity or unemployment into employment.

19. **Many households remain vulnerable to the risk of falling into poverty, or are "nearly poor."**[6] Among those who moved out of poverty between 2001 and 2004, about 70 percent may be considered "nearly poor" and vulnerable to falling back into poverty.

20. **Employment remains a key determinant of poverty.** The 2006 Labor Force Survey suggests that informality is associated with lower average (and more unequal) earnings. In addition, joblessness is associated with worse welfare outcomes. Among working-age individuals, those who are jobless account for the largest share of the poor and face the highest poverty risks. Joblessness is the highest among the young, women, the relatively less educated workers and workers over 40 years of age. Qualitative research suggests that subsistence agriculture and remittances from abroad continue to play a role in many rural households' coping strategies.

21. **While gender equality and women's rights are included in law, the situation of women in BH remains of concern.** In rural areas, traditional gender roles have resulted in limited access for women to productive resources, such as land. Employment remains difficult and women's participation in the labor market continues to be low compared with men. Many women are not covered by health insurance. Provisions to guarantee women equal pay are in place but they are not consistently applied. Women continue to be under-represented in politics and official authorities[7].

22. **There are 17 officially recognized minorities in BH, but the law on the Protection of Ethnic Minorities continues to be poorly applied.** The Roma continue to be the most vulnerable minority and discrimination against this community persists, with problems in access to housing, social services, education and employment[8].

23. **The Bank's understanding of poverty and well-being after 2004 is constrained by the lack of data.** Information on household consumption was collected during the 2001 and 2004 Living Standard Measurement Survey (LSMS). For 2004, data on household expenditure is also available from the Household Budget Survey (HBS). Data from the latest HBS (2007) will be available only in 2008. Further, all survey data collection efforts are constrained by the lack of a recent population census. The most recent census was taken in 1991 and a new one is urgently needed. The government is considering preparation of a new census in the near future.

24. **Though still substantial, it is likely that poverty has fallen since 2004.** Data that supports such an inference includes: strong real GDP growth, robust increases in real wages and pensions, and a robust increase in employment of late. Moreover, informality appears to have been reduced, following the introduction of the VAT and helped by robust lending by foreign-owned banks.

25. **The Bank will continue to support BH in trying to achieve the MDGs.** The statistics that measure BH's progress towards the Millennium Development Goals (MDGs) have not been updated since 2005, although the picture can be supplemented from other data sources (see Annex

[6] This corresponds to consumption levels up to 50 percent above the poverty line, following the 2003 Poverty Assessment.
[7] European Commission Bosnia and Herzegovina Progress Report, 6.11.2007
[8] European Commission Bosnia and Herzegovina Progress Report, 6.11.2007

8). The data available shows a positive trend across measured MDG indicators. It also shows that BH is well advanced towards meeting the MDG goals. The Bank will focus its interventions on the reduction of poverty, which is still the largest problem area for BH in relation to the MDGs. As poverty in BH is strongly correlated with lack of employment, the Bank's focus is on poverty elimination through economic growth and job creation. Finally, the Bank will continue to advocate improvements in means-testing of social programs to help reduce poverty through increased efficiency of government spending.

D. Medium Term Outlook

26. **The 'baseline' case scenario over the CPS period assumes only modestly ambitious structural and fiscal reforms and slower growth.** BH could achieve sustained strong growth in output and employment over the medium term provided key reforms are advanced further and vulnerabilities tackled. However if, as anticipated, reforms proceed at a more modest pace, consistent with the recent experience, growth will ultimately slow down from the robust pace observed in 2006 and 2007. The 'baseline' scenario assumes only modestly ambitious structural and fiscal reforms, continued adherence to the currency board arrangement and improvements in regional stability.

27. **Real GDP growth is projected to accelerate to 6.5 percent in 2008 but slow thereafter** (Table 1)**.** GDP growth is expected to rise briefly as substantial new metal processing capacity is introduced and as a result of structural reforms carried out earlier. After 2008, growth is projected to ease to about 4-4.5 percent a year by 2010 and 2011 - under the assumption of modest reform efforts. The longer-term growth rate under the baseline case scenario reflects continued increases in employment at the rate of 2 percent a year, slower than in recent years. Consumer price inflation is assumed to average about 2 percent in 2007, thanks to the currency board arrangement.

28. **The current account deficit is expected to remain large and continue to represent an important vulnerability.** After rising to about 17 percent of GDP in 2007, the officially-estimated current account deficit is projected to narrow to about 13 percent of GDP by the end of the CPS period. Inflows of foreign direct investment are expected to peak at about 11 percent of GDP in 2007 and 2008, reflecting privatization receipts and, thereafter, average about 5 percent a year. Inflows of foreign direct investment and capital grants (included in the capital and financial account, and not in the current account) should finance more than one half of the deficit. These inflows, together with continued reflows of resident capital should help limit reliance on foreign borrowing.

29. **The general government balance is assumed to shift from equilibrium in 2007 into a modest deficit of about 2 percent of GDP by the end of the CPS period, reflecting a decline in grants and a growth in expenditures.** Capital expenditures are set to rise in line with government plans to boost infrastructure outlays but these will be constrained by the ability to secure financing. Over the CPS period, it is projected that the fiscal deficit will be financed largely through net domestic borrowing, draw-downs of government deposits and privatization receipts. Privatization receipts are projected to amount to about Euro 1 billion in 2008 (about 8.7 percent of GDP), assuming enterprise sales in the Federation proceed as planned[9].

30. **The baseline scenario assumes a fiscally responsible resolution of the large amount of domestic claims, reflecting substantial efforts made to date.** Domestic claims have an estimated face value of about 16 percent of 2007 GDP. The current size of domestic claims compares well

[9] Significant revenues from privatization were received in Republika Srpska during 2007.

with much larger estimates from 2004. Some of these estimates amounted to as much as 200 percent of GDP, reflecting lack of clarity about many of the claims. In addition to these claims, the authorities will need to tackle property restitution. The amount of claims is substantial, and the authorities are working on a comprehensive strategy for dealing with property restitution. Nonetheless, risks remain that political pressures will lead to a fiscally unaffordable settlement.

31. **Pre-war arrears amounting to EUR 48.8 million at the end of October 2007, owed to the IFC by two government-owned companies, have been transferred to the BH authorities**. Resolution of these arrears has been elusive for some years. The authorities have recently agreed to renew and advance their discussions with the IFC on ways to resolve this issue in a manner agreeable to both parties. It is fully expected that BH would make progress on this expeditiously.

E. External Financing Requirements

32. **The external debt burden is projected to ease moderately under the baseline scenario, but the debt service will worsen after the CPS period as external financing shifts further to non-concessional sources.** The face value of external debt is projected to remain close to, but below, 50 percent of GDP throughout the CPS period. The Net Present Value (NPV) of external debt is set to fall from 47 percent in 2005 to about 40 percent by 2008, but rise thereafter to about 43 percent by 2011, as borrowing on concessional terms falls sharply. Debt service ratios are projected to improve through 2010 before worsening thereafter, as the share of concessional debt is reduced.

33. **Financing requirements are projected to decline as a percentage of DEP over the CPS period, but rise modestly thereafter.** The evolution of financing requirements reflects the narrowing of the current account deficit and the assumed shift in foreign borrowing from concessional to market terms (Table 2).[10] The balance of payments projections imply that financing requirements will ease from 18.3 percent of GDP in 2006 to 11.5 percent by 2012 but rise modestly to 12.2% by 2016 reflecting the shift in foreign borrowing from concessional to market terms.

F. Public Financial Management and Fiduciary Assessment

34. **Bosnia and Herzegovina has established, but generally not implemented, modern public financial management institutions and systems**. The State and both Entities have laid the foundation for sound public financial management, including independent external audits. The reforms have been characterized by growing domestic ownership, particularly the finance ministries' efforts to improve the planning and execution of government budgets. However, many of the improvements that have been enshrined in laws and institutional arrangements still need to be implemented in practice.

35. **Fiscal policy remains fragmented between the State, the two Entities and Brcko District.** While agreement has been reached recently on a law that sets the stage for fiscal coordination, the law has not yet been implemented. A functional, intergovernmental National Fiscal Council (NFC) that can make timely and binding decisions on fiscal policy will be critical to overcoming the current fragmentation of fiscal policy-making. The creation of a unified indirect taxation system is a positive development, despite disagreements over the revenue-sharing formula between the Entities and Brcko District.

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[10] Financing requirements are defined as the sum of the current account deficit including both current and capital transfers, principal repayments due and the change in foreign exchange reserves.

36. **Strategic planning and budgeting has improved and ownership is more evident**. It is hoped that the Medium Term Expenditure Framework (MTEF) can be sustained without external support and there are indications that it is becoming the starting point for preparation of annual budgets. Preliminary steps have been taken toward a program-based budgeting process. Significant institutional reforms have been introduced by the State and Entity governments to improve organic budget laws. In addition, an intergovernmental Budget Coordination Board has been formed for coordinating medium-term budget development among the governments including aligning macro-fiscal assumptions.

37. **An automated treasury system at the State level and in the two Entities has improved budget controls, but does not include extra budgetary funds.** The treasury system has improved controls, brought discipline to the budget execution system, improved overall cash management and improved the availability and quality of financial reporting. It is important that extra budgetary funds (particularly health insurance and pension funds) and municipalities are also brought into the treasury system, because these bodies manage significant resources.

38. **A country-wide Law on Public Procurement (LPP) came into force in January 2005, but is not being implemented consistently.** The new law is in line with EU requirements and, if implemented, would provide the basis for the Bank to use the country's own procurement systems. However, it is not yet being consistently and effectively implemented at the State or Entity levels. The Supreme Audit Institution of the State has reported several instances of violation of the LPP in its respective audit reports. For these reasons, the LPP is not yet acceptable for use under World Bank-financed projects. However, improvements in implementation of the law are supported by various donors and monitored closely by the country fiduciary team.

Table 2: Bosnia and Herzegovina: External Financing Requirements

Bosnia and Herzegovina: External Financing Requirements, 2005 - 2016
(In millions of U.S. dollars)

	2005	2006	2007	2008	2010	2012	2014	2016
Financing requirements	**2,587**	**2,248**	**2,847**	**2,660**	**2,079**	**2,291**	**3,078**	**3,120**
(In percent of GDP)	24.0	18.3	20.1	17.3	11.8	11.5	13.7	12.2
Noninterest CAB including a	1,549	927	1,155	892	965	1,056	1,074	1,157
Interest	171	188	220	244	306	373	480	550
Amortization	397	360	379	680	465	730	1,392	1,281
Government	94	162	129	122	143	157	181	205
Nongovernment	303	197	250	557	322	573	1,210	1,076
Reserves	470	773	1093	844	343	132	132	132
Financing sources	**2,587**	**2,248**	**2,847**	**2,660**	**2,079**	**2,291**	**3,078**	**3,120**
Disbursements	1,272	810	744	735	1,029	1,152	1,981	1,725
o/w World Bank	0	56	58	55	60	65	69	50
Resident lending abroad (oth	793	1,014	408	192	285	260	33	107
Foreign direct investment	522	424	1,695	1733	765	879	1,064	1,288
Memoranda:				(In percent of GDP)				
Current account balance	-19.8	-10.7	-16.9	-16.2	-13.6	-13.3	-12.7	-12.3
Noninterest current account t	-18.2	-9.1	-15.3	-14.6	-11.9	-11.3	-10.3	-9.7

1/ Including both current and capital grants.

II. COUNTRY DEVELOPMENT PROGRAM AND ISSUES

A. Country Priorities

39. **The BH authorities' MTDS for 2004-2007 had three goals: a) create the conditions for sustainable and balanced economic development and restore partial creditworthiness on the international capital markets; b) reduce poverty by 20 percent, and c) accelerate EU integration.** The strategy emphasized the inter-relationship between these objectives and aimed to transition BH from a largely aid-dependent economy to one that is self-sustaining. A mid-term progress report and revised strategy was approved in September 2006. The Revised MTDS retained the three main goals of the original strategy, but introduced greater prioritization of measures with the intention of improving implementation.

40. **The MTDS presented a bold reform agenda, but was not fully implemented**. Legislation in the Entities has, at times, run counter to the strategic goals set out in the MTDS, raising questions about the full political ownership of the main tenets of the strategy. Further, the MTDS was never fully linked to annual budgets, the MTEF or Public Investment Plans (PIP).

41. **A new Country Development Strategy for the period 2008-13 is currently under preparation in BH**. The process is being led by the Coordination Board for Economic Development and EU Integration, but is currently still in its early stages and may not be completed until late 2008. Early indications suggest that the three overarching policy goals will remain the same as those in the MTDS.

42. **In the meantime, the Bank team has been in close and regular discussion with the BH authorities on their priorities**. Shortly after the October 2006 elections, the Bank prepared a series of Policy Notes for the incoming Governments, outlining: the Bank's assessment of progress in reconstruction and development; remaining challenges and areas of vulnerability; and, policy recommendations covering 10 key sectors.

43. **The dialogue with the Government on the Policy Notes and the Entity Governments' investment programs were used as vehicles for expressions of interest in future World Bank support**. The Bank was requested to put an increased focus on investment projects. Priority sectors highlighted for investments were: infrastructure (especially transport and energy); agriculture; development of small and medium size enterprises; and, corporate restructuring of enterprises. Other priority areas emphasized include strengthening of the single economic space in BH, increasing employment, development of local government, restructuring the economy, improving the management of loss-making companies and harmonization with European legislation.

44. **In October 2007, the State and Entity Governments, as well as the Mayor of Brcko District, identified their economic policy reform priorities** with the signing of a Platform for Action (see Annex 1). The proposed CPS program is closely attuned to these priorities.

B. Sectoral Issues

Business Environment

45. **Some progress has been made in improving the business climate, but BH lags behind its regional neighbors**. Progress **through the last CAS period** includes facilitating access to finance and strengthening the legal framework for non-banking financial institutions, improving the efficiency and effectiveness of the business inspection regime and introducing a new business

registration system. However, the degree of private sector activity is below regional averages and accounts for only about 55 percent of GDP. The World Bank's Doing Business reports show that BH's relative ranking in terms of ease of doing business has been falling[11]. Creating an investor-friendly business environment will be the key for attracting foreign direct investment (FDI) and strengthening growth. A Strategy and Action Plan to enhance corporate financial reporting in line with the EU standards and international good practice has been approved and now needs to be implemented.

46. **Several obstacles to an attractive investment climate remain.** Key challenges include: reducing the time it takes to register a new business; improving the corporate sector's financial reporting, auditing and accounting standards; reviewing and rationalizing the different taxes and levies imposed on businesses by various levels of government; integrating banking supervision (the Bank recommends full unification at the national level); and, reducing the regulatory burden on businesses. Stronger and better regulated capital markets and better corporate governance are also needed.

Infrastructure

47. **Infrastructure improvements are critically needed: transport and energy have been singled out as key priorities for BH by the authorities.** The stock of infrastructure in BH, outdated at the time it became a sovereign country, was extensively damaged during the war. Post-war reconstruction was, to a large extent, focused on restoring electricity generating capacities, roads, schools, bridges and other key infrastructure. The authorities have identified further improvements in infrastructure and convergence towards EU standards in this area as being both of the utmost importance and an area where the Bank can provide significant support. Two key sub-sectors have been singled out: transport and energy.

Transport

48. **Demand for most modes of transport is growing rapidly, consistent with GDP growth**. Road traffic in and around the major urban areas is currently rising by five percent a year, increasing congestion and pollution while worsening road safety. On the railways, heavy freight volumes are projected to increase markedly through the medium term, but passenger volumes are broadly static. Growth projections on the inland water transport system are modest and dependent on investment to return the system to navigability.

49. **Transport networks need to be rehabilitated and extended, supported by a national transport strategy and backed by private financing.** About 40 percent of the main and regional road network remains in poor condition and the current allocation for maintenance of the network remains inadequate. The development of Corridor Vc (part of the Trans European Network) is considered a national priority and the authorities have begun to implement key sections of the project. The Bank believes that a National Policy and Strategy for transport is needed to ensure investments are made with regard for the fiscal envelope. Given the scale of the project and fiscal constraints, private sector capital will be required in some form of public-private partnership (PPP), requiring prior improvements in the institutional framework.

Energy

50. **Power sector rehabilitation is partially complete, but needs further investment.** BH's power facilities have largely been restored since the end of the war and the power sector is being

[11] Doing Business 2008-BH ranks 105th in the 178-country Ease of Doing Business global rating. In Doing Business 2007 BH's rating was 95/105 countries.

restructured to reduce the outstanding inefficiencies and to comply with EU regulations (designed to promote a unified, competitive, regional electricity market based on free and equal access to all participants). Nevertheless, there are still some power system facilities damaged during the war that have yet to be rehabilitated and the authorities project continuing large investment needs because of aging facilities.

51. **Investment in new power facilities is needed, supported by a national energy sector strategy and backed by private financing.** There have been no significant investments in new power system facilities in BH since the war. The authorities recognize that the investments needed to harness the substantial and relatively diversified energy resource base in BH to expand power generation capacity to meet growing domestic and regional demand may be larger than can be covered with traditional donor-financed projects. Recognizing fiscal constraints, the authorities have launched a comprehensive energy sector study at the State level to inform the preparation of a BH energy sector strategy (expected completion in December 2007). The Entities have also begun to explore avenues for spreading risk and limiting fiscal costs through private sector participation. Although recent initiatives have involved some studies and a competitive process (primarily for some hydro-power plants), several initiatives are linked to unsolicited proposals from the private sector.

Service Delivery

52. **Service delivery is poor, especially in rural areas.** Responsibility for service delivery lies with municipalities in BH. Having achieved a great deal in terms of reintegrating returnees and internally displaced persons following the war, municipalities must now focus on service delivery. Almost 1.4 million people in BH do not have running water in their household and lack regular waste removal services. Half a million people lack any sanitation service. One third of rural households use water from unsafe water sources because they lack water connections.

53. **BH must simultaneously reduce high public expenditure and increase the quality and quantity of public services.** While responsibility for the delivery of local public services rests with municipalities, services are delivered by local utility companies that operate as autonomous entities. Many are in a perpetual financial crisis due to low collections, low tariffs and lack of maintenance. As a consequence, service quality and reliability are generally unsatisfactory, which makes consumers reluctant to pay the tariffs and the resultant lack of revenue in turn, prevents maintenance and causes service to deteriorate still further. Recent ITA/VAT sharing reforms promise to provide all municipalities, including poor ones, with a stable, autonomous, and equitable source of funding. However, BH will need tools to help municipalities enhance expenditure efficiency and meet minimum standards. An independent benchmarking of municipal service delivery and improved monitoring capacity will be necessary. A three-phase strategy will: i) safeguard quality by focusing on rehabilitation and maintenance; ii) create the conditions for financial autonomy of utilities; and, iii) adjust tariff levels after improving collections and system efficiency.

54. **The Government has identified solid waste management capacity as a priority.** The rapidly growing volume of solid waste outstrips municipal utilities' ability to keep pace. Only 36 percent of households have regular waste removal services, so people burn or dump their waste illegally - polluting land, roadsides, and rivers thus posing a direct risk to public health. Although waste collected by municipalities has to be disposed in "official" dumpsites, these are generally open dumps rather than controlled landfills.

Education

55. **Inefficient education spending has resulted in unacceptably low education outcomes in BH.** Forty percent of students do not acquire basic skills and knowledge by the end of fourth grade, while many students enrolled in costly vocational schools receive insufficient general education and are ill-equipped to meet the challenges of today's labor markets. Pre-primary education enrollment rates are the lowest in the region. While primary education enrollment rates remain high at about 93 percent, BH has the lowest rate of net secondary enrollment (73 percent overall, with only 57 percent of the poor attending) of all 12 transition countries for which data are available.

56. **Recently adopted laws on education, would have the potential to improve the education system, if implemented.** The State Parliament has recently adopted a number of new framework laws in education. The challenge now is to implement these laws effectively. Support is being provided by the European Commission for vocational education and training and the proposed law on the Education Agency. Two laws where little or no international support is being provided are the Law on Preschool Education and Upbringing and the Law on Higher Education. BH's participation in the Bologna process is a major opportunity to improve the quality of teaching and learning and realize efficiency gains.

Health

57. **Despite progress achieved since the war, health outcomes in BH lag behind those found in other countries of the region**. Some key outcome indicators raise concerns: infant mortality is higher than in most CEE countries; the incidence of tuberculosis is four times higher than the EU average; disability, posttraumatic stress, depression and chronic diseases rank highly on the burden of diseases. Accidents and injuries are at a high level and appear to be rising. The incidence of high-cost diseases of the heart and circulatory system, stroke and cancer is above the European averages.

58. **The BH healthcare system is fragmented and burdened with substantial duplication, excess employment and inefficient service delivery**. Utilization of primary and preventive health care is substantially lower than in other countries in the region, while referral rates to the more expensive secondary and tertiary care level are high. Efforts to improve primary health care, resolve a large number of cases at the primary level, and adherence to standard referral protocols have started. To improve hospital efficiency, BH would need to reduce a considerable number of beds and adjust infrastructure and the health workforce accordingly. Controlling medical technology costs and quality assurance requires the authorities to consolidate expensive equipment into one or two tertiary hospitals while ensuring that there exists an efficient referral system. Fragmented drug procurement and pricing add to the existing inefficiencies and increase the opportunities for corruption.

59. **The insurance benefit package, co-payment levels and purchasing power vary across the cantons and the Entities, leading to unequal access to care**. Health care is mainly financed through payroll social insurance contributions collected by the Health Insurance Funds. Collection has been poor due to a large informal economy, rampant evasion and substantial legal exemptions from contribution payments. The consequent deficits result in the accumulation of payment arrears and in the implicit rationing. These financial challenges will further increase as the population ages rapidly, and the concomitant rise in demand for high-cost treatment for chronic diseases. Inequity in health financing and the high share of out-of-pocket spending raise concerns about access to care.

60. **Systematic changes in the way health care is financed, organized and delivered are required to help improve health outcomes, provide access to quality care and ensure the financial sustainability of the health care system**. It is recommended that BH's health strategy focus on three main objectives: (i) more efficient resource collection and allocation; (ii) improved access to quality and efficient service delivery; (iii) improvements in governance and stewardship.

Social Protection

61. **Outlays on social transfers in BH are high, but are not poverty focused.** Levels of social welfare and child protection are broadly in line with other countries in Central and Eastern Europe relative to GDP. However, social transfers are not targeted to need and provide ample opportunities for double dipping, thus having limited impact on poverty alleviation. Further, coverage across the entities and sub-Entity governments varies considerably. While the number of registered social welfare beneficiaries is large, only a fraction of those receive cash benefits.

62. **Veterans' benefits are high relative to other disability benefits, pensions and average wages**. When transfers to veterans and survivors are added to the other social transfers, outlays are even higher and the poverty impact is further reduced. The tendency of most social protection benefits to gravitate toward the levels set by the veterans' benefits is worrying and potentially counterproductive. For example, the size of the potential obligations accrued in the past few years in the Federation would require tax increases or the reduction of under-financed welfare benefits.

63. **The social welfare system in BH contains multiple programs that compete for scarce resources**. It is recommended that the authorities start targeting benefits to need, in line with the proxy-means testing and conditional cash transfer parameters. Further, spelling out precise eligibility criteria for more than one benefit, and by strengthening an integrated beneficiary database to ensure effective monitoring should help reduce opportunities for "double dipping".

Agriculture

64. **While agriculture contributes 10 percent of GDP and 21 percent of overall employment, 20 percent of the people working in the natural resources-based economy live in poverty**. BH needs to transition from low technology agriculture towards a modern sector with agricultural policies and institutions, food safety and animal health requirements aligned with EU requirements.

65. **Rural productivity needs are still subject to underdeveloped rural credit markets, the slow land consolidation process and poor rural infrastructure**. Land consolidation and administration improvement (where property rights have been clarified and land markets are more fluid) could help conserve agricultural land, enforce spatial planning and avoid further urban encroachment. The context of an ageing rural population and farm fragmentation is expected to lead to land consolidation into larger production units and/or pull together farmers associations to share resources, and involve more mechanization.

66. **The war in BH resulted in significant population displacement as well as the loss of property records so that legal records may not correspond with the current patterns of land use.** As a result, it is very difficult to complete basic real estate transactions or to borrow money based on property as collateral, particularly for women who sometimes waive their property and inheritance rights to male family members.

Environment

67. **While there is no national level environment strategy, BH has made progress on some aspects of environmental management**. The MTDS has a chapter on environment, both Entities are working on their own environment strategies and a National Biodiversity Strategy and Action Plan is nearly complete. Legal frameworks exist for environmental protection, water resources management, air quality protection, forestry, and nature protection. There is also a new focus on economic instruments for mitigation of environmental impacts to implement 'polluter pays' principles.

68. **However, governance challenges remain, particularly in enforcement, planning and, management practices**. Particular attention needs to be paid to improving: sustainable forest management; water management practices; and management of BH's river basins for power generation, irrigation, tourism, and water and waste water services. Capacity is weak and needs to be further developed to harness the potential of the country's tourism sector, to help BH prepare for absorption of possible EU pre-accession funds and to meet the EU accession requirements.

69. **Disaster preparedness is limited.** The prevalence of regional risks, such as forest fires earthquakes and communicable diseases have gained increasing attention on the need for disaster preparedness, reduction and response. BH is improving its surveillance, diagnostics, and technical capacity to monitor and treat diseases such as Avian Influenza.

C. Governance

70. **BH's complex governance structure makes governance reform difficult and commitment to reform appears to be weak.** BH lags significantly behind its income group on three dimensions of governance**:** political stability/absence of violence, government effectiveness, and the quality of regulation (see Annex 6). All of these dimensions are related to BH's complex institutional structure, albeit not to the same degree. BH has several positive governance characteristics including the functioning of the supreme audit institutions, adoption of the new law on public procurement, a free and vibrant press and democratic elections. However, commitment to tackle the governance agenda in a comprehensive manner appears to be lacking.

71. **EU accession is one of the key entry points for the Bank on governance reform in BH**. While it is important to address all dimensions of governance, the Bank's approach is guided by its capacity to make a difference and a focus on its area of expertise. The OHR takes the lead on constitutional reform issues, while donors such as USAID, OSCE, the EC, UNDP, SIDA, DFID and the Netherlands are involved in other aspects of the governance agenda, such as public administration reform, training of journalists and the Governance Accountability Project. To move towards EU accession, BH will need to create the European administrative space and strengthen government effectiveness and regulatory quality. These are the areas where the Bank intends to focus its efforts.

72. **The World Bank will aim to affect both supply and demand factors in governance.** In applying the Bank's Governance and Anti-Corruption strategy in BH during this CPS, the World Bank will identify sectors where governance reforms are possible and visible so as to create a demonstration effect, while also stimulating demand for good governance through local level accountability interventions, analytical work and strategic communications.

73. **The CPS includes instruments to affect the supply of governance reform**. The performance benchmarks for high-case lending are directly aimed at improving the efficiency and

effectiveness of government spending. CPS benchmarks will regulate the flow of resources to those policy areas where strong government commitment is demonstrated and which have the potential to significantly affect the supply of better governance. Programs under Pillar 1 will aim to improve the regulatory quality dimension of governance and Pillar 2 will focus on improving government effectiveness and efficiency in providing services at the municipal level and managing public resources such as forests and the environment. Finally, the CPS relies on partnerships and consultations with key public officials to enhance their ownership of these efforts.

74. **In addition, the Bank will continue to facilitate the demand for the improvement of governance by engaging local communities in decision making processes**. The CPS will continue to support youth groups and other NGOs in developing an effective and strategic demand for improved governance. Throughout the CPS period, effective communication and media campaigns will be launched to stimulate the demand of citizens for better governance.

III. WORLD BANK GROUP PROGRAM

A. Implementation of the Last CAS and Lessons Learned

75. **Overall performance under the previous CAS (FY05-07) was moderately satisfactory** (for the full CAS Completion Report see Annex 2.) The Bank's investment operations continued to have a positive impact on improving access to basic services, developing core infrastructure in support of economic growth, and strengthening the financial sector. Most of the projected outcomes were fully or partially achieved during this CAS period. However, at times, Government commitment to structural reforms proved to be elusive. The Bank's adjustment credits[12], based on MTDS-identified priorities, triggered some important reforms (see below), but the overall pace of reforms was slower than expected. Several adjustment credit tranches were not disbursed and a programmatic DPL that was planned to account 40 percent of the CAS base-case lending program was not delivered. The complexity and aggregate level of ambition of Bank adjustment operations also contributed to this result.

76. **The modestly satisfactory reform performance resulted in a reduced lending program – between low and base case.** Base case lending triggers required satisfactory macroeconomic performance, satisfactory MTDS implementation, satisfactory progress in improving the business environment, satisfactory performance towards a reformed public administration and private sector wage determination mechanisms, and a reduction in the public sector wage bill as a share of GDP. These triggers were only partially and unevenly met. The base case lending envelope was projected at US$152 million, but, the actual lending program was US$123 million (or 81 percent of the projected base case). The Bank team demonstrated flexibility in re-allocating IDA resources to the sectors and operations which demonstrated capacity for further progress and productive use.

77. **As of June 30, 2007, the IFC's committed portfolio in BH amounted to US$166 million, of which US$27 million in equity and US$139 million in loans.** During the last CAS period, IFC expanded its program, committing US$106 million, compared to US$60 million under the FY02-04 CAS. IFC had a number of successful new operations over the last CAS period, including the provision of funding to financial institutions to support SMEs and microfinance industry (initially launched and developed with support of IDA), the promotion of energy efficiency and the development of housing finance. It also supported a glass and chemical company to facilitate FDI and the transfer of modern technology and a producer of generic pharmaceutical products to increase substantially the variety of domestically produced drugs. IFC has been following closely opportunities to support private sector participation in infrastructure, but slow progress on privatization has prevented IFC's engagement. In addition to BH specific investments, IFC has also invested in one regional project and two private equity funds, which operate in Southeast Europe, including in BH.

78. **Pre-war arrears amounting to EUR 48.8 million at the end of October 2007, owed to the IFC by two government-owned companies, remain outstanding.** These arrears have been transferred to the BH authorities, but resolution of the situation has been elusive for some years. The resolution of arrears to IFC would allow the World Bank Group to further increase its program in BH through mobilizing more resources to finance private sector projects in the country as well strengthening its catalytic role in promoting FDI in the country

79. **MIGA's outstanding gross exposure in BH as of June 30, 2007 amounted to US$203 million**, equivalent to 3.8 percent of MIGA's total portfolio. Over the last CAS period, MIGA

[12] Referred to now as Development Policy Lending (DPL)

issued new guarantees in support of investments in the financial sector for an overall gross amount of about US$136 million.

80. **Analytical and Advisory Activities (AAA) carried out during the previous CAS provide strong input for the current and future policy dialogue.** The key pieces of analytic work included: Country Economic Memorandum; Public Expenditure and Institutional Review (PEIR); Labor Market Update; Financial Sector Assessment Program; Debt Sustainability Analysis; BH Pension System Note; and Fiduciary Update. These reports, the PEIR in particular, triggered important policy dialogue during the previous CAS period and provide an analytic basis for the new CPS. In addition, the Policy Notes the Bank prepared provided an opportunity to discuss with the newly elected governments the priorities for the next four years.

81. **IFC advisory services in BH focused on specific programs covering four business lines**: i) value addition to firms, improving management practices, increasing competitiveness of local companies and improving supply-chain practices regarding the collection and re-use of recyclable materials; ii) improving the business enabling environment with programs on alternative dispute resolution and sub-national competitiveness; iii) access to finance with programs on housing finance, micro—finance and sustainable finance; and iv) infrastructure to promote private sector participation in all infrastructure sub-sectors (although slow progress on privatization prevented the IFC from engaging in this area).

Box 2: IFC Alternative Dispute Resolution Project

Alternative Dispute Resolution Project

Since 2003, IFC Advisory Services has been implementing an Alternative Dispute Resolution Project (ADR) in Bosnia and Herzegovina to foster the development of mediation in order to allow efficient and cost-effective resolution of commercial disputes. Mediation is an important factor in enhancing the business environment, as it helps businesses to unlock capital tied up in litigation while reducing pressure on the courts. In order to accelerate the resolution of commercial disputes, IFC established a cooperation arrangement with the Ministry of Justice of Bosnia and Herzegovina and with other institutions, organizations and development agencies, to ensure institutionalization of a sustainable mediation system. IFC also helped to develop a professional cadre of mediators, trained according to best international practices, and supported the growth of the Association of Mediators in Bosnia and Herzegovina (AOM).

As a result, more then 600 cases with a success rate of 55% were mediated releasing EUR 9.5 million in assets to parties blocked for more than three years in court procedures. Recently, IFC marked the completion of successful pilot projects and transferred two fully equipped mediation centers in Sarajevo and Banja Luka to the AOM. In addition, IFC supported AOM in drafting the law on Mediation Procedure (enacted by the Parliamentary Assembly of BH in August 2004) and additional bylaws (enacted by the State Parliament in March 2006). Since July 2007, all necessary preconditions for full implementation of the mediation law are met and 33 certified mediators are offering mediation services nation-wide.

82. **Effectiveness delays are causing significant delays in project implementation.** All the projects approved in the previous CAS period have experienced effectiveness delays due to the complex signing and ratification procedures of the BH governments. However, the State-level Council of Ministers recently expressed commitment to address the issue and has already taken actions to streamline the ratification procedure. The Bank's Portfolio Management Team in

Sarajevo is working with counterparts in the Council of Ministers to develop processes that should reduce the time between Board approval and project effectiveness to a maximum of 4-6 months (from an average of 9–10 months currently).

83. **The Bank maintained a strong relationship with the BH Governments and its services are still considered highly valuable.** Despite the problems encountered with DPLs, the Bank maintained a strong relationship with the client. The client survey, carried out in October–November 2006, interviewed about 250 stakeholders, two-thirds of whom were Government officials at different levels. A client survey indicated high level of satisfaction with the Bank services (see Box 2). Clients had a favorable impression of Bank's effectiveness in BH, with an average rating of 7.52 on a scale from 1 (lowest) to 10 (highest). This compares favorably to the World Bank global average of 6.4. Almost 60 percent of respondents wanted more Bank involvement and only about five percent thought that the Bank should be less involved than before. The Bank's knowledge combined with its financial resources still seemed to be perceived as highly (and equally) valuable. Limited use of local experts and bureaucratic policies and procedures were identified as the two greatest weaknesses. Government commitment and weak capacity were assessed as the most significant factors inhibiting future sustainable growth and development.

Lessons learned and implications for the new CPS

84. **Tailor the CPS program to the level and areas of Government commitment and capacity to deliver on reforms.** Government capacity and commitment to reforms is the key factor. While rather obvious, such a principle is particularly relevant in BH. Identifying areas of intervention that have strong ownership by the BH Governments and yet also have significant development impact will continue to be the key challenge for this CPS.

85. **Improve political economy analysis when deciding about the instruments to pursue development priorities.** The uneven experience with DPLs and technical assistance was not due to a failure by the Bank or by the BH Governments to recognize the country's main development challenges. On the contrary, in the design of both, cancelled, adjustment credits (SOSAC II and EMSAC) the priorities requiring urgent tackling were clearly identified by the Governments, but were frustrated by political factors. However, the respective Bank teams appear to have overestimated the capacity of the Government to deal with several parallel reform processes pursued by different international organizations. Better analysis of the political economy should be applied during the preparation and implementation of all projects.

Box 3: World Bank Client Survey

World Bank Client Survey for Bosnia and Herzegovina

The Client Survey, conducted in late 2006, was followed by in-depth interviews with officials and staff of government ministries, parliaments and implementation agencies; bilateral and multilateral agencies; academic and research institutes; business and private sector organizations; NGOs and the media. In summary, the findings are:

- Almost all respondents evaluate the World Bank and its work in BH as positive, useful and desirable.
- They consider that the Bank has played a significant role in BH and has provided assistance and support to strategic development.
- The attributes most frequently ascribed to the Bank are skill, professionalism, support, desirability, constructiveness, technical experience, carefulness, significance, seriousness and importance.
- Bureaucracy, insufficient [local] exposure, bad moves and inadequate familiarity with the current situation in the country are some of the criticisms of clients.

86. **Pursue reforms through investment lending and, provided there is political commitment, very focused DPLs.** Under the previous CAS the Bank provided a combination of DPL, investment loans, technical assistance operations and ESW to support BH's reform program. Investment operations helped move reform forward in key sectors, including health, energy, roads, and solid waste management. Although DPLs were less successful, a measurable part of the reform agenda supported by these credits was accomplished. Continued policy dialogue resulted in progress on several fronts. For example: internal audit and procurement laws have been enacted; synchronized laws on internal audit were drafted; and, while the law in the RS has been enacted, while the laws at the State level and in the Federation are in parliamentary procedures. Further, the RS has drafted a law on public sector salaries that aims to bring the existing supra-wage allowances into the base wages; to ensure effective mechanisms of fiscal sustainability; and, to promote transparency in public wage setting. Efforts should be made in the new CPS to use investment operations to speed up the reform processes. At the same time, the policy dialogue should continue and, should the appetite for the pace and type of reform change, Development Policy Loans should feature as a part of the high-case scenario.

87. **Consider project design, which rewards the best performing segments of BH, while at the same time not undermining the single economic space.** Recent experience suggests the need for greater flexibility in project design to support reforms and investments where they make the greatest development impact. Whereas most project funds are currently allocated to both Entities (in accordance with a pre-set ratio), the World Bank is willing to explore the possibility of introducing, upon request of the authorities and in selected projects, a mechanism whereby, during the course of project implementation, a portion of the funds would be allocated to the Entity or beneficiary that demonstrates the strongest ability to absorb more funds and make faster progress towards meeting the project's development objectives. It should be stressed, however, that such performance-based flexibility would only be exercised where the approach is acceptable to, and requested by, the authorities and if it will not undermine efforts to deepen the single economic space and foster social cohesion in BH.

88. **Focus on results and the importance of monitoring and evaluation beyond Bank-supported operations.** The focus on results should clearly go beyond Bank financed operations. Bank teams should assist the Government to set up mechanisms to monitor its own performance, including enhancement of the country's overall statistical capacity.

89. **Create enabling environment for CPS implementation.** The CPS requires a carefully tailored communication strategy that would help the Government explain the benefits of reforms and the costs of inaction. Therefore the operations to be supported under the new CPS will be accompanied by a communication strategy that would help the Government and the Bank to communicate better the potential benefits of the proposed operations, as well as to demonstrate the benefits and costs of reforms – or inaction on reform.

90. **Continue to use AAA as the basis for policy dialogue and formulation of the CPS program.** During the previous CAS period, the Bank produced several important documents that formed a basis for CPS consultations. The PEIR and Policy Notes in particular were useful in informing policy dialogue. Finally, regional studies (Doing Business, Anticorruption in Transition, and Life in Transition Survey) attracted a lot of interest among policy makers and opinion formers. These studies provide clear evidence about the trends in BH in comparison with other countries in the region and should continue to be used strategically to target operations and to develop domestic "champions" of reforms.

B. Proposed World Bank Group Country Partnership Program for BH

91. **During the CPS implementation period, the World Bank Group will strive to be a catalyst for the inclusive and sustainable integration of BH's economy in Europe**. Economic and social development in BH is part of the process of EU integration. This provides the overall institutional and legal framework to underpin economic development and poverty reduction in BH. This is recognized in the MTDS and continues to be the overall objective of the new government's development agenda, in spite of the slow progress towards signing the SAA in the last twelve months. Bank-supported projects will aim to help BH reach their EU goal.

92. **BH will need to continue to improve the competitiveness of its economy in support of its EU objective**. BH has made very substantial progress in economic reconstruction since the end of the war, but compared to other transition countries, more than a decade in transition reforms has been lost to war and the reconstruction efforts. There is still a large unfinished reform agenda that is holding the country back on its goal of convergence with South-Eastern Europe and the EU. The importance of this unfinished reform process is recognized by the BH authorities and is reflected in the MTDS priorities and State and Entity investment programs. A further indication of the centrality of the structural reforms for the future of BH is the signing in October 2007 by the State and Entity prime ministers and the mayor of the Brcko district, of a joint Platform for Action to accelerate the implementation of urgent reforms to attract investment, accelerate job creation and improve living standards in the country (Annex 1).

93. **The new CPS supports the country's priorities by focusing on two pillars: (a) improving the environment for private sector-led growth and convergence with Europe; and, (b) improving the quality of Government spending and the delivery of public services for the vulnerable**. Under the first pillar, the CPS strives to support the country to: (i) expand business activity and increase economic opportunities; (ii) improve key infrastructure; (iii) strengthen regional cooperation to manage public goods; and, (iv) invigorate privatization and corporate restructuring. Under the second pillar, the CPS will support the governments to: (i) improve the delivery of municipal services and strengthen municipal finance; (ii) improve the quality of social service delivery; (iii) reduce urban-rural disparities in income; (iv) increase the targeting of social benefits; and, (v) reduce the burden of Government in the economy and strengthen fiscal coordination. Thus, the Bank Group's program under the new CPS will retain considerable continuity in view of the previous CAS. Figure 1 illustrates the structure of the CPS.

Figure 1: The World Bank Group Strategy for Bosnia and Herzegovina

COUNTRY GOALS:
Economic Growth
Poverty Reduction
EU accession and integration

COUNTRY PARTNERSHIP STRATEGY

PILLAR 1
Improve the environment for private sector led growth and convergence to Europe

PILLAR 2
Improve the quality of Government spending and the delivery of public services for the vulnerable

Areas of Focus

Pillar 1:

Core Program
Expand business activity and increase economic opportunities
Improvements in key infrastructure and links to Europe
Regional approach to public goods, including environment and clean energy
Non-Core Program
Advance privatization and corporate restructuring

Pillar 2:

Core Program
Improve delivery of municipal services and strengthen municipal finance
Non-Core Program
Improve quality of social services delivery
Reduce urban rural disparities in income
Increase targeting of social benefits
Reduce excess burden of Government in economy and strengthen fiscal coordination

WORLD BANK GROUP PRODUCTS

Pillar 1:

Current Portfolio
BAC, Power III, ECSEE APL 3, Small Scale Commercial Agriculture, Land Registration, Urban Infrastructure and Services, Forest Development and Conservation, Avian Flu
New Base Case (FY08/09)
Road Infrastructure and Safety, Sava River Project-Brcko, GEF Neretva Trebisnjica, GEF Forest and Mountain Protected Areas, IFC investments, MIGA guarantees
High Case or outer years
Investment climate project, Land Registration II, Regional Transport project (Corridor Vc), Disaster Risk Mgt project
AAA and other instruments
IFC advisory services, WBI advisory services, ROSC A+A follow-up Transport study, Energy study, ICA

Pillar 2:

Current Portfolio
CDP, SESP, HSEP, ERP, SITAP, Solid Waste, GEF Water Quality**,** Agriculture and Rural Development
Base Case (FY08/09)
Municipal Development Project, Solid Waste II,
High Case or outer years
Public Sector project, Social Sector project, Readiness for IPA accession funding project, Rural/Ed Conditional Cash Transfer project
AAA and other instruments
Poverty Assessment, CEM, IFC Advisory Services, IFC PPP in Health/Ed, WBI advisory services

The Allocation of Resources

94. **While a base and high case lending scenarios will be used to define the level of access to IBRD resources, the Government's Coordination Board[13] will also periodically assess the allocation of Bank resources** and update the operations program agreed between the Bank and the Governments of BH. Joint annual assessments will consider progress in the preceding year against the development objectives and results outlined in the CPS and agree priorities for the next two years. The program will remain shaped by and within the boundaries set by this CPS, combining the Government's evolving priorities and the Bank's corporate strategy. The timing of these reviews will be linked to BH's budget cycle.

95. **To maximize flexibility and to avoid some of the pitfalls of the last CAS, the CPS program is being notionally divided into a 'core' and a 'non-core' program**. The 'core' represents those activities for which political commitment on the part of the BH authorities has been tested. It is represented by projects and programs already underway or likely to be introduced in the first two years of the CPS. This includes lending projects, as well as IFC investments, MIGA guarantees, WBI training activities, TA assignments and AAA work. Outcome indicators for these activities have been developed and are set out in the Results Matrix in Annex 3. Due to the flexible nature of the CPS, the results matrix will be further developed as the program evolves and will be revisited in the mid-CPS Progress Report.

96. **The 'non-core' program represents interventions in areas where political commitment needs testing or where a ceiling on resources will prevent implementation in the early years of the CPS. The 'non-core' program represents two types of situation.** First, those reform areas where the Bank Group could support BH to make progress, but where (given past experience with slow moving or cancelled projects) political commitment needs to be tested prior to re-engagement. Where possible, these important reform areas will be monitored and supported with non-lending activities, such as TA and ESW. Second, those projects where commitment is apparent, but where a ceiling on resources will prevent implementation in the early years of the CPS. Decisions regarding the prioritization of these projects and the appropriate instruments will be taken jointly by the World Bank and the authorities at the annual Coordination Board review of CPS progress.

Financial Envelope

97. **BH continues to benefit from exceptional access to IDA resources.** Due to its low creditworthiness and despite a per capita income that exceeds the normal IDA cut-off by a large margin, BH has continues to receive access to IDA resources.

98. **Over the last CAS period, BH had an envelope of SDR78 million IDA, with access to IBRD lending conditional on achieving enhanced creditworthiness.** Creditworthiness was proxied by five performance benchmarks. During the CAS period, BH achieved some, but not all of the performance benchmarks and, therefore did not draw any IBRD resources (see Annex 2).

<u>The Base Case</u>

99. **The CPS spans the last year of IDA14 and the 3 years of IDA15, during which a phasing out of IDA is expected in BH**. In the first year of the CPS, SDR16.8 million (US$26m at current exchange rates) of IDA resources are available, which is the full performance based

[13] The Coordination Board comprises the three Prime Ministers and their respective Finance Ministers, plus the Mayor of Brcko District.

allocation after taking into account front-loading of IDA assistance in FY07. In the second year, the full performance based allocation would be again available to BH - which is expected to be about SDR25 million (US$39 million)[14]. Thereafter, BH would receive two-thirds of its full performance-based allocation (PBA) in FY10 (estimated at SDR 17 million) and one-third of the allocation in FY11 (estimated as SDR8 million), with an expectation of graduation from IDA at the end of FY11.

100. **Reflecting some improvement in economic performance since the last CAS, limited volumes of IBRD will be made available to BH in the base case of this CPS**. In FY08 and FY09, access to IBRD would be limited to US35 million (over the two years), in FY10 a ceiling of US$24 million and in FY11 a ceiling of US$37 million IBRD is proposed, bringing the total resources available to BH in each year to roughly US$50 million[15]. Overall during the CPS period, a maximum of US$200 million would therefore be available in the base case.

101. **To remain in the base case, BH will need to demonstrate: continued satisfactory macroeconomic performance; satisfactory debt sustainability prospects; and no reversals of key economic reforms**.

<u>The High Case</u>

102. **The high case reflects a stronger reform environment and strengthened creditworthiness prospects**. In addition to meeting the base case indicators, BH would need to take concrete steps towards the creation of a single economic space, as evidenced by measurable progress in implementation of the Platform for Action signed by the three Prime Ministers and the Mayor of Brcko District in October 2007. In the high case lending scenario, IBRD incremental lending would be limited to an annual amount of USD20 million.

<u>A Low Case</u>

103. **Any serious deterioration in the base case indicators would cause the Bank to reconsider its levels of support**. Serious repercussions from regional political events or the worsening of the political dialogue on the reform agenda would cause the Bank to review its lending arrangements to BH. Under a low case scenario, project preparation would proceed more slowly and would focus only on those parts of the program where there is the greatest cross-governmental support.

104. **Table 3 below sets out specific indicators, against which progress will be assessed jointly (with the BH Governments) and collectively (i.e. a collective assessment of progress and reform momentum) to evaluate whether higher levels of lending are justified**. The Coordination Board will undertake such an assessment annually. A mid-CPS Progress Report will be undertaken by the Bank in partnership with the authorities in late FY09 and submitted to the Board. The levels of access to IBRD will be reviewed at that point. Access to IDA would not be

[14] This is the estimated allocation in FY09, based on performance in FY08 and assumptions about the size of IDA15. Actual allocations during the CPS period will be determined on an annual basis and will depend on: (i) total IDA resources available in IDA15, (ii) the country's performance rating; (iii) the performance and assistance terms of other IDA borrowers and (iv) the number of IDA-eligible countries. The US$ amount will also depend on the prevailing SDR:US$ exchange rate.

[15] The US$ amount will also depend on the prevailing SDR:US$ exchange rate.

linked to these assessments; rather it will continue to be based on the performance based allocation system as described below.

Table 3: Lending scenarios for BH: Base and High Case

Base Case	High Case
Satisfactory macroeconomic performance	Improved satisfactory macroeconomic performance
No reversals of key economic reforms	No reversals of key economic reforms
Satisfactory debt sustainability prospects	Strengthened creditworthiness prospects
	Concrete steps towards a single economic space, as evidenced by measurable progress in the implementation of the Platform for Action taking into account the following: • National Fiscal Council is fully operational • Revenue allocation formula from the single account is fully operational • Integration of banking supervision • Governments begin to settle domestic claims in a fiscally affordable fashion • The investment climate improves including harmonization of profit and income taxes.

Lending and Analytical Program

105. **Within the first pillar - improving conditions for private sector led growth - the BH authorities have indicated a strong demand for a core lending program focused on infrastructure** (in particular transport and energy). These are areas where the Bank's program had strong results in the last CAS and have the potential for further development impact. In support of the goal of improving key infrastructure, the core program will include on-going projects to improve hydropower and thermal power stations and improve access to reliable, low-cost electricity. An Energy Sector Study will inform future potential World Bank Group supported projects in this area. The BH authorities are keen to receive additional World Bank Group support to put in place measures that would spread risks and limit fiscal costs of establishing new power generation and transmission infrastructure through private sector participation; the aim of such support would be on assisting the authorities to meet the Energy Community Treaty commitments, for example by helping put in place transparent and competitive procedures (in accord with the relevant EU Directives) for solicitation, selection and authorization of all new power generation and transmission projects.

106. **A comprehensive sector strategy will drive the Bank's engagement in transport.** The State and Entity ministries, with support from the World Bank and the European Bank for Reconstruction and Development (EBRD), are now developing a comprehensive transport sector policy and strategy framework covering aviation, roads, railways, urban transport and inland waterways. A new project in support of maintenance of roads and road safety will be delivered in FY08. Further, the authorities have expressed considerable interest in a Sava River project which would include marking of the waterway and the rehabilitation of the port on the Sava River in Brcko which used to carry considerable volumes of freight. The Bank plans to support this project in the early years of the CPS. Projects supported by the EBRD, and the EIB will continue to improve the rail infrastructure.

107. **The Bank and other donors are also assessing the possibility of further assistance to the authorities' plans to build the European Transport Corridor Vc**. In addition to EBRD and EIB, which have demonstrated readiness to finance sections of corridor Vc, the resources used to build such a project should come largely from the private sector. The Bank Group and other donors may be able to assist with limited financing for less profitable sections of the road, a guarantee, transaction advice from the IFC and/or other technical assistance. As in energy, the focus of support to such big infrastructure projects will be on ensuring that the process is conducted in a manner that is transparent, competitive and avoids the escalation of costs.

108. **The World Bank Group anticipates playing an important role helping the government to structure possible public private partnerships (PPP) transactions**. The IFC will continue to seek opportunities to help the Governments to structure private sector participation in transport, energy and municipal waste treatment. Through its Private Enterprise Partnership in Southeast Europe (PEP-SE) advisory facility, IFC will explore the opportunities to support PPPs through project preparation, structuring transparent bidding processes, and mobilization of financing. MIGA can also play a role in supporting foreign direct investment in infrastructure through the provision of political risk guarantees. During FY07, the Bank held a training seminar on PPPs that was very well attended by a cross-section of regulators and officials from BH. Follow-up activity has been requested and will be implemented through the CPS period.

109. **The authorities have also expressed interest in stimulating rural business and agriculture**. Under the core program, a small-scale agriculture project is underway, which aims to help farmers make productivity gains through credit lines, provide assistance in forming producer associations and help in easing supply-chain bottlenecks. A regional Land and Gender Review will identify the extent to which land rights are different between men and women in BH and examine the impact of these differences on women's access to land markets and any impact on family welfare as a result of gender differences in land ownership. The study will outline key issues examining the intersection between formal entitlements and actual practices with respect to gender and women's access to resources for land. A land registration project which was approved in 2006 may be a candidate for a second phase or increased financing, if it proceeds well.

110. **Regional issues will receive greater attention during the CPS period**. In the core program, the Bank supported Avian Influenza Preparedness Project, which provides critical support to enhance public health system infectious disease response and control capacities, is expected to become effective in the first year of the CPS. The importance of climate change and hazard risk management has been brought into stark relief after significant forest fires in the region during 2007. Mitigation and adaptation activities under a regional Southeast Europe Disaster Risk Reduction and Adaptation Program may form part of the non-core program.

111. **The Bank is also supporting projects on environmental protection, both to improve governance and transparency and to support tourism**. The Forestry Development and Conservation Project, which promotes capacity building and governance in the sector, received additional financing in FY07. Environmental capacity building will also be supported in the CPS period through the implementation of two GEF-funded projects: Neretva and Trebisnjica Management Project (for the water sector), and the Forest and Mountain Protected Areas Project (for biodiversity conservation and tourism promotion).

112. **In the corporate sector, IFC and MIGA will continue to support strategic FDI in BH with a focus on encouraging regional cooperation by encouraging good and growing companies active in the region to invest in BH.** IFC will focus on investors in the commercial property and food sectors. IFC will also seek opportunities to support domestic companies, such as the

automotive, metals and tourism sectors, to become more competitive in the domestic and regional market. IFC focus will be on post privatization support, as well as facilitation of the transfer of technology and increased competitiveness. WBI and the Bank are cooperating on joint program to promote private sector led-growth through innovation and technology in selected sub-sectors. IFC's PEP-SE will continue to be active in supporting SME development in BH. MIGA will be open to support FDI in the manufacturing and agribusiness sectors through the provision of guarantees. MIGA will also consider opportunities to promote SMEs in BH through its Small Investment Program.

113. **The Bank will also continue to promote reforms that aim to expand business activity and improve the business environment**. A Business Enabling Credit that yielded several notable results, including improved access to finance, faster bankruptcy procedures and a more efficient inspection regime, is due to close at the time the CPS starts and will be evaluated in the first year of the CPS. In this CPS period, an Enterprise Restructuring Grant from the European Union, administered by the Bank, will aim to move the corporate restructuring agenda forward with a restructuring of over a dozen Voucher-Privatized Enterprises and will pave the way for further corporate restructuring.

114. **Non-lending service will also support the improvement of the business environment.** An Investment Climate Assessment will be produced during the first year of the CPS. Further, the Bank will support improved corporate financial reporting and auditing in line with international standards. Other Bank Group interventions towards this goal in the core program may include IFC advisory services and WBI's capacity building and in conjunction with other development partners. WBI also has a program to improve the competitiveness of the ICT sector in BH.

115. **Privatization, corporate restructuring and firm exit reforms are areas where commitment has been mixed under previous Bank projects**. While there is strong demand for Bank support for corporate restructuring from some parts of Government (the RS in particular), uneven performance on these reforms under the last CAS suggest that this be part of the non-core program to be supported initially by training activities and ESW. Additional Bank financial support would be considered to support privatization or corporate restructuring if commitment to reform in this area is demonstrated.

116. **The IFC will continue to be active in the financial sector**, using loan and equity financing, as well as advisory services. IFC will seek strategic partners to establish greenfield banks and support local financial institutions to develop into high-quality banks, while continuing to support the development of microfinance, leasing, housing and energy efficiency through existing financial institutions. MIGA will also consider opportunities to support foreign strategic investors in the financial sector, focusing on projects which promote the development of specialized products, such as leasing, and improve SMEs' access to finance.

117. **Under the second pillar - improving government effectiveness – the Bank will support efficiency improvements in agriculture**. An Agriculture and Rural Development Loan, approved in FY07 for implementation through this CPS period, will help improve the efficiency of public financing for the agricultural sector under the core program by strengthening the capacity of the State- and Entity-level institutions to deliver more efficient and effective agricultural services**.** It will also accelerate the country's eligibility to access support under the EU Instrument for Pre-Accession Assistance for Rural Development (IPARD). The project will also promote harmonization of food safety and animal health requirements to the EU *acquis communitaire*. Associated farm and client registries should allow better targeting of subsidies.

118. **The BH authorities have indicated interest in continued investment borrowing for social service projects, including pension system reform, but performance in other human development projects has been uneven**. In the core program, the Bank has a social insurance TA program and an employment services project due to close soon after the introduction of the CPS. Education and health projects are also underway, both of which will close towards the end of the CPS period. While the health project is proceeding well, limited commitment to reform in education and in social protection has led to lower than anticipated development outcomes to date. Therefore, the Bank will continue to try to influence these important parts of BH's social service agenda under the non-core program with policy dialogue and AAA. If progress is seen in some of the areas listed as challenges in the sectoral section of the CPS, further engagement will be warranted. For example, a new social sector project, possibly pension reform, will be considered in the outer years of the CPS.

119. **Bank support for municipal development is of particular interest to the authorities**. Under the core program, the Bank's urban infrastructure project assists municipalities to improve service delivery. A new Municipal Development Project will be introduced in the early years of the CPS. A community development approach proved to be a successful instrument for investments in small local infrastructure in the poorest municipalities. IFC will also seek to support local authorities and help them in structuring private sector participation in municipal infrastructure. However, institutional capacity is weak and the legal framework is not yet adequate to allow for private sector participation arrangements in public infrastructure projects at the municipal level.

120. **The Bank has been active in the solid waste sector and plans to continue in this area.** The current Bank-supported project has established six regional landfills; safe methods of disposal; public awareness; training of sector staff; and extending waste collection to those areas that are not currently serviced. However, additional bilateral funding sought from numerous donor agencies has not resulted in any concrete commitments. Given the financing gap and repeated and urgent requests by the Governments, the Bank provided additional financing to the project and has been requested to support further implementation of the Nationwide Solid Waste Management Strategy to arrive at nationwide coverage of the program. More financing will be provided to complete the national coverage of this project in the early years of the CPS.

121. **The Bank will also continue to advocate for structural reforms to improve fiscal coordination and improve the efficiency and tracking of public expenditure more broadly through non-core and non-lending activities**. Further financing activities in this area would be considered for fields where commitment to implement the Platform for Action is demonstrated, and, as opportunities to engage emerge. Strategic communications will be critical to create knowledge and public demand for structural reform in partnership with the authorities and other donors.

122. **Capacity and coordination in the field of statistics are weak and need urgent improvement.** The existence of multiple statistical agencies with weak capacity has hindered the effective collection and analysis of statistics. Most nationwide survey efforts since the war have been donor-financed. Capacity building in the area of statistical reporting remains a focus of the Bank's poverty work, including thorough training undertaken in conjunction with WBI. The lack of a census since 1991 presents major difficulties in establishing per capita statistics and in effectively targeting vulnerable groups. Should it be decided to proceed with a new census towards the end of this decade, World Bank support would be provided.

123. **Flexibility, results and partnerships are the key operating principles of the CPS.** The political deadlock of the last twelve months, the difficult institutional environment and the experience accumulated with the implementation of the previous CAS indicate that the Bank needs to fine tune the CPS program in relation to the level and areas of Government interest as well as

their commitment and capacity to deliver reforms. This requires a flexible approach to the partnership program, a strong focus on results and close partnerships with other donors. Resources will be channeled towards those specific policy areas or sub-sectors where reform commitment and an opportunity to engage exist. Additional resources may be used to top up or extend existing successful operations, to introduce new operations and/or to introduce DPLs.

Table 4: Indicative Lending Table

Fiscal Year	**Projects**	**IDA** US$m*	**IBRD** US$m
FY08	Road Infrastructure and Safety	25	
	Solid Waste II		25
	GEF Neretva Trebisnjica	8**	
	GEF Forest and Mountain Protected Areas	4**	
FY09	Municipal Growth	15	10
	Sava River / Brcko Port	10	15
Outer Years / Non-core	**Pillar 1** Investment Climate Privatization / Corporate Restructuring / Bankruptcy Land Registration II Regional Transport Project (Corridor Vc) Disaster Risk Mgt project **Pillar 2** Public Sector / Administration Reform Social Sector project Readiness for IPA accession funding Rural/Ed Conditional Cash Transfers	42	46
Total		104	96

* IDA amounts are determined in SDR, therefore the dollar amount may vary. The SDR amount is subject to the internal resource allocation mechanism
**GEF Financing

Table 5: AAA Table

Planned AAA products	**Year of delivery**
Energy Sector Study	2007
Strengthening Local Governance Study	2007
Transport Sector Review	2008
Investment Climate Assessment	2008
Country Economic Memorandum	2008
Poverty Assessment	2008
Other anticipated AAA products	
Regional climate change/disaster mitigation	
PPP training follow-up	
IFC and WBI advisory services	
Evaluation of reform in selected areas of primary health care sector in Bosnia and Herzegovina	
Proxy Means Targeting for Equitable and Sustainable Social Assistance in Bosnia and Herzegovina	
Annual Fiscal Updates	

Flexibility

124. **The customary system of allocating Bank resources to BH has not encouraged flexibility**. To date, most Bank loans have been made to the State of BH and then divided according to a pre-determined ratio between the two Entities. Progress has been assessed nationwide, so that delays in preparation, effectiveness or implementation of a project in one Entity have held up the project in relation to both Entities.

125. **In early 2007, the authorities proposed a greater degree of flexibility in project design**. The flexibility proposed would allow more funds to be absorbed by the Entity or beneficiary that demonstrates the strongest ability to make progress towards the development objectives of the project. The Bank is open to supporting all options that support reforms and investments where they can make the greatest development impact, but the ultimate decision on the allocation of funds in each project must lie with the authorities. Therefore, were the authorities to request such performance-based flexibility, the Bank would be open to explore ways to allocate part of individual project financing to Entities or beneficiaries on a performance basis provided it will not undermine efforts to deepen the single economic space and foster social cohesion in BH..

Results

126. **The proposed program of activities is results-oriented.** The program is designed to help BH reach its overarching goal of EU accession. It supports the MTDS goals and those in the recently signed Platform for Action. A results matrix is attached (Annex 3). To enhance results in individual operations the Bank has agreed to introduce flexibility in some projects (as described above).

127. **The Bank will aim to promote monitoring and evaluation capacity building beyond its portfolio.** Bank-supported projects will seek to impact sector-wide monitoring of results by the authorities. Enhancing BH's statistical capacity is an important element of this approach. Furthermore, the Bank will seek opportunities to enhance the role of civil society to monitor and evaluate the performance of their elected officials. The CPS will be monitored jointly by the Bank and the BH authorities on an annual basis. Findings of the annual portfolio reviews will be presented to the Coordination Board for review and action.

C. Partners' Role and Participatory Process

128. **BH still enjoys significant, albeit declining, support by development agencies**. Overall, in 2007, support by 18 most active development agencies (excluding EIB) in BH is expected to reach Euro 400 million. Areas that attract most support include private sector development, financial sector (including microfinance), municipal development, agriculture, and social protection. See donor matrix attached in Annex 4.

129. **The authorities have yet to assume full leadership over donor coordination**. Domestic capacity for donor coordination is still weak and fragmented. However, there has been progress in developing adequate architecture for donor coordination following the decision to transfer donor coordination of responsibilities from the Ministry of Foreign Trade and Economic Relations of BH to the Ministry of Finance and Treasury of BH. It is expected that these recent activities, supported by DFID, will build capacity of the Government to be more pro-active in specifying its needs to donors and in guiding and monitoring the manner in which assistance is delivered. In addition to this, UNDP supports development of a Grants Resource Management System (GRMS) that should further strengthen Government's capacity for donor coordination.

130. **Meanwhile, the Donor Coordination Forum (DCF) represents the main vehicle for coordination and exchange of information among donors**. The DCF was established in December 2005 as a semi-formal platform of information exchange among major donors in BH. Guided by the principles of the Paris Declaration, the objective of the DCF is to enhance the efficiency of the use and allocation of official development assistance in the country and thus secure better aid effectiveness. In 2006, the DCF secretariat conducted the first Donor Mapping Report for BH. This report includes past, current and future resource allocations of the 18 largest donors in BH (including the Bank). Furthermore, an interactive donor mapping database was established thus allowing for regular updating of information about donor programs in BH.

131. **The authorities' over-arching goal is EU accession and the Bank is partnering closely with the EU in order to ensure that support provided by the Bank enhances the prospects of BH reaping the benefits of EU accession as soon as possible**. The Bank will continue to strengthen further its close collaboration with the EC – particularly in pursuing public sector reform and reforms in the agriculture sector in accordance with the EU standards. Partnership with the EC and regional development banks (EBRD and EIB) in supporting investments in transport and energy sectors have already yielded positive results and leveraged significant volumes of resources. A Joint World Bank-EU office in Brussels facilitates coordination of development issues with the EC.

132. **Cooperation with other development partners remains close and will be further reinforced during the CPS period.** Examples of successful partnership with development partners over the last CAS period include: partnership with SIDA (Sweden) in promoting Agriculture and Rural Development; with GTZ and SIDA in developing and implementing the Land Registration Project; with DFID in supporting development of an enabling business environment; and, with EBRD and EIB in transport and energy. In particular, strong cooperation with EBRD/EIB will be continued in supporting infrastructure investments. Over the CPS period, close cooperation will be required with UNDP, USAID, the Government of the Netherlands, and SIDA in developing a common front in supporting municipal development. DFID remains an important partner in corporate restructuring and promoting efficient and pro-poor public financial management, as well as social sector reforms in the interest of the most vulnerable categories of the population. Finally, the Bank will continue its close collaboration with the IMF.

Participatory Process

133. **The CPS was developed after substantial consultations with key stakeholders.** Consultations were organized in two phases: preliminary consultations (late 2006 – early 2007), and another round of consultations conducted in September-October 2007. During the preliminary consultations, the Bank team obtained feedback from the outgoing and newly elected Government officials (following the October 2006 elections). Thorough preliminary consultations were also conducted with key development partners through a thematic session of the Donor Coordination Forum and through separate consultative meetings with the EC, EBRD, DFID and continued consultations with IMF. Inputs from civil society representatives were received at the CPS consultation meetings and through regular interaction with the Youth Voices Group - a consultative body operating in association with the Country Office.

134. **Formal consultations with key Government officials were held in September 2007 at a Coordination Board meeting organized for this purpose in addition to continuous, informal, discussions**. The formal discussion of the new CPS program was based on the following: (i) key principles outlined in the MTDS; (ii) recently adopted development strategies of the two Entities; (iii) Government's response to the Bank's policy notes; (iv) lessons learned from the previous

CAS; (v) substantial AAA work carried out during the previous CAS; and, (vi) transition to IBRD. Broad agreement was reached about areas of intervention and principles that should shape future partnership. Following the formal consultations with the Government, the Bank team engaged in additional consultations with development partners and civil society through separate meetings. Feedback received from these meetings is reflected in the CPS document.

135. **Donors emphasized the need for a common approach, while civil society organizations emphasized their role in monitoring**. Two messages came out clearly in the consultations. First, development partners increasingly recognize the need for a common approach in supporting much needed structural reforms in an environment where there is limited commitment by the authorities. Second, civil society organizations insisted on partnership with the Bank in introducing sound monitoring and evaluation practices. Given that ensuring a strong development impact of public spending is the cornerstone of the Bank program in BH, partnership with civil society organizations with demonstrated capacity to promote sound monitoring and evaluation practices will be explored further during this CPS period.

IV. MANAGING RISKS

136. **Despite strong economic performance and a reasonably healthy portfolio, the level of risk in the BH program is substantial**.

Internal

137. **The greatest risk to implementation of the BH program is political obstruction of economic reforms**. The previous CAS assessed that sufficient reform commitment would allow for a strong structural reform agenda through a series of DPLs, anchored by the SAA with the EU. This CPS is more cautious and proposes to support reforms in the base case through investment loans and advisory support, with policy-based lending only in the high-case and subject to assessments of commitment.

138. **Following the 2006 elections, heightened political polarization between the three constituent peoples and the key political parties has lead to delays and wrangling in every project or initiative**. The positions of the Entities are often mutually exclusive. For example, while the Federation generally seeks a stronger role for the State in every project, the RS would generally prefer no State involvement. The political costs of reform and risks of instability need to be weighed carefully against the potential growth and poverty reduction benefits they could bring. This charged atmosphere makes project preparation, negotiations, effectiveness and implementation slow.

139. **To mitigate the risk of slow or faltering project implementation, the degree and form of the State-level involvement will be negotiated on project by project basis.** Agreement will be sought on the aspects of the project to be undertaken at the State level early in project preparation. Political economy analysis will be undertaken in each project and strong signals of ownership and commitment will be required prior to proceeding.

140. **The complex and fragmented governance structure of BH potentially undermines government transparency and accountability.** This potentially allows entrenched interests and informal networks along ethnic, professional and economic interest lines to thrive. In such environment, corruption may be difficult to detect. The Bank will continue to use Bank-systems of financial management and procurement to mitigate the risk of fund misuse.

141. **The transition from IDA to IBRD may reduce BH's interest in World Bank loans**. BH has been borrowing on IDA hardened terms for some years although BH's per capita income exceeded the normal IDA cut-off. The blending arrangement proposed in this CPS and the recent price reduction for IBRD loans will help the BH authorities move smoothly from IDA through blend towards IBRD-only status.

142. **Access to other sources of finance, including significant EBRD and EIB loans and EU grants may also render the Bank's products and advice less attractive**. The World Bank has partnered successfully with other development banks in BH to leverage (rather than compete with) their programs. The authorities have a genuine interest in continued World Bank support to BH. The relationship between the Bank and the BH authorities remains strong as evidenced by the Client Survey (April 2007) which reports strong satisfaction with the Bank in BH. Meanwhile, increasing attention to Africa by bilateral donors may see international aid flows to BH decline at a faster-than-anticipated pace. Coordination with other donors and the strength of the Country Office help to keep the World Bank's advice relevant and timely.

143. **Substantial risks exist that outstanding domestic claims will be settled at a fiscally unaffordable level.** Such an outcome would reflect ongoing pressures by vested interests - which the governments have resisted so far - to provide more generous settlement terms than the estimated face value of about 16 percent of 2007 GDP. Risks are also large so that the ultimate settlement of property restitution, and any other contingent liabilities that may emerge, could undermine debt sustainability.

External

144. **The key external risk to BH's program arises from the lack of resolution of Kosovo's status**. Specifically, it is feared that discussion on autonomy or independence for Kosovo could negatively affect the political environment in BH. Lack of international support for a divided BH, including from the EU, may inhibit such a move.

145. **High growth rates in recent years have undermined the need to make structural change in the economy for the medium-term**. A sharp reversal of the currently favorable external climate, particularly high international prices for metals and wood, could result in a 'hard-landing'. This CPS period will see a more sustained and strategic use of communication that seeks to inform the public of the costs of inaction on the reform front and to stimulate debate about options and trade-offs. As other emerging markets, BH faces risks related to the ongoing turbulence in international financial markets. There are also risks that negative economic events in one country in the region could spill over to others since the foreign-owned banks which dominate BH's banking system are present throughout the Central and Eastern Europe and beyond. Slower inflows of foreign investment, should these risks materialize, would have a negative impact on BH's growth prospects.

146. **The OHR maintains an interventionist approach in BH with active use of the 'Bonn Powers'.** Should the international community's support for this role and the approach wane, BH may become caught in a political gridlock, falling further behind its neighbors. There is currently a broad agreement amongst the international community that such a role is still needed in BH.

Annex 1: Platform for Action

October 16, 2007

OUR PLATFORM FOR ACTION

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We fully accept that urgent economic reforms cannot be put on hold until major political disputes have been resolved. We understand that attracting investment, creating employment and raising living standards represent our most important and immediate challenges and we are committed to making economic growth one of our key objectives. We acknowledge that the EU association process represents the best strategy for development, but we also recognize that we can secure rapid results by supporting the passage and implementation of laws and initiatives that have already been prepared and agreed in principle.

We the undersigned confirm our support for:

Improving fiscal coordination and stability by, *inter alia*:

- agreeing on the revenue allocation formulae consistent with the principles of simplicity, clarity, and fairness;
- establishing a legal basis for setting up a National Fiscal Council as a means to set and pursue the overall fiscal policy objectives of the various levels of government;
- reviewing and streamlining social spending schemes with a view to improving their effectiveness;
- reducing the public expenditures' share of GDP.

Creating a better business environment by, *inter alia*:

- dismantling administrative obstacles to and creating harmonized conditions for doing business in BH, including harmonizing the base for profit and income tax;
- substantially upgrading the functioning of the financial sector by increasing integration of the banking supervision systems, securities markets and insurance activities;

- promoting regulation of contractual relations in the manner ensuring legal certainty and business predictability;
- further facilitating opening of the market and thus undisturbed movement of goods, services and capital, especially in fields such as pharmaceuticals and medical devices;
- dismantling obstacles to labor mobility and, to this end, also working towards modernizing labor, pension and social insurance provisions.

Promoting other reforms ensuring sustainable development, including, *inter alia*:

- promoting the development of a competitive and dynamic agricultural and food sector;
- supporting initiatives and forums for constructive dialogue on how to make the economy grow more rapidly, among policymakers, employers and workers;
- taking an active part in the development of a Mid-Term Development Strategy for 2008-2013 and thereby establishing further priorities for sustainable economic development in BH.

……………………….	………………………….
Dr. Nedzad Brankovic	Milorad Dodik
Prime Minister of the Federation of BH	Prime Minister of Republika Srpska

For issues that fall within the competence of the Brcko District BH:

………………………….

Mirsad Djapo

Mayor of Brcko District BH

………………………….

Dr. Nikola Spiric

Chair of the Council of Ministers of BH

Annex 2: CAS Completion Report

WORLD BANK
COUNTRY ASSISTANCE STRATEGY (FY05 – FY07)
FOR
BOSNIA AND HERZEGOVINA

COMPLETION REPORT

November, 2007

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EXECUTIVE SUMMARY

INTRODUCTION

This completion report evaluates the implementation of the World Bank Country Assistance Strategy (CAS) FY05 – FY07 for Bosnia and Herzegovina (BH). The current Bank program has been closely focused on supporting key reforms in BH envisaged under the country's Poverty Reduction Strategy/Medium-Term Development Strategy (MTDS). The FY05-FY07 CAS period has been characterized by:

- **relatively strong growth**, driven largely by high international prices for BH's main commodity exports, but
- **slow progress in structural reforms** and therefore in BH's transformation to a modern market economy.

COUNTRY'S OBJECTIVES

In the MTDS, BH committed itself to pursue three objectives in parallel during the period 2004-2007:

- **Create conditions for sustainable and balanced economic development.**
- **Reduce poverty by 20 percent from the 2004 level.**
- **Accelerate EU integration.**

COUNTRY OUTCOMES

BH has come a long way since the end of the 1992-95 conflict, but a lot more remains to be done to achieve the MTDS goals. The physical post-conflict reconstruction effort has progressed well. The Government has implemented numerous political, security sector and state-building reforms, which enabled the start of SAA negotiations in December 2005. BH experienced strong growth over the past three years (5-6 percent of GDP). Some economic reforms, most notably the successful introduction of a flat rate VAT from the start of 2006, as well as customs and banking sector reforms, have also been completed and have earned BH an upgrade of its credit rating by Moody's (from B3 to B2) in early 2006.

Nevertheless, a large outstanding reform agenda remains. A large current account deficit (estimated at 16.9 percent of GDP in 2007) poses a risk to macro-economic stability, and unemployment and poverty remain high. Thus, there is an urgent need to accelerate structural reforms and improve the climate for private sector development while ensuring that state building and EU integration activities are carried out in a fiscally responsible manner.

CAS OBJECTIVES

The CAS for BH covering FY05-07 was presented to the Board of Directors in September 2004, and was anchored in the MTDS. It was structured along three mutually reinforcing pillars, reflecting BH's principal challenges:

- Pillar I: Improving public finance and strengthening institutions;
- Pillar II: Promoting sustainable private sector led growth; and
- Pillar III: Investing in key social and economic infrastructure.

This CAS marked the end of exceptional post-conflict levels of IDA for BH. IDA commitments were reduced from an average of over US$ 100 million per year during the immediate post conflict reconstruction (FY96 – FY03) to an average of about US$ 40 million per year during this CAS period. BH continued to benefit from exceptional access to IDA, despite a per capita income three times above the IDA threshold.

CAS OUTCOMES

Overall CAS performance was moderately satisfactory. The Bank's investment operations continued to have a positive impact in improving access to basic services, developing core infrastructure in support of economic growth, and strengthening the financial sector. Most of the projected outcomes were fully or partially achieved during this CAS period. However, Government commitment to structural reforms proved to be elusive. The Bank's adjustment operations (today Development Policy Loans – DPLs), although based on MTDS-identified priorities, failed to trigger necessary reforms. The complexity and aggregate level of ambition of Bank adjustment operations also contributed to this result.

WORLD BANK PERFORMANCE

The World Bank's overall performance was moderately satisfactory. Investment projects were appropriately designed and well supervised leading to satisfactory outcomes and a strong, positive development impact. However, the reform scenario pursued by the Bank during the FY05-07 CAS was complex and overly ambitious. The Bank misjudged the Government's and Parliament's capacity and readiness to pursue such an ambitious program of reforms. Nevertheless, the Bank remained proactive and flexible in resolving identified weaknesses and has maintained a strong relationship with the client. Apart from the failure of some adjustment operations, most of the investment credits maintained satisfactory performance ratings throughout the CAS period. According to a recently conducted client survey, the Bank's analytic and advisory activities remain highly valuable in informing policy dialogue and will play an important role beyond this CAS period. The client survey also showed a high level of satisfaction with the work of the Bank in BH, and 60 percent of respondents requested a greater involvement with financial and knowledge support.

LESSONS FOR FUTURE CPS DESIGN

Recommendations for the preparation of the next CPS are summarized below:

- **Tailor the CPS to the level and areas of Government commitment and capacity to deliver on reforms.** Identifying areas of intervention that have strong ownership by the Government will be the key challenge for the next CPS.

- **Improve political economy analysis when deciding about the instruments to pursue development priorities.** Experience with some adjustment loans and technical assistance operations during this CAS suggests that the Bank overestimated the capacity of the Government to deal with several complex reform processes in parallel. Better analysis of the political economy in the BH should be applied during the preparation of the next CPS.

- **Pursue reforms through investment lending and, provided there is political commitment, very focused DPLs in the outer years.** Several investment operations helped move the reform in their respective sectors forward. Efforts should be made in the new CPS to use the potential of investment operations to impact on the reform processes.

- **Consider project design, which allows the best performing beneficiaries to absorb more project finance.** However, care should be taken to ensure this does not undermine the single economic space, strengthening the State, or fostering social cohesion.

- **Focus on results and importance of monitoring and evaluation using Bank financed operations to impact sector-wide monitoring of results by the authorities.**

- **Create an enabling environment for CPS implementation.** The next CPS and Bank financed operations should be accompanied by communication efforts that would help the Government better communicate the benefits of the proposed reforms and strengthen local capacity to debate alternative development choices.

- **Improve internal communication and greater synergy between the Bank teams from different sectors and across the World Bank Group should be encouraged.** Synergy between the Bank teams may lead to better outcomes and help the Government effectively respond to cross-sectoral issues.

- **Continue to use AAA as the basis for policy dialogue and formulation of the new CPS program.**

- **Reduced IDA allocations, and a likely small IBRD lending program, will necessitate concentration on fewer operations and a less ambitious reform agenda**. This will also require closer collaboration with other international partners to leverage World Bank Group resources. In particular, the Bank should complement the EC and its efforts to assist BH in the process of EU integration.

1. INTRODUCTION

This report reviews the experience implementing the World Bank's Country Assistance Strategy (CAS) for Bosnia and Herzegovina (BH) presented to the Board of Directors in September, 2004. The Bank's program under the CAS FY05-07 was closely focused on supporting key reforms in BH envisaged under the country's Poverty Reduction Strategy/Medium-Term Development Strategy (MTDS). The FY05-07 CAS period was characterized by:

- **relatively strong growth**, driven largely by high international prices for BH's main commodity exports; and
- **slow progress in structural reforms** and therefore in BH's transformation to a modern market economy.

2. COUNTRY'S OBJECTIVES

BH's complex political and institutional environment, with a State-level of government and two entities (the Federation and Republika Srpska) each with revenue-raising powers, continues to present a challenge for domestic policy makers as well as international community actors. Not surprisingly, the authors of the MTDS experienced many difficulties while trying to develop a comprehensive yet realistic and sustainable development strategy for BH. Finally, after a successful consultative process, all levels of government in BH committed themselves to pursue three objectives in parallel during the period 2004-2007:

- **Create conditions for sustainable and balanced economic development.**

Through implementation of the macroeconomic reform scenario of the MTDS, BH aimed to restore partial creditworthiness on the international capital markets, establish a functioning market economy and strengthen the capacity of domestic companies to compete in external markets, particularly in the EU market. In view of variations in the level of economic development between different parts of the country, creation of a more balanced and equitable development of all parts of BH was also recognized as crucial.

- **Reduce poverty.**

The 2005 Poverty Update found that one in five inhabitants of BH may be considered poor. The MTDS aimed to lower the poverty rate by 20 percent from the 2004 level by accelerating structural reforms, which in the short term might have caused job losses, and consequently an increase in poverty, but would have put BH on a longer-term path of sustainable growth. Therefore, all levels of government were urged to implement such economic policy measures that would address the main causes of poverty including: slow pace of reforms, high unemployment, poor quality of education, and high levels of corruption. The MTDS outlined the following reforms and measures that were to be implemented in order to achieve projected poverty reduction: (i) fiscal reform to ensure a more effective collection of public revenues and higher assistance to the poor; (ii) accelerate the private sector growth to increase employment; (iii) establish an adequate system of social protection; (iv) reduce corruption; (v) reduce the level of "informal economy", which would lead to increases in pensions and reduction of poverty among the elderly; (vi) ensure safeguarding of human rights guaranteed by the existing legal framework and signed international treaties, which would lead to a better integration of returnee and Roma population into the community and reduce the poverty levels among these categories; (vii) fully implement the Law on Gender Equality; and (viii) the reform of the education system.

- **Accelerate EU integration.**

Integration of BH into the EU has been a generally accepted goal of all governments and all segments of society for some time. The MTDS aimed to accelerate integration of the country into the EU, and the focus was placed on signing and implementation of the Stabilization and Association Agreement (SAA). In particular, by implementing the actions outlined in the MTDS, BH would have met the second and the third Copenhagen Criteria, i.e. the existence of a functioning market economy able to endure on the EU market, and the ability to assume obligations arising from EU membership.

3. COUNTRY'S PROGRESS TOWARDS ITS OBJECTIVES

Macroeconomic performance

3.1 **Economic activity has remained robust, supported by some structural reforms introduced before and during the CAS period, privatization of some enterprises, as well as buoyant remittances and rapid credit growth**. Nonetheless, conditions for sustained private-sector led growth are yet to be created, leaving growth vulnerable to a substantial slowdown. Over the past decade, nominal GDP has trebled and is now approaching pre-war levels. The reconstruction process has generally been highly successful, due to BH's own efforts and unprecedented levels of donor support (donor flows amounted to more than $5 billion, including commitments by the Bank of more than $1.1 billion in credits and grants between 1995 and 2006). Average real GDP growth has picked up to 6.3 percent in 2006 from about 5.3 percent on average in the previous three years, due in large part to the re-starting of production at Mittal Steel after its privatization, and the impetus to production from a jump in international prices for metals and other raw materials. Consumer price inflation, anchored in the currency board arrangement, has been stable and/or low, except for the one-off pick up in inflation in 2006 due to the introduction of the VAT. The current account deficit has narrowed to about 10.7 percent of GDP in 2005 from about 20 percent on average in earlier years, due to robust across-the-board export growth and much improved statistical coverage in the context of VAT introduction. Nonetheless, the current account deficit has subsequently widened again to 16.9 percent of GDP in 2007and remains large and a key vulnerability. External weaknesses are exacerbated by limited progress in advancing structural reforms, including privatization, which has kept inflows of foreign direct investment low (approximately 3.5 percent of GDP a year).

3.2 The VAT was successfully introduced. One of BH's major achievements during the CAS period was successful introduction of a state-wide single-rate VAT from the start of 2006. Also noteworthy was the harmonization of indirect taxation, culminating in the establishment of the Indirect Tax Authority at the beginning of 2004. The RS introduced simplified personal and corporate income tax laws in 2006; the Federation in late 2007.

3.3 BH rating on external debt was upgraded to B2 in early 2006. Moody's Investors Service upgraded BH's key debt ratings to B2 from B3 in early 2006 in light of the economic and institutional advances that had taken place since the rating were first assigned in March 2004. The affected ratings include the foreign currency country ceiling for debt and the Government of BH's domestic and foreign currency issuer ratings. The rating outlook is still stable.

3.4 Large government spending remains a drag on the economy. Government spending amounts to about one-half of the official GDP (and over 40 percent of GDP adjusted for the informal economy). Even when adjusted, spending is about 5 percent of GDP higher than other countries in south eastern Europe and well above fast growing economies in the region, including the Baltics, Ireland or Slovakia. Strong revenues from the VAT helped the modest fiscal surplus in 2005 triple in 2006, but the medium-term outlook is at risk due to decisions enacted before the October 2006 elections to further increase non-targeted social benefits. Resolving outstanding domestic claims resulting from war damages, property restitution, and frozen currency deposits could also add a significant burden to the budget, as could plans to boost infrastructure spending on roads and electricity generating capacity.

3.5 **Absence of rule-based intergovernmental transfers worsened fiscal imbalances between levels of governments (vertical) and across regions (horizontal).** The new VAT allocation mechanism seeks to address, at least partially, both the vertical and the horizontal imbalances in intergovernmental fiscal transfers; however, its real impact is still unknown. There are substantial regional variations in per capita revenues and expenditures, with municipalities witnessing the largest horizontal fiscal disparities in both entities. Uneven regional economic development and reliance on an origin-based tax sharing principle has resulted in the poorest and stagnating regions being left behind. Vertical fiscal imbalances favor the revenue-raising entities and run against the State level government and the municipalities because of their very limited own revenues as a source for financing their current responsibilities.

Unemployment and poverty reduction

3.6 **BH has made a little progress in reducing unemployment and poverty.** While new data enabling estimates of poverty for 2004-2007 will be available only after the next Household Budget Survey is published in 2008, it is likely that poverty has fallen since 2004 due to strong GDP growth and increases in real wages and pensions. Data for 2005 suggest that about 18 percent of the population is below the poverty line, with another one-third in danger of falling into poverty. Unemployment and poverty are strongly linked and remain persistently high (data for 2004 suggest that about 20 percent of the population are unemployed; a more recent Labor Force Survey put the number at 31 percent, but there are questions as to the quality of data underpinning this result).

3.7 **Social services: relatively high spending levels do not lead to satisfactory outcomes.** Inefficient spending within institutionally complex structures results in poor outcomes. Education and health outcomes are broadly comparable to other countries with similar incomes, but much lower than would be expected given high current spending levels. In education, while general government expenditures are relatively high[16] (higher than the OECD average), education outcomes are unacceptably low. For example, the percentage of students performing below minimum acceptable standards in the 4th grade mathematics is at 43 percent in the Federation BH and 35 percent in the RS. In the health sector relatively high spending levels also do not seem to produce satisfactory outcomes. Indicators related to maternal deaths, infant mortality and immunization (measles) are much worse than in other countries with similar levels of spending.

3.8 **Social transfers in BH are insufficiently targeted to the poor and there is no evidence that these transfers have had any impact on poverty reduction**. According to the Bank's Public Expenditure and Institutional Review (September 2006), social transfers financed via general revenues amount to 4 percent of GDP, with veterans' benefits accounting for about two-thirds of this spending. During the CAS period, these untargeted benefits were increased. Only a small fraction of general revenue financed transfers are means-tested with the aim of providing a safety net for the most vulnerable groups. While veterans' benefits are very high and not based on need,

[16] As a percentage of GDP.

the social welfare and child protection system in BH remains underdeveloped with spending relative to GDP lower than in almost all countries in the region including the new member states of the EU. The MTDS acknowledges that reform is needed to introduce fewer better defined benefits, more efficient benefit administration, and better targeting mechanisms based on vulnerability rather than the status, but political will to make such changes has been lacking.

3.9 Progress in advancing structural reforms has been limited. Privatization has barely been advanced in the Federation BH over the last two years, while the RS authorities have recently made reasonable progress. In particular, progress on this front slowed substantially ahead of the elections held in October 2006. As a result, the private sector generates only about one-half of GDP. The business environment is not perceived as investor-friendly, despite recent improvements in the areas of business registration, bankruptcy and business inspection. The Bank's *Doing Business* 2008 rates BH 105th out of 178 countries (roughly equivalent to its neighbors but well behind the new EU member states and lower than 2006 and 2007 ratings). The key areas of concern are: starting a business, dealing with licenses and permits, and registering property. Licensing and permit requirements are also excessive, with both indicators worse in the Federation BH than in the RS. Recent passage of the business registration and business inspection laws in both entities offers a real opportunity to advance private sector development.

3.10 Levels of corruption are still high and "state capture" remains the biggest concern. The World Bank study "Anticorruption in Transition 3" found that the highest level of state capture in the ECA region was perceived by firms in BH. The impact of state capture was also perceived to have an increasing trend in 2005 compared to 2002 figures. State capture refers to corruption in the law-making process (powerful business elites influence decision and policy making of the state) and can have a very negative impact to an economy and society as a whole, because it can fundamentally and permanently distort the "rules of the game" in favor of a few privileged insiders[17].

Accelerate EU integration

3.11 Stabilization and Association Agreement (SAA) negotiations are technically complete and BH joined NATO's Partnership for Peace program. Furthermore, in July 2006, the BH Directorate for European Integration (DEI) developed the "EU Integration Strategy of Bosnia and Herzegovina", a comprehensive document which reviews the situation in BH, the situation in the EU and necessary measures to be taken in the process of EU integration. Seven consultative working groups composed of 124 civil servants from State and Entity ministries and institutions, as well as external national experts, developed this Strategy, which is a comprehensive document covering the period right up until full membership in the EU. The fact that BH opted for developing an EU Integration Strategy at such an early stage reflects its intention to accelerate and assume full ownership of the integration process. However, BH did not manage to initial its SAA during the CAS period due mainly to the failure to agree on police restructuring measures.

Revised MTDS

3.12 Implementation of the MTDS could be significantly improved through better prioritization and more realistic planning. BH revised its MTDS in 2006. The revised strategy reaffirmed BH's commitment to the three main objectives outlined in the original strategy. However, it recognized that the implementation and impact of reforms could have been

[17] Anticorruption in Transition 3 – Who is Succeeding…. and Why

considerably improved through better prioritization. The revised MTDS, that was approved by the Council of Ministers and both Entity governments and subsequently presented to all three parliaments, disaggregated the three main objectives into the following six general development priorities in BH:

- Maintain macroeconomic stability;
- Increase private investments;
- Restructure the economy;
- Increase employment and strengthen connections between human resources and the labor market;
- Improve the system of social protection; and
- Increase transparency and capabilities of BH society.

3.13 The revised MTDS is an improvement to the original document but it requires stronger linkages to the budget and medium term expenditure framework (MTEF). As outlined in the Joint Staff Advisory Note on the Revised Poverty Reduction Strategy Paper (IMF and IDA, June 2007), further improvements could be made to the strategy, including:

- The development of a costed strategy integrated with annual budgets, the MTEF and the Public Investment Program (PIP), and consistent with the fiscal revenues and foreign assistance likely to be available.
- Greater prioritization focusing on and clearly linked with poverty reduction and growth enhancement, specifying realistic implementation timeframe.
- An improved set of monitoring indicators, related to overall objectives and inputs that can be controlled by the government. .

4. CAS OBJECTIVES

The FY05 – FY07 CAS was anchored in the MTDS and was structured along three mutually reinforcing pillars, mirroring BH's principal challenges:

- **Improving public finance and strengthening institutions,** through:
  (i) a leaner and more efficient public administration and civil service;
  (ii) institutionalization of fiscal coordination between various levels of government;
  (iii) more efficient and higher quality education administration;
  (iv) better-targeted and more efficient social safety nets; and
  (v) greater transparency and accountability of public resource management.

- **Promoting sustainable private sector led growth**, through:
  (i) lower barriers to business activity;
  (ii) more competitive, investment-friendly enterprises;
  (iii) improved corporate sector operations;
  (iv) more robust private sector financing services;
  (v) increased efficiency and access to core economic infrastructure; and
  (vi) more efficient and sustainable natural resources utilization.

- **Investing in key social and economic infrastructure,** through:
  (i) promoting effective protection of the vulnerable through a fiscally sustainable social safety net, including rationalized veterans benefits;

(ii) improved health sector management and better access to quality health care;
(iii) improved service quality in water and sanitation, electricity, and local roads;
(iv) a higher quality and more equitable education system;
(v) greater rural agriculture productivity and profitability; and
(vi) conservation of critical forests and mountain ecosystems.

5. CAS RESULTS

5.1 **The CAS was result oriented.** While not formally a results-based CAS, since such CASs were mainstreamed only in January 2005, the BH CAS was still results oriented. The CAS contained a monitoring and evaluation system starting from a "results framework" (which lays out the logical relationships between interventions and outcomes) with measurable indicators to track progress.

5.2 **The CAS has been generally well aligned with the MTDS and its moderately satisfactory results reflect BH's moderately satisfactory overall performance against the MTDS targets.** The three pillars of the CAS closely mirror the objectives of the MTDS. Of the three CAS Pillars, Pillar 2 "Promoting sustainable private sector led growth" has had the best progress. Pillars 1 and 3 – "Improving public finance and strengthening institutions" and "Investing in key social and economic infrastructure" made less progress because of the slow implementation of the reform program and the delayed start of several projects. The matrix which outlines progress against agreed outcome indicators is attached as Annex I to this report.

5.3 **Results under Pillar 1 "Improving public finance and strengthening institutions" were seriously affected by the lack of progress in implementing structural reforms**. Despite progress in strengthening budgetary practices, and rationalizing intergovernmental transfers a large number of results under this pillar were not achieved. Overall, 8 out of 23 outcome indicators under this pillar were not accomplished (see Annex I). General government spending was reduced to about 48 percent of GDP in 2006, but it is still much larger than most other countries in emerging Europe and faster growing economies in other parts of the world. There was little progress in improving the efficiency of the education sector administration. Only limited progress was made in ensuring better management of the social protection system. New legislation on veteran benefits was adopted but annual budgets in the Federation far exceeded the targets agreed in the CAS (i.e. the legislated nominal freeze at the 2005 level was not maintained). The pension reform strategy has not been formulated. The PEIR, as the key piece of analytic work underpinning this pillar, provides recommendations on improving the composition, quality and effectiveness of public spending to help shift to a more growth-oriented fiscal policy. The PEIR recommends reducing general government spending by 7 percent of GDP by 2010 to help reduce the government burden on the economy and help accommodate fiscal pressures, including those related to settling domestic claims and restitution and strengthening public institutions as EU accession is advanced.

5.4 **Progress under infrastructure projects and continued strong performance in the financial sector contributed to satisfactory performance under Pillar 2 "Promoting sustainable private sector led growth".** There has been continued progress in developing core infrastructure in support of economic growth. Projects supporting investments in solid waste, the power sector, urban infrastructure and road management and safety maintained satisfactory performance throughout the CAS period. All outcome indicators related to "private sector financing services", "core infrastructure" and "growth based on more efficient use of natural resources" were either fully or partially accomplished. In the financial sector, banking has remained strong and has further improved performance. The Financial Sector Assessment Program provided recommendations on additional steps that need to be taken to ensure the long term soundness of the financial sector in BH. The Bank-supported microfinance operation (Second Local Initiatives Project) met the objective of ensuring sustainable access to credit services for micro and small enterprises. Legislation on business registration and inspections has been adopted in the two entities in an attempt to improve the overall business environment. However, a lack of progress in corporate restructuring and privatization negatively affected results under this pillar. The Bank's Policy Development Programmatic Credit and Privatization Technical Assistance Credit operations failed to trigger appropriate actions on these two fronts.

5.5 Pillar 3 "Investing in key social and economic infrastructure": access to basic services has improved but the social sector still does not provide adequate services to the vulnerable population. Large inefficiencies in the health and education sector are yet to be addressed. There was modest progress in improving efficiency, quality and access to health care. Education system remains poorly aligned with the changing needs of the economy. The social protection system is also inefficient and requires the introduction of better targeting mechanisms to benefit the poorest and the most disabled. The PEIR provided an assessment of inefficiencies in these sectors as well as recommendations on actions that could be taken to address the identified weaknesses. On the other hand, Bank supported infrastructure projects, as well as efforts made under the Community Development Project and Small Scale Commercial Agriculture Development Project, have helped improve access to basic services across the country. Agricultural productivity has increased and the Bank financed operations contributed to notable improvements in the quality of and access to basic services in water and sanitation, solid waste, electricity, and transport.

5.6 The modestly satisfactory reform performance resulted in a reduced lending program – between low and base case. Base case lending triggers required satisfactory macroeconomic performance, satisfactory MTDS implementation, satisfactory progress in improving the business environment, satisfactory performance towards a reformed public administration and private sector wage determination mechanisms, and a reduction in the public sector wage bill as a share of GDP. As discussed in the previous sections, these triggers were only partially met. Consequently, the Bank lending program was between low and base case. The base case lending envelope was projected at US$ 152 million while the actual lending program was US$ 123 million (81 percent of the base case). In light of the adjustment operations not moving ahead, the Bank's teams responded quickly and redirected resources to areas where further investments were needed and would have positive development impact. Additional financing was approved for four investment operations, while new operations were designed to meet demands in the agriculture sector, land registration and to help the country prepare a response in the case of avian flu outbreak.

5.7 At the same time, progress has been made against the high case (IBRD) lending. An assessment of BH's progress is presented in Table 1.

5.8 Effectiveness delays – the key cross-cutting portfolio issue. Complex signing and ratification procedures in three levels of government caused significant delays in project implementation. All the projects approved in this CAS period experienced significant effectiveness delays[18] and required several extensions of the effectiveness deadlines. While effectiveness delays may be another indicator of the poor ownership of the projects, procedural (rather than substantive) issues were the main reason for delays in the complex administrative set up of BH. Delays in forming parliaments and governments after the October 2006 elections blocked every activity on this front for several months. However, the State level Council of Ministers recently expressed

[18] Effectiveness delay – delay in declaring the credit effective more than three months after approval.

commitment to address the issue and has already taken actions to streamline the ratification procedure.

Table 1: High Case Triggers Under the Previous CAS

Trigger:	**Progess:**
Indirect Tax Authority and Value-Added Tax operational	TA set up in 2004, VAT introduced in January 2006
100 companies have filed for bankruptcy	Achieved by April 2005
Reduction in: the share of total non-interest recurrent public spending from 42.1 percent (2003) to 38 percent GDP; and the share of the public administration wage bill from 36 percent (2002) to 32 percent of total non-interest recurrent spending	Partially achieved - 40.6 percent GDP in 2007 Achieved – 29.6 percent GDP in 2006
Newly harmonized wage determination systems (public and private) operational, linking wage setting to productivity	Not achieved
Affordable domestic debt settlement plan adopted and satisfactory implementation progress	Partially achieved – affordable plan adopted, verification of debts in progress, first bonds to be issued in 2008

Table 2: Planned (Base-Case) vs. Actual Lending Program

Fiscal Year	**Planned Program**	**US$ (m)**	**Actual Program**	**US$ (m)**
2005	- PDPC - Education restructuring - Health scale-up - GEF Water quality prot.	20.0 12.0 15.0 8.9	- Education restructuring - Health scale-up - GEF Water quality prot.	10.0 16.0 8.9
2006	- PDPC - SEE Energy APL - GEF Integr. Ecosystem - GEF Biodiversity cons.	25.0 36.0[19] 8.0 4.0	- Solid Waste (add.fin.) - SEE Energy APL - Land Registration	8.0 36.0 15.0
2007	- PDPC - SEE Regional	20.0 24.0	- Comm. Dev. (add.fin) - Agric. & Rur. Devt. - Urban Infr. (add.fin) - Avian flu - Forestry (add.fin)	5.0 20.0 5.0 5.0 3.5
Total IDA **Total GEF** **TOTAL**	IDA Country Allocation	**152.0** **20.9** **172.9**	IDA Country Allocation	**123.5** **8.9** **132.4**

[19] US$ 12 million IDA Country Allocation + US$ 24 million IDA Regional Allocation.

6. IDA PERFORMANCE

6.1 **Satisfactory performance was maintained under most of the investment credits**. Projects aimed at strengthening the financial sector were well designed and effective, with Private Sector Credit playing a role in strengthening the banking sector in the RS while the Second Local Initiatives (Microfinance) Project continued with successful development of the microfinance sector in BH. A In the agriculture sector, Small Scale Commercial Agriculture Development Project has been successful in developing sound agriculture practices and building capacity of financial intermediaries to extend financial services to farmers. Bank teams designed effective operations in the area of infrastructure and energy. These operations maintained satisfactory performance throughout the reporting period (see Annex II). Similarly, adequate design and supervision of projects aimed at strengthening local governments and improving capacity of the local utility companies (Solid Waste Management, Urban Infrastructure and Service Delivery, and the Community Development Project) lead to a positive effect in stimulating local economic development.

6.2 **Performance under most of the adjustment credits and technical assistance credits was less than satisfactory**. Poorer performance was found in the three structural adjustment credits (Second Social Sector Structural Adjustment Credit - SOSAC II; Economic Management Structural Adjustment Credit - EMSAC; and Business Enabling Environment Structural Adjustment Credit - BAC), and related technical assistance projects (Social Insurance Technical Assistance Project – SITAP; and Privatization Technical Assistance Project – PTAC). These operations were designed during the previous CAS period (CAS FY02-FY04) with the objective to tackle a backlog of tough structural reforms. The BH authorities were not able to achieve all the requirements for tranche releases under the structural adjustment credits, resulting in these operations experiencing serious delays. While there has been continued, although slower than expected, progress under BAC and SITAP, poor performance under SOSAC II, EMSAC and PTAC led to cancellation of these operations.

- **SOSAC II** – the credit was intended to cap, in nominal terms, very high war veterans' benefits and to redirect social transfers to the most vulnerable groups in society. Although the RS has come some way toward meeting the conditions, political pressures have led to back-tracking by the Federation BH, which instead substantially increased total spending on war veterans. Despite extensive discussions, the Federation BH authorities have proved unable to undertake a minimum credible package of reforms that would allow a restructuring of the credit. The VAT revenue surge has encouraged significant fiscal expansion in both the RS and the Federation BH in the lead up to October 2006 elections. As a result, two years after the Board approval the credit could not be declared effective and finally US$ 51 million of the IDA credit lapsed on June 30, 2006.

- **PTAC -** lapsed on August 16, 2006 with less than US$ 4 million of the US$ 23 million disbursed five years after the credit was approved. This primarily reflected a lack of enthusiasm on the part of the authorities, especially in the Federation, to borrow for technical assistance despite the concessional nature of the credit. Government officials have suggested that their reluctance reflected high prices charged by international consultants, but have been unable to hire even (lower-priced) local consultants, making this argument untenable. In the Federation, the key underlying reason for the unsatisfactory performance under the credit reflects lack of political consensus on the pace of privatization. In the RS, progress has been somewhat better and the credit helped finance consultants for the largest privatization in the country to date (RS Telekom).

- **EMSAC -** lapsed on December 31, 2006 with $10 million disbursed in December 2004 and an undisbursed second tranche of US$ 24 million. The decision to let the second tranche of the credit lapse was due to lack of progress in meeting the agreed conditions. Namely, attempts to advance higher education reform failed; no progress was made in advancing reforms of public wages, and internal audit laws were not passed (the three remaining EMSAC conditions). Six months after the credit lapsed, the authorities enacted a version of the higher education law that has been under discussion before the credit lapsed, but the law lacks many of the provisions that would have made it acceptable to the Bank. Similarly, eight months after the credit lapsed there is no progress achieved on public sector wages, and only the RS has enacted an internal audit law.

- **BAC –** while slower than originally anticipated, progress continues to be made in the areas of business registration and inspection reform. Although the closing date of this credit has been extended ten times, each time it was clearly linked with progress against a certain benchmark. The Bank team has received a "highly satisfactory" QAG rating for the quality of supervision.

6.2 A Policy Development Programmatic Credit (PDPC) that was planned to account for 40 percent of the CAS base case lending program was not delivered. The Bank team identified corporate restructuring as the critical issue to be addressed during this CAS period and Government counterparts repeatedly stated the need for an operation in this area. However, during PDPC preparation the Government demonstrated little actual commitment to corporate restructuring. At the same time, the Bank team was unable to identify an "entry point" to develop a coherent corporate restructuring policy program. The proposed approach that would link significant payments to fictitious and redundant workers to encourage them to leave companies, with enforcement of changes in ownership and management practices in state-owned companies, proved to be overly complex and ambitious. Finally, given the performance of other adjustment credits and the lack of BH's commitment to structural reforms, it was decided that PDPC should not proceed.

6.3 The lack of government commitment to undertake structural reforms and overly complex operations, resulted in less than satisfactory performance under adjustment operations. A combination of several factors led to this result. First, the Bank overestimated government's capacity and commitment to pursue structural reforms in the complex political environment of BH. After the 2002 elections, for the first time since the war, BH had a government with a four year mandate. The impressive results of the post-conflict reconstruction and the relative lack of political tensions suggested that the international community may be successful in supporting the newly elected governments to pursue a more dynamic reform agenda. However, the Government's ownership of the reform agenda proved to be weak and the key reason for the lack of progress. Second, some of the projects supported by the Bank were overly complex. The targets to be achieved under the above mentioned adjustment credits were numerous. Further, the reform scenario was based on the available data that proved to largely underestimate the size of GDP and overestimate the current account deficit. For example, IMF projected a fiscal deficit of 5.8 percent of GDP in 2003 and three percent of GDP in 2004 while the outcome was substantially different with a fiscal deficit of two percent of GDP in 2003 and 0.4 percent of GDP in 2004. As the global economy entered into a period of robust expansion with metal prices surging, the pressure to secure external funding for the budget and to reduce the current account deficit eased. Finally, the VAT revenue surge in 2006 and the prospect of new elections, which were held in October 2006, further reduced the appetite to secure budget funding by pursuing tough, although much needed, reforms.

6.4 IDA was proactive in trying to improve the Government's ownership of the reform agenda. The Bank consulted very closely with the BH governments as well as with key development partners regarding cancellation of these loans. In January 2006, a high level retreat was held between the Bank team and the key government officials including the Chairman of the Council of Ministers, the Prime Minister of the Federation BH and the Ministers of Finance from both entities, to discuss next steps in moving the reform agenda forward. On this occasion government officials confirmed their commitment to the reforms envisaged under the adjustment credits and the Bank expressed readiness to restructure some operations, subject to demonstrated progress over the short-term. However, there was little evidence of such progress in the following months and it was finally jointly agreed that allowing these credits to lapse was the most appropriate course of action in the given circumstances.

6.5 The Bank team demonstrated flexibility and responsiveness in allocating IDA resources to the sectors and operations which demonstrated capacity for further progress. Poorer performance in areas of structural reform and the lack of Government's willingness and capacity to engage in corporate restructuring reform might have suggested that IDA resources allocated in this CAS would not be used. Instead, the Bank's teams identified sectors where new or additional financing may be used productively. While such flexibility was welcomed by the BH Government and ensured maintenance of a good relationship between the Bank and its client, this carried a risk of abandoning certain projected outcomes. Nevertheless, all new and additional financing was in line with the MTDS and CAS objectives.

6.6 The Bank maintained a strong relationship with the BH Governments and its services are still considered as highly valuable. In spite of the problems encountered with adjustment credits as discussed above, the Bank maintained a strong relationship with the client. The client survey, carried out in October – November 2006, interviewed about 250 stakeholders, two thirds of whom were Government officials at different levels. The client survey indicated high level of satisfaction with the Bank. In terms of the Bank's effectiveness in BH, clients have had a favorable impression with an average rating of 7.52 on the scale from 1 to 10. This compares favorably to the World Bank global average of 6.4. Interestingly, almost 60 percent of respondents wanted more Bank involvement and only about five percent thought that the Bank should be phasing out and be less involved than before. The Bank's knowledge combined with its financial resources still seemed to be highly (and equally) valuable. Limited use of local experts and bureaucratic policies and procedures were identified as the two greatest weaknesses. Government's commitment and weak capacity were assessed as the most significant factors inhibiting future sustainable growth and development in BH.

6.7 Analytical and Advisory Activities (AAA) carried out during this CAS period have provided strong input for the current and future policy dialogue. The key pieces of analytic work included: Public Expenditure and Institutional Review (PEIR); Labor Market Update; Financial Sector Assessment Program; Debt Sustainability Analysis; and Fiduciary Update. Although these pieces of analytic work, and the PEIR in particular, triggered some important policy dialogue during this CAS period, the contribution of these reports will extend beyond this CAS and will form an analytic basis for the next CAS. In addition to providing an excellent analysis of public expenditures that informed and triggered policy dialogue on this subject, the PEIR dissemination was also highly satisfactory. PEIR dissemination and discussions on particular sector issues involved sector teams and has contributed to broader understanding of problems related to public spending in BH. The PEIR dissemination is summarized in Annex III to this report. In addition to these, the Bank provided a set of ten Policy Notes[20] to the newly elected governments. These policy notes provide a summary assessment of the areas that require actions over the next four years and provide recommendations about priorities.

6.8 Overall, BH's portfolio performance indicators compare well with ECA and Bank averages (see Table 3 below). The average age of projects at the end of FY07 was 3.3 years and the overall disbursement ratio was 15.4 percent. In ECA, the average age was 3.2 years and disbursement ratio was 18.8 percent while for the Bank as a whole the average age was 3.4 years and the disbursement ratio was 22.8 percent. Effectiveness delays were the main reason for the lower disbursement ratio in FY07. The percentage of commitments at risk was 3.3 compared with 10.1 in ECA and 14.7 for the Bank.

Table 3: Comparative analysis of selected indicators (FY07 data)

	BH	**ECCU4[21]**	**ECA**	**Bank**
No. of projects	16	67	304	1,471
Portfolio ($mil)	301	1,226	16,676	98,877
Disbursement ratio[22]	15.4	19.8	18.8	22.8
Average project age[23]	3.3	2.4	3.2	3.4
percent commitment at risk	3.3	5.3	10.1	14.7
percent projects at risk	6.2	9.0	8.6	16.0

6.9 This CAS marked the end of exceptional post-conflict levels of IDA for BH. IDA commitments were reduced from an average of over US$ 100 million per year during the immediate post conflict reconstruction (FY96 – FY03) to an average of about US$ 40 million per year during this CAS period. The number of projects has been reduced from 20 at the end of the last CAS period to 16 at the end of FY07. The active portfolio of Bank financed operations at the end of FY07 amounts to about US$ 300 million. About 37 percent of the committed amount has been disbursed (US$ 112 million). The list of projects is attached as Annex II to this report. BH's continued exceptional access to IDA, despite a per capita income now three times higher than the IDA threshold, was justified given its lack of access to IBRD or capital market finance. However, in the next CPS, BH will need to graduate to IBRD terms, which may also improve the Government's ownership and planning of the use of resources borrowed on less concessional terms.

7. INTERNATIONAL FINANCE CORPORATION - IFC

7.1 Most of IFC's objectives in FY05-07 CAS were met. As of June 30 2007, the IFC committed portfolio in BH was US$166 million (US$27 million in equity and US$139 in loans). During FY05-07 IFC has developed a much larger program compared to the previous CAS, committing US$106 million compared to US$60 million during FY02-04. IFC made a number of successful new operations over the last CAS period including to several financial institutions to

[20] Note 1: Macroeconomic Policies; 2: Private Sector Development and Labor Markets; 3: Social Protection; 4: Health Sector Policies; 5: Transport Sector; 6: Electricity Sector Policies; 7: Education; 8: Pensions; 9: Agriculture, Forestry and Natural Resources; 10: Local Governance and Municipal Development.

[21] ECCU4 includes SEE countries – Albania, Bosnia and Herzegovina, Kosovo, Macedonia, Montenegro, and Serbia

[22] Disbursement ratio – percentage of the outstanding balance at the beginning of the period (FY) that has been disbursed during the period.

[23] Average project age – years from the Board approval date.

support micro-credit and SMEs to support the development of new microfinance institutions, the promotion of energy efficiency, the development of housing finance, support to a glass and chemical company to facilitate FDI and the transfer of modern technology, and support to a producer of generic pharmaceutical products to substantially increase variety of domestically produced drugs and replace expensive imported medication. In particular, support to further development of the microfinance industry in BH represents a success story of complementarities between IDA and IFC. The microfinance industry which had been initially launched and developed with support of IDA continues to develop into a commercially viable industry with support from IFC. Also, IFC has been closely following opportunities to support private sector participation in infrastructure. However, slow progress on privatization prevented IFC from engaging with financing and advisory services in infrastructure projects. In addition to BH specific investments, IFC has also invested in one regional project and two private equity funds, which operate in Southeast Europe, including in BH.

7.2 IFC Advisory Services in BH are provided through PEP-SE[24] and have been focused on specific programs covering four business lines:

- **Value Addition to Firms**: which seek to increase knowledge and improve practices through a combination of direct company-level assistance, public awareness campaigns (combination of trainings, seminars, workshops), and in-company consultancies. Expected impact of the programs are: (i) improving management practices in both financial institutions and industrial companies, with the objective of attracting more investment; (ii) increasing competitiveness of local companies looking for export opportunities in the EU as well as global markets; (iii) improving supply-chain practices in scrap metal, plastic and glass recycling industries and increasing collection and re-use of recyclable materials.
- **Business Enabling Environment**: with programs on alternative dispute resolution, and sub-national competitiveness. The alternative dispute resolution (ADR) program has been active since 2003 and seeks to introduce quicker, cheaper and better access to justice for companies and individuals through mediation. In cooperation with FIAS, IFC has been streamlining regulations related to business inspections, permits and licenses, and increasing the efficiency of regulators. The program is expected to increase private sector investment and reduce the cost of doing business in selected municipalities.
- **Access to Finance**: with programs on housing finance, micro-finance, and sustainable finance. IFC has supported the development of micro-finance institutions, through a combination of financing and advisory services, to develop new products such as energy efficient home improvements. IFC has also supported the transformation of microfinance institutions into fully regulated financial institutions. Current investment and advisory services clients include MI-BOSPO and EKI.
- **Infrastructure**: promoting private sector participation in all infrastructure sub-sectors. Slow progress on privatization has prevented IFC from engaging in a more active advisory role in the privatization of key infrastructure projects and in attracting private sector participation.

[24] As SEED (Southeast Europe Enterprise Development, an IFC managed facility) completed its 5-year mandate on June 30, 2005, IFC continued to provide advisory services (AS) through Private Enterprise Partnership Southern Europe or PEP –SE, covering Albania, Bosnia and Herzegovina, FYR Macedonia, Serbia, Montenegro, Croatia, Bulgaria, Romania and Moldova. Programs are co-financed by IFC and bi-lateral donors: Austria, Canada, IFC, Italy, the Netherlands, Norway, Slovenia, Switzerland and USA.

8. LESSONS FOR SUBSEQUENT CPS DESIGN

8.1 Tailor the Bank supported program to the level and areas of Government commitment and capacity to deliver on reforms. Government capacity and commitment to reforms is the key. While rather obvious, such a principle has proven its full value in BH. The Bank seemed to misjudge the political complexity of BH and its Government's expressed commitment to pursue structural reforms was taken at face value. Identifying areas of intervention that would have unconditional ownership by the Government and would have the greatest development impact will be the key challenge for the next CPS. The Bank team should involve counterparts in the early stage of the CPS preparation.

8.2 Improve political economy analysis when deciding about the instruments to pursue development priorities. Recent experience with structural adjustment loans and technical assistance operations should not be interpreted as failure to recognize the country's main development challenges. On the contrary, in the design of both SOSAC II and EMSAC the priorities that should be urgently addressed were identified by the government, but frustrated by political factors. However, while developing the reform agenda to be addressed under these two credits, the Bank teams also overestimated capacity of the Government to deal with several parallel reform processes (military and police reduction, constitutional changes, EU integration, public administration reform, social sector reform, education reform, investment climate, privatization etc.). Better analysis of the political economy in the BH should be applied during the preparation of the next CPS.

8.3 Pursue reforms through investment lending and, provided there is political commitment, very focused DPLs in the outer years. A substantial and tough reform agenda is ahead of the recently elected governments at all levels in BH. The Bank has tried to assist with a combination of structural adjustment credits (containing conditions related to progress in almost all key areas), investment loans, technical assistance operations and ESW to strengthen BH's capacity to implement needed reforms. The results of such a multi-faced approach were not encouraging. On the other hand, several investment operations helped move the reform in their respective sectors forward (health, energy, roads, solid waste management). Efforts should be made in the new CPS to recognize potential of investment operations to speed up the reform processes. Development Policy loans may be a feature of a future high-case scenario, should the appetite for reform change.

8.4 Consider project design, which allows for performance-based flexibility, while at the same time deepening the single economic space, strengthening the State, and fostering social cohesion. Recent experience suggests that there may be a need for greater flexibility in the project design to support reforms and investments where they can make the greatest development impact using performance-based allocation of some project financing. However, care will be taken to ensure that such flexibility does not exacerbate divisions between the two Entities. Such an approach would be exercised only if it is requested by the authorities and if it will not undermine efforts to deepen the single economic space and foster social cohesion in BH.

8.5 Focus on results and importance of monitoring and evaluation using Bank financed operations to impact sector-wide monitoring of results by the authorities. The Bank teams should assist the Government to set up mechanisms to monitor its own performance and be on top of the agenda, including enhancement of the country's overall statistical capacity. The focus on results should clearly go beyond Bank financed operations. The Bank teams should help their counterparts develop appropriate results framework for all operations.

8.6 Create an enabling environment for CPS implementation. As discussed in section 6.3, the Bank overestimated the capacity and ownership of the Government to pursue structural reforms. At the same time, the Bank should have recognized that even with the stronger Government's ownership such an ambitious reform scenario would have required a carefully tailored communication strategy that would help the Government explain the benefits of reforms and the costs of inaction. Discussion about the main pillars of the next CPS should be followed by a discussion about a broad communication strategy that would help the Government better communicate the potential benefits of the proposed operations.

8.7 Improve internal communication and greater synergy between the Bank teams from different sectors should be encouraged. Greater synergy between the Bank's sector teams, and across the World Bank Group, may lead to better outcomes and help the Government effectively respond to cross-sectoral issues. Internal communication between the teams should be improved. The PDPC experience showed that poor communication between sector units resulted in an overly complex and ambitious operation for which there was little interest among the counterparts.

8.8 Continue to use AAA as the basis for policy dialogue and formulation of the new CPS program. During this CAS period, the Bank produced several important documents that should form a basis for CPS consultations. The PEIR and policy notes in particular will be useful in informing policy dialogue. Finally, regional studies (Doing Business, Anticorruption in Transition, Life in Transition Survey) attracted a lot of interest among the policy makers and opinion formers. These studies provide clear evidence about the trends in BH in comparison with other countries in the region and should be used strategically to develop domestic "champions" of reforms.

8.9 Reduced IDA allocations, and a likely small IBRD lending program, will necessitate concentration on fewer operations and a less ambitious reform agenda. This will also require closer collaboration with other international partners to leverage World Bank Group resources. In particular, the Bank should complement the EC and support BH's EU integration efforts.

CONCLUSION

The results of the previous CAS and the Bank's overall performance were moderately satisfactory. Most of the investment credits maintained satisfactory performance throughout the CAS period, and infrastructure projects in particular continue to make positive development impact. Although based on stated commitments in the MTDS, the reform scenario pursued by the Bank during the FY05-07 CAS was complex and overly ambitious. The Bank also misjudged Government's capacity and readiness to pursue such an ambitious program of reforms. However, the Bank remained proactive and flexible in resolving identified weaknesses and has maintained strong relationship with the client. The Bank Group's analytic and advisory activities remain highly valuable in informing policy dialogue and will play an important role beyond this CAS period. Finally, portfolio performance indicators suggest that the appropriate actions were taken to ensure that a healthy portfolio is carried forward into the next CPS period. Important lessons can be drawn from this CAS that should influence design of the future program. The importance of the Government's demonstrated commitment and ownership is obviously the key. However, better assessment of the political economy, complexity of the environment and well defined communication strategy are as important in developing a sound program.

Annex I: Outcome Indicators for CAS Period (FY04-07)

Pillar I - Improving Public Finance and Strengthening Institutions		
Strategic Long – Term Goals outlined in MTDS/PRSP	**Outcomes influenced by the CAS program**	**Status**
Strengthen weak and fragmented governance to enable sustained and inclusive growth.		
Maintain macroeconomic stability	**Satisfactory macroeconomic program**	- Aggregate spending numbers not met. - No IMF program since early 2004. - MTDS updated in early 2006.
Public sector operates efficiently and transparently with greater accountability to the public. - Public expenditures are consolidated. - Budget allocations and expenditures are aligned with stated economic development plans. - Civil service is modernized.	**The excess burden of government in the economy is reduced; public administration provides better services.**	
	- Public expenditures as a share of GDP is reduced to below 50 percent (including municipalities)	- ***Not accomplished***. *Public expenditures c. 50 percent in 2006, despite 9-percent upward revision of GDP. Relative to the measure assumed in the CAS of no upward revision of GDP, this is not achieved.*
	- Civil service wage determination system reformed.	- ***Not accomplished.*** *There has been some work toward improving wage determination in the RS, little to no effort in the Federation and the State.*
	- Wage increases contained to no more than 2-5 percent per annum (nominal).	- ***Not accomplished***. *Wage increases not contained, significant increases planned for 2007.*
	- *Military expenditures as a share of GDP reduced.*	- ***Accomplished***. *Military spending has been reduced.*
	- Medium-term and annual budget formulation processes improved and better linked.	- ***Partially accomplished***. *Budget formulation has been improved. Some progress in coordination and linking of medium-term and annual budget processes. Further improvements required.*

Efficiency of public services more consistent across BH.	**Fiscal coordination between the various levels of government improves** - *Fiscal and economic policy coordination improved.* - *Revenue and expenditure assignments clarified.* - *Budgetary practices strengthened at sub-Entity levels.* - *Intergovernmental transfer rationalized.* - *Reliable budget execution and fiscal reporting established, including for extra-budgetary funds.*	- ***Not accomplished****. Modest improvements in fiscal and economic coordination. But crucially, reform of the National Fiscal Council has not been met.* - ***Partially accomplished.*** *Revenue assignments clarified, expenditure assignments require further streamlining.* - ***Accomplished****. Budgetary practices strengthened.* - ***Accomplished****. Intergovernmental transfers rationalized and formalized through revenue assignment mechanism.* - ***Accomplished****. Budget reporting improved, including EBFs.*
Public spending on education is sustainable.	**Efficiency of education sector administration improved** - *Responsibility for higher education financing established at Entity levels.* - *Corporate management structure adopted by Universities.* - *Reliable management information tools support policy making.* - *More generalized curriculum* - Net graduation rate within four years at University of Sarajevo increased by about 10 percent by 2008.	– ***Not accomplished****. Law on Higher Education passed but higher education financing not established at Entity levels.* – ***Partially accomplished.*** *Two universities in the Federation (Tuzla and Zenica) transitioned to corporate management structure. Progress in the RS* – ***Partially accomplished****. Education Management Information System (EMIS) implemented in Tuzla Canton and Banja Luka.* – ***Not accomplished****.* – *Data collection underway.*

Laws and regulations fairly enforced.	**Public resources are managed more transparently and public officials are perceived as more accountable.** - *Public procurement reformed.* - *Public forest administration improves.* - *High performing micro-credit institutions sustained.* - *Administration of solid waste further rationalized.* - *Mostar public administration effectively integrated and managed.*	- ***Accomplished**. Public procurement has begun to function, law adopted and procurement agency and review body operational.* - ***Accomplished**. State Forest Inventory methodology agreed and tested on 13 percent of the total forest area. Basic computerization accomplished and capacity building for business planning, spatial analysis and timber pricing/grading initiated.* - ***Accomplished**.* - ***Accomplished.*** - ***Accomplished.***
Government better serves the vulnerable population.	**Social protection system is better managed.** - *Social assistance and child protection policies are better targeted and more equitable.* - *Veterans benefits targeted on the most vulnerable in a fiscally sustainable way.* - *Employment services are more effective in assisting the unemployed.* - *The pension system provides old-age security in an effective and sustainable way.*	- ***Partially accomplished**. Social Welfare and Child Protection legislation did not materialize in the Federation.* - ***Not accomplished**. New veteran legislation successfully implemented but annual budget for veterans' benefits in 2006 exceeded 2005 allocations by 30 percent with additional benefits for veterans & demobilized soldiers legislated in September 2006.* - ***Partially accomplished**. New policy of employment services on active and passive labor market programs is being developed. Non-transparent soft credit programs eliminated.* - ***Not accomplished**. No new pension strategy adopted yet; governments continue to build capacity to evaluate options through SITAP and pension modeling training*

Pillar II – Promoting Sustainable Private Sector Led Growth		
Strategic Long – Term Goals outlined in MTDS/PRSP	**Outcomes influenced by the CAS program**	**Status**
Promote private sector led growth as a principal means for improving economic opportunity for all Bosnians		
Improving the environment for private enterprises.	**Expanded business activity increases economic opportunity.** - *Harmonized bankruptcy, business registration, pledges/movable registry procedures established.* - *Time required to register a business lowered by: 25 percent (from 31 days) in RS and over 50 percent (from 80 days) in the Federation in 2002** - *On-site inspector days per inspected business per year reduced by 45 percent in the RS; one-third in the Federation.*	- ***Accomplished****. New inspection pledges/movable registry and business registration laws adopted.* - ***Partially accomplished****. Overall for BiH, no. of days to register a business reduced for over 30 percent.* - ***Accomplished****. Business inspection system rationalized across Entities, and standard guidelines identified.*
Competitiveness of the economy adequate for sustained economic growth. - *Social costs of enterprise restructuring mitigated.* - *Rigidities in labor market reduced.*	**Privatization process more efficient.** - *Legislative and regulatory frameworks required for divesting "strategic" companies advanced.* - *Labor taxes reduced (from 69 percent)** - *Collective bargaining system reformed; less rigid wage-setting system in place*.* - *Sound business management practices established within Entity employment institutes* - *Liberal trade policies sustained.*	- ***Accomplished.*** - ***Not accomplished.*** - ***Not accomplished.*** - ***Partially accomplished****. Substantial progress was made but operations of the Federation Employment Institute are at risk due to recent law on demobilized soldiers.* - ***Partially accomplished****.*

Share of state owned enterprises (SOEs) reduced from about 60 percent of the economy (in 2002).	**Corporate sector operations more rational.** - *Excess indebtedness of corporate sector lowered with key stakeholder support.* - *Loss-making enterprises exit the market.* - *Instruments to divest "strategic" SOEs in place.* - *Sustainable SOE management practices established.* - *Minimum legal, regulatory and institutional framework to resolve existing claims established.* - *Core elements of an affordable social policy program, mitigating short-term costs identified.* - *Corporate governance rules clarified.* - *Privatization strategy for a select state-owned utility (or monopoly providing public services) implemented.*	- ***Not accomplished**.* - ***Partially accomplished**. Progress in the RS, virtual stop in the Federation.* - ***Accomplished**.* - ***Not accomplished**.* - ***Not accomplished**.* - ***Partially accomplished** in the RS. In the Federation, there is a tendency to shift the burden onto the Pension and Employment Funds – without any bearing on their capacity to deal with these issues.* - ***Partially accomplished**. Progress in the RS, no progress in the Federation* - ***Partially accomplished**. Progress in the RS, no progress in the Federation*
Financial services sufficient to support private sector growth.	**Private sector financing services expanded.** - *Soundness of banking system in RS increased.* - *Scope of bank and non-bank financial institutions' services expanded.* - *Sustainable financing for high performing microcredit institutions secured.*	- ***Accomplished.*** - ***Accomplished.*** - ***Accomplished.***

Core infrastructure supports sustained economic growth across all of BiH.	**Core infrastructure efficiently developed and maintained to support growth.** - *BiH electric power system operated as a single control area.* - *Particulate emissions reduced.* - *BiH electricity exports sustained or increased.* - *Efficiency of roads management increased and road maintenance budget sufficient.* - *Traffic flows improved, and accident rate reduced.* - *Local roads upgraded and developed.* - *Number of accidents at "black spots" lowered by 20 percent from 2002.*	- ***Accomplished*** *with the rehabilitation of the high-voltage transmission network.* - ***Partially accomplished****. On track - the relevant investments by EBRD under the Power III project are ongoing and the outcome will be achieved when these investments are completed in early 2007.* - ***Accomplished****.* - ***Partially accomplished****. Efficiency of roads management increased and budget sufficiency improved but not fully achieved.* - ***Accomplished.*** - ***Not accomplished****. The local roads project was in the high-case scenario.* - ***Accomplished****. 269 traffic deaths reported in 2005 vs. 500 in 2003.*
Economic growth grounded on more sustainable use of natural resources.	**Growth based on more efficient and sustainable natural resource utilization.** - *Sustainable timber production practices employed.* - *Water utility management rationalized (in Mostar).* - *Critical forests and mountain ecosystems conserved.*	- ***Accomplished****. Standards for sustainable forest management (including timber production) developed and initial three Forest Management Units certified.* - ***Accomplished****.* - ***Partially accomplished***. Guidelines for high conservation value forests designed and tested, and detailed preparation proposed protected area investments completed.

Pillar III - Investing in Key Social and Economic Infrastructure		
Strategic Long – Term Goals outlined in MTDS/PRSP	**Outcomes influenced by the CAS program**	**Status**
Build social sustainability by improving the reach of social services and economic infrastructure.		
The vulnerable population is better protected.	**Social protection system better protects those most in need in a sustainable way.** - *Cash transfer system reforms, and labor market reforms, benefit the poorest and most disabled.* - *Regional imbalances in social protection reduced*.* - *Living standards monitoring and information underpin social policy formulation.* - *Income earning opportunities for active job seekers are increased.*	- ***Not accomplished****. Despite progress in some areas, cash transfers are largely non-targeted.* - ***Not accomplished****. Significant regional imbalances still exist.* - ***Not accomplished****.* - ***Partially accomplished****. On-track - more effective job brokerage and active labor market programs adopted by public employment services in BiH.*
Improved overall health status for more BiH citizens - *Reduce maternal and child mortality* - *Reduce the incidence of non-communicable diseases.* - *Reduce the variance in health outcomes between the poor and the non-poor*	**Health care, especially primary health care (PHC) services, delivered more efficiently and at higher level of quality to a greater proportion of the population, thereby improving overall health conditions** - *Duplication of services lowered; hospital sector rationalized.* - *Costs for PHC lowered; payment mechanisms expanded beyond original intervention areas to include all cantons/regions and 50 percent of population.* - *Coordinated policy formulation mechanisms, focusing on cost effective interventions sustained.*	- ***Partially accomplished****. Master plan for rationalization of hospital services developed and approved by both Entities. Plans for Implementation being drafted.* - ***Not accomplished****. No PHC cost analysis available. Payment mechanism being reformed but not implemented yet* - ***Partially accomplished****. Successful SITAP SC helps to coordinate. Within Entities, RS policy formulations more advanced than the Federation.*

	- *Access to Family Medicine (FM), including preventive care, increased.* - *Access to health insurance increased.* - *Quality of PHC improved.*	- ***Not accomplished**. No change in PHC utilization rates.* - ***Not accomplished**. Unchanged proportion of insured since 2004, 85.5 percent in the Federation and 73 percent in RS. Overall 80.5 percent of population is insured.* - ***Partially accomplished**. Health care in hospitals and primary health care (PHC) centers is delivered at higher level of quality as indicated by an increasing number of trained family doctors working in PHC centers. However, no official quality study conducted.*
Improvements in the education sector enable increased employment opportunities and greater quality. - *Curricula better aligned with the needs of the transition economy* - *Participation in more economically relevant secondary educations programs increased* - *Overall quality of education improved across BH, with disparities in outcomes reduced both across Entities and cantons and between BH and EU comparators*	**The education system is better aligned with the changing needs of the economy, more accessible and overall quality is improved.** - *Tertiary and vocational training systems modernized.* - *Access to secondary education, especially by the underprivileged, increased.* - *Standards and Assessment Agency operations sustained.* - *Primary school teacher professionalism raised.* - *Net enrollment in four year secondary programs increased by over 25 percent from 2002 (at 59 percent)*	- ***Not accomplished.*** - ***Not accomplished.*** - ***Accomplished.*** - ***Partially accomplished.*** - ***Not accomplished**.*
Economic growth in rural areas increased. - *Poverty incidence in rural areas reduced.* - *Income of rural households increased.*	**Rural agricultural productivity and profitability increased.** - *Small-scale commercial agriculture further developed.* - *Share of agriculture in GDP increased.*	- ***Accomplished**. Small scale agriculture in Herzegovina region is developing rapidly with an increasing number of farmers shifting from subsistence to commercial production.* - ***Accomplished** although not as a share of GDP. There has been 9.3 percent growth in agriculture outputs in 2006.*

	- *Share of agriculture in foreign exchange earnings increased through export of agricultural and agro-processed products*	- ***Accomplished***. *There was 60 percent increase of agriculture export in 2006. However, overall share of agriculture in foreign exchange earnings did not increase due to a surge in metal and wood prices.*
An increased share of the population has access to better basic services -- water, wastewater treatment, electricity and improved roads – improving their quality of life. **The poor population has increased access to services and basic infrastructure.**	**Service quality in water and sanitation, solid waste, electricity and regional/ local roads improved and access expanded.** - *Regional solid waste sites established.* - *Cost effective, safe and environmentally sound water management system established.* - *Regulation of "wild" dumpsites established and number of such sites significantly reduced.* - *Private sector involvement in waste collection established.* - *Transport Ministry and Roads Directorates institutionalize investment planning and prioritization.* - *Framework for the rationalization of responsibilities for roads rehabilitation across levels of government outlined.* - *Public/private roads financing options explored.* - *Access and sustainability of financial services to lower-income clients improved.* - *The capacity of poorer municipalities to provide basic social infrastructure increased.*	- ***Partially accomplished***. *On track. - 3 out of 7 planned solid waste sites were established.* - ***Partially accomplished***. *On track - Law on water management adopted.* - ***Partially accomplished***. *On track - 2 wild sites completed. Work underway on other sites.* - ***Partially accomplished***. *Progress on track.* - ***Accomplished***. - ***Partially accomplished***. *Activities underway but the task is yet to be fully accomplished.* - *Partially accomplished. Progress on track.* - ***Accomplished***. *Increased percentage of microenterprises served in rural and semi-urban areas by financially viable Microcredit Organizations.* - ***Accomplished***. *Community infrastructure sub-projects implemented in 88 of the poorest municipalities. Over 400 sub-projects in total with 1.3 million beneficiaries. Citizens' involvement in municipal investment planning demonstrated and increased.*

ANNEX II – List of active projects and performance indicators as of June 30, 2006

Sector Unit	Project name	Age in years	Latest Implementation rating	Latest Development Objective rating	Risk flags
Human Development	Community Development Project	6	Satisfactory	Satisfactory	0
	Education Restructuring Project	2.2	Moderately Unsatisfactory	Moderately Unsatisfactory	4
	Health Sector Enhancement Project	2.2	Moderately Satisfactory	Moderately Satisfactory	1
	Second Employment Support Project	3	Satisfactory	Satisfactory	0
	Social Insurance TA Project (SITAP)	4.1	Moderately Satisfactory	Moderately Satisfactory	0
Sustainable Development	Agriculture and Rural Development Project	0	Na	na	0
	Avian Influenza Preparedness Project	0	na	na	0
	ECSEE APL3 - BH	1	Satisfactory	Satisfactory	1
	Electric Power Reconstruction III	6	Satisfactory	Satisfactory	1
	Forest Development and Conservation Project	4.1	Moderately Satisfactory	Moderately Satisfactory	0
	Land Registration Project	1.2	Satisfactory	Satisfactory	1
	Small-scale Commercial Agriculture Development	4.3	Satisfactory	Satisfactory	0
	Solid Waste Management	5	Satisfactory	Satisfactory	1
	Urban Infrastructure and Service Delivery	3	Satisfactory	Satisfactory	0
	Water Quality Protection - GEF	2.1	Satisfactory	Satisfactory	0
Private Sector	Business Enabling Environment SAC	5.1	Moderately Satisfactory	Moderately Satisfactory	0

Note: Four risk flags are related to effectiveness delays (Education Restructuring Project, Health Sector Enhancement Project, E$CSEE APL3, and Land Registration Project). Two projects (Solid Waste Management, and Electric Power III) also have risk flags for slow disbursement. Finally, Education Restructuring Project also has risk flags for M&E, procurement management, and financial management (due to the fact that appropriate staffing arrangements were not in place for these functions).

Annex III - PEIR Dissemination

A. With the governments before the October 2006 elections:

1. The full PEIR, with a focus on Chapters 1-4

BH Ministry of Finance and Treasury - Minister Maric, Assistant Ministers Sakota and Dugandzic
WB: Ivailo Izvorski, Irina Smirnov
Ministry of Finance of the Federation- Assistant Ministers Ivosevic and Hadjimehanovic, Ministry Secretary Izmirlija
WB: Irina Smirnov and Ivailo Izvorski
RS Ministry of Finance - Minister Dzombic, Assistant Minister Plavljanin, Mrs Nena Crnic (Director of sector for allocation of government revenues)
WB: Ivailo Izvorski

2. Chapter 4, Public Administration

BH Civil Service Agency – Agency Director Mr. Jakob Finci
WB: Ivailo Izvorski, Irina Smirnov
Civil Service Agency of the Federation – Director Mr. Enver Iseric
WB: Ivailo Izvorski, Irina Smirnov

3. Chapter 5, Education

Ministry of Education of the Federation - Minister Pasic, Ministry secretary Zekovic, Assistant Minister Montana, Ms. Hotic (director of sector for economic and financial work) and Mr. Leto (sector director)
WB: Ivailo Izvorski and Zorica Lesic
RS Ministry of Education and Culture – Minister Kasipovic and Assistant Minister Zdravko
WB: Ivailo Izvorski

4. Chapter 6, Social Welfare and Social Protection

Ministry of Labor of the Federation – Minister Vignjevic, pension fund director Kovacevic
WB: Ivailo Izvorski, Irina Smirnov, Csaba Feher, Goran Tinjic and Vedad Ramljak
RS Ministry of Labor and Veterans' Affairs - Minister Bosko Tomic and Assistant Olivera Kunjadic
WB: Anita Schwartz, Csaba Feher, Vedad Ramljak and Ivailo Izvorski (during pension note presentation in Sarajevo); Ivailo Izvorski in a separate meeting in Banja Luka

RS Ministry of Health and Social Welfare - Assistant Ministers Mr Nedeljko Milakovic, Mr. Milan Latinovic and Mr. Ljubo Lepir, and Ms. Dragica Medjedovic, Deputy Director Health Insurance Fund
WB: Pia Schneider, Ivailo Izvorski and Vedad Ramljak
Ministry of Health of the Federation – Minister Mandic
FBH Health Insurance Fund- Meeting with Ms. Novka Agic, Director
WB: Pia Schneider, Vedad Ramljak

5. Chapter 7, Transport

BH Ministry of Communications and Transport - Minister Dokic, Assistant Minister Bajrambasic and Ministry Secretary Sego.
WB: Vesna Francic and Ivailo Izvorski

RS Ministry of Transport and Communications - Minister Cubrilovic and Mr. Mihajlovic, director of the RS Road Directorate
WB: Vesna Francic and Ivailo Izvorski
Ministry of Transport and Communications of the Federation – Minister Brankovic, Assistant Ministers Boban and Mehinagic

International Community – joint presentation of the PEIR, CPPR and SITAP - IMF, EU; Austrian Development Agency; SIDA Sweden; Embassies of the US, the Netherlands, Japan, France and Norway; OHR; UNICEF;
WB: Irina Smirnov, Ivailo Izvorski, Pia Schneider, Goran Tinjic, Vedad Ramljak

B. With the governments after the 2006 elections:
At the level of ministers: together with the policy notes

C. Ongoing and in the future:

Leaders of political parties: All key parties, detailed discussions: Mr. Lagumdzija (SDP), Mr. Silajdzic (SBiH), Mr. Ivanic (PDP), Ms. Cenic (DEPOS), Mr. Covic (HDZ)
WB: Country Manager and Ivailo Izvorski

Newsletter: Used all chapters in individual quarterly issues

Two dissemination events at BH Universities (Sarajevo and Banja Luka). Audience: professors, students. Time: October/November.

Meetings with business associations, associations of employers. Time: October.- November.

"Bosnia-Day" with the EC in Brussels. During preliminary CAS consultations with the EC.

Discussions with the new governments: top-level discussions and technical discussions, with the same chapter-by-chapter format as with the old governments. Time: as new governments are formed.

Public presentation event, including for the media (major event in October 2006. The whole team presented individual chapters.

Annex 3: Country Partnership Strategy (FY08-11): Results Matrix

Pillar I – Improve the environment for private sector led growth and convergence to Europe				
Country's Strategic Goals	**Issues and Obstacles**	**CPS Outcomes supporting the Country Goals**	**Milestones of achievement**	**CPS program**
Create the conditions for sustainable and balanced economic growth and EU integration process Key reform priorities in the Platform for Action supporting this goal: - Create a better business environment - Promote reforms that ensure sustainable economic development	In order to create the conditions for sustainable and balanced growth and accelerate the EU association process BH needs to : 1. Facilitate business activity and increase economic opportunities 2. Improve key infrastructure and links to Europe 3. Manage global public goods, including environment, clean energy and hazard risk, with a regional perspective and in cooperation with neighboring countries Additionally, 4. the advancement of privatization and corporate restructuring would also contribute to the country goal. This is	**Core Program Outputs:** **1.** ***Reduction in the duration and number of procedures required to register a business***. **Baseline:** June 2007: New business Registration System (BRS) launched – Average registration time 54 days (doing business) **Target:** 30 days in the Federation, 23 days in the RS (2008) ***Development of transparent land markets through registration of real estate*** **Baseline:** 2006: 150,000 registry folders completed in the automated Dbase, 80,000 backlog cases, several months to complete real estate transactions **Target:** 2m folders, full reconciliation, no backlogs (2011) ***Small-scale market integrated commercial agriculture further developed***. (Improve access to credit for agribusiness-agri-processing and for small farmers **Baseline:** 2006: US$2.15 million for agribusiness/agri-processing; US$1.5 million for micro credit **Target: -** US$4.5 million long-term loans by 2010 for agribusiness/agri-processing, US$7.5 million disbursed as micro-credit to small farmers and rural families with 99.5 percent repayment rates	**2008:** 16 courts use the new BRS; average registration time: 30 days in the Federation, 23 days in the RS **2008** 500,000 registry folders in the automated database and at least 50% registry folders updated and reconciled; **2011:** 2m folders, full reconciliation, no backlogs **2009: US$2m** long term loans made to agribusinesses/agri-processing; US$3 million disbursed as micro credits to small farmers/rural families**;** **2011**: US$4.5 million for agribusiness and US$7.5 million as micro credit with 99.5 percent repayment rates.	Current portfolio: Business Enabling Environment Structural Adjustment Credit (BAC), EC grant on enterprise restructuring, Small Scale Commercial Agriculture Development, Agriculture and Rural Development Project, Land Registration Project , IFC investments Potential new financing: Investment climate Project, Land Registration II, IFC investments, MIGA guarantees AAAs: Investment climate assessment, ROSC A+A, IFC advisory services, WBI competitiveness Partners: DFID, USAID, SIDA, EC , IFAD, GTZ Current portfolio: Power III, ECSEE

	an area however that the CPS would support provided the political commitment to these reforms is strong.	2. ***Road network better maintained and safer*** **Baseline:** 2006: road user costs US$0.25 per km per vehicle **Target:** Reduction in Road User Costs of at least 10 percent on rehabilitated roads [a total 2,200 kms of regional and rural roads rehabilitated with EIB and EBRD-240 kms by IDA] (2011) **Baseline:** No integrated road safety strategy at the State and Entity level **Target**: Integrated road safety strategy at the State and Entity level is implemented (2011) *(To Facilitate BH's participation in the SEE energy market and integration into the EU)* ***BH electricity system operated as a single control area;*** **Baseline:** no ISO (2006) **Target:** ISO-administered "Balancing Market/Mechanism" for the entire BH electricity system is fully operational (2001) ***and BH electricity generation and exports sustained or increased at corresponding hydrological conditions*** **Baseline:** 2006:power generation 12,800 Gwh **Target:** Equal or greater and Commercial "Power Exchange" is established to intermediate electricity import/export transactions between EPs in BH and other regional power utilities	**2011**: Reduction in Road User Costs of at least 10 percent on rehabilitated roads **2009** Strategy and Action Plan issued **2011:** Road safety strategies implemented at State and Entity levels **2007:** ISO created **2008:** ISO has functional market Operation system **2011:** ISO-administered "Balancing Market/Mechanism" for entire BH electricity system is fully operational **2007-2011** generation equal or greater than baseline **2011:** Commercial "Power Exchange" is established	APL III, Urban Infrastructure and Service Delivery Project, Forest Development and Conservation <u>Potential new financing</u>: Road Infrastructure and Safety, Sava River Project, , Regional/Urban Transport Project, Regional Energy Project/Electricity Market Development Project , Support for Corridor Vc, IFC investments, MIGA guarantees <u>AAA</u>: PPP training follow-up, PPIAF TA, IFC advisory services, Local Roads Study <u>Partners</u>: EC, EBRD, EIB, KFW, USAID, GTZ, ADA, SIDA,

		Improved commercial use of the Sava river corridor **Baseline:** 2007: sections of the river are not navigable **Target:** Priority sections of the River Sava returned to navigability	**2012:** Priority sections of the River Sava returned to navigability	Current portfolio: Forest Development and Conservation , GEF Water Quality Protection Potential new financing: GEF Neretva-Trebisnjica River Basin Protection, GEF Protected Mountain Areas, Avian Influenza Preparedness Project, Regional disaster risk project AAA: Regional climate change study Partners: Croatia
		3. Critical forests, water and mountain ecosystems protected and used in a sustainable way **Baseline:** 2007: Area under formal protection is 0.55% **Target:** protected area 3% (2010)	**2008:** Administrative separation of forest administration and forest enterprise functions **2009:**new ecosystem approaches implemented in at least 3 areas **2010**: Area under formal protection is increased to 3%;	
		Enhanced capacity for an effective response to avian influenza infection **Baseline:** 2007 : weak and inconsistent safe poultry handling procedures **Target:** 50 % of at risk population practicing safe handling procedures in respect to poultry meat	**2010**: Integral Neretva and Trebisnjica river basin management plan implemented (BH-Croatia).; **2011** 50 % of at risk population practicing safe handling procedures in respect to poultry meat	
		Non-Core Program Goals: **4.** ***Privatization and corporate restructuring advanced***	TBD during CPS implementation	Potential new financing: Corporate Restructuring/Private Sector Development Project, IFC investments, MIGA guarantees, WBI competitiveness project AAA: Investment Climate Assessment, Country Economic Memorandum Partners: USAID, EC, ADA

Pillar II – Improving the quality of public spending and the delivery of public services for the vulnerable (Core Program)				
Country's Strategic Goals	**Issues and Obstacles**	**CPS Outcomes supporting the Country Goals**	**Milestones of achievement**	**CPS program**
Reduction of Poverty Key reform priorities in the Platform for Action supporting this goal: - Improving stability and fiscal coordination by, inter alia**:** - Reviewing and streamlining social spending schemes with a view to improve their effectiveness;	Slow formal employment is a key determinant of poverty and vulnerability in BH. Thus the CPS supports this country goal, in part, via Pillar I strategies, aimed at creating growth and a better business environment, conducive to job creation. The CPS also supports this country goal by strengthening the quality of public spending and the delivery of public services, particularly for the vulnerable. Thus the CPS will aim to: **5**. Improve delivery of municipal services and strengthen municipal finance **6.** Improve quality of social services delivery **7.** Reduce urban-rural disparities in income Additionally, and provided there is strong political commitment to reform, it will also support the achievement of this goal by supporting:	***5. Improved delivery of water supply, sanitation and urban services*** **Baseline:** 2004 **Target:** 100% in 4 large municipalities *Administration of solid waste at municipal level improved* **Baseline:** 2003: 1 regional (not sanitary) landfill operational, numerous wild dumpsites **Target:** Six regional sanitary landfills established and operational (2009); 20% reduction in wild dumpsites *Sustainable mechanisms for municipal capital investments* **Baseline:** 2007 weak citizens participation in decision making at local level **Target:** Improved participatory budgeting in 30 poor municipalities (2009) ***6. Significant increase in utilization of family medicine in primary health care*** **Baseline:** 2004 : 22% **Target:** 70% (2010) *Significant reduction in utilization of secondary and tertiary health services* **Baseline:** 2004 **Target:** 10% (2010)	**2008**: 60%, **2010** 100% in four large municipalities **2008:** 3 regional sanitary landfill established and operational; 10% reduction in wild dumpsites**; 2009** Six regional sanitary landfills established and operational, 20% reduction in wild dumpsites **2008** Capacity building program in participatory budgeting underway in several poor municipalities; **2009:** Improved participatory budgeting in 30 poor municipalities **2008**: 30%, **2010**: 70% **2008**: - 3%, **2010**: -10% **2008:** 20%; **2009**: 30%	Current portfolio: Community Development Project, Solid Waste Management Project, Urban Infrastructure and Services Delivery Project Potential new financing: Municipal Development Project, Solid Waste II, Readiness for IPA Accession funding project AAA: Strengthening Local Governance study, WBI Advisory services Partners: USAID, SIDA, Netherlands, UNDP Current portfolio: Health Sector Enhancement Project, Education Restructuring Project, SITAP, Second Employment Support Project Potential new financing: Social Sector Project Partners: EC, OHR, IM

	8. The increased targeting of social benefits **9.** Reducing the burden of Government in economy and strengthen fiscal coordination	*7.* ***Increase in marketable horticultural produce in poor southern BH areas*** **Baseline:** 2004 **Target:** 30 percent (2009) *Stakeholder driven extension services operational* **Baseline**: 2007: limited in the RS, none in the Federation **Target**: Stakeholder managed, contracted public-private extension services reaching 20% of commercial farmers	**2008:** extension agencies established/restructured, **2010:** extension services reaching 10% of commercial farmers; **2011**: target TBD during CPS implementation	Current portfolio: Agriculture and Rural Development Project, Community Development Project, WBI capacity building program Potential new Financing: Secondary education for rural areas AAA: *Partners: EC, USAID, UNDP, IFAD, SIDA*
		Non-Core Program Goals: **8.** increased targeting of social benefits	TBD during CPS implementation	Current portfolio: Social Insurance TA Project, Second Employment Support Project Potential new financing: Social Sector Project AAA: Poverty Assessment Partners: EC, DFID, CIDA, WHO, UNDP, UNICEF
		9. Reduce the burden of Government on the economy and strengthen fiscal coordination		Current portfolio: Potential new financing: Public Sector reform Project AAA: Country Economic Memorandum *Partners: EC, IMF, OHR*

Annex 4: Donor Support Matrix

Donor Harmonization Table
Donor Partners in Bosnia and Herzegovina

Donor Agency	Approx. annual funding (EUR m)	Sector/Thematic Areas																
		Private sector development	Financial sector (incl. microcredit)	Transport	Energy	Agriculture & Rural Development.	Water & sanitation	Municipal development	Environment	Forestry	Solid waste	Education	Health	Social protection	Public sector reform	Judicial and legal reform	Youth	Information technology
Austria (ADA)	2.5	x	x					x	x			x	x	x		x	x	x
Canada (CIDA)	4.5		x		x	x		x	x	x		x	x	x	x	x	x	x
EBRD	145	x	x	x	x		x											
EC	68	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x
France	1.3	x										x	x	x		x		x
Italy	9.7	x	x			x		x	x	x		x	x	x		x	x	
Germany (KfW/GTZ)	32.3	x	x		x	x	x	x				x	x	x		x	x	x
Japan	10.3	x	x					x				x	x		x	x		x
The Netherlands	2	x				x	x	x	x	x				x				
Norway	13.8	x	x		x	x	x	x				x	x	x	x	x	x	x
Spain (AECI)	14.6	x	x	x	x	x	x	x						x	x	x		
Sweden (SIDA)	30	x	x			x	x	x			x				x	x	x	
Switzerland	10.5	x	x			x	x	x	x				x	x			x	
UK (DFID)	6	x	x											x	x	x		x
UNDP	12.5	x				x		x	x				x	x	x	x	x	x
UNICEF	3						x				x	x	x		x	x		
US (USAID)	26.3	x	x		x	x		x		x				x	x	x	x	x

Annex 5: Relationship with the EU and Progress Towards EU Accession

1) Stabilization and Association Process (SAP)

The Stabilization and Association Process (SAP) is a special regional approach of the European Union (EU) that has been designed exclusively for the Western Balkan countries to pave their way for membership of the EU. SAP is the cornerstone of the EU's policy towards the region, aiming to promote stability and to facilitate closer association with the EU. The credible prospect of membership of the EU is the main motivator for reform in these countries; each country moves towards the EU at its own pace.

A key element of the SAP is a formal contractual relationship in the form of Stabilization and Association Agreement (SAA) entailing mutual rights and obligations. The SAA is signed with countries that have made sufficient progress in terms of political and economic reform and administrative capacity. Once the SAA has been signed and ratified, the country in question officially becomes a candidate country – the next step in the EU accession ladder.

The SAA foresees the establishment of a free trade area between candidate countries and the EU by the end of a five-year transition period, enhanced cooperation in the economy, environmental protection, justice and security. The main benefits of the SAA are:

- Economic development through enhanced trade and economic cooperation and the creation of a business environment facilitating investments;
- Enhanced political stability and security due to good relations with neighbors, regional co-operation and deeper integration into the EU; and
- Political and economic reforms, including in institution building, public administration reform, respect of human rights and the rule of law.

2) Current status of the SAP/SAA process in Bosnia Herzegovina

The EU Council established political and economic conditionality for the development of bilateral relations between the EU and Bosnia and Herzegovina in 1996. At the same time Bosnia and Herzegovina started to benefit from EU financial assistance for reconstruction efforts after the war.

A feasibility study assessing Bosnia and Herzegovina's ability to launch SAA negotiations with the EU was presented by the EU Commission in November 2003. The study specified 16 areas in which Bosnia and Herzegovina needed to make substantial progress before negotiations could start.

In November 2005 the EU Commission recommended to the EU Council the opening of SAA negotiations with BH. Technical talks on the SAA were concluded in December 2006. However, the report to the EU Council of November 2007 notes that the process can not be formally concluded due to Bosnia and Herzegovina's lack of progress in implementing the necessary reforms.[25]

According to the EU, the SAA will be initialed as soon as Bosnia and Herzegovina has made sufficient progress in addressing key outstanding requirements, notably police restructuring. Despite several attempts to break the deadlock, agreement has not yet been reached.

[25] European Commission Bosnia and Herzegovina Progress Report, 6.11.2007

The signature of the SAA will require evidence that the police restructuring is irreversibly on track, as well as full cooperation with the International Criminal Tribunal for the former Yugoslavia (ICTY). Progress in the areas of public broadcasting and public administration reform will also be required before the SAA is signed. Furthermore, BH needs to address key economic issues, in particular improve fiscal sustainability through increased revenue collection and efficient control of expenditure; resolve satisfactorily restitution and internal debt-related issues; establish a framework favoring private and foreign investment and promote enterprise development.

Top EU and OHR officials have called for a responsible and constructive approach from the politicians and warned that if the stalemate continues, the European perspective for Bosnia and Herzegovina will be delayed or even suspended, which would leave the country trailing far behind the rest of the former Yugoslavia in its efforts to integrate with Europe.

3) EU financial assistance to Bosnia and Herzegovina

Despite the absence of a signed SAA the majority of products from Bosnia and Herzegovina can enter the EU duty-free, thanks to a preferential trade regime adopted in 2000. The regime is valid until 2010 in its current form. Trade with the EU represents over 50 percent of Bosnia and Herzegovina's total trade.

Between 1991 and 2006, EU has given Bosnia and Herzegovina approximately 2,6 billion euros in financial assistance. In the immediate post-war years funds were focused on refugee programs and reconstruction projects and were distributed through the EU's humanitarian aid arm ECHO.

Since 2001 Bosnia and Herzegovina has been a beneficiary of the CARDS program, with aid shifting from post-war assistance to institutional capacity-building and economic development. In 2001-2006, the total EU assistance to Bosnia has been in the region of EUR 600 million. Key CARDS target areas in Bosnia and Herzegovina have been public administration reform (including customs and taxations), issues related to justice and home affairs (police restructuring, border management, and judicial reform) and improvement of investment climate (including trade, education, environment and infrastructure).

In order to simplify and harmonize the different external aid components, to facilitate coherence and improve consistency and to achieve better results, the EU is currently adopting a new financial aid mechanism called IPA (Instrument for Pre-Accession Assistance) to replace all previous external assistance programs for candidate and potential candidate countries in the Western Balkan region. In its current form, IPA will cover the period 2007-2013. The overall financial IPA envelope for Bosnia and Herzegovina amounts to EUR 226 million in 2007-2009. Assistance under the 2007 IPA program totals EUR 62.1 million. IPA will support BH in strengthening the rule of law, human rights, social inclusion and the protection of minorities. Support will be also given to the reform of the media sector, public administration improving the functioning of the judiciary, overcoming high unemployment, and reform the education and public health systems.

Annex 6: Governance Assessment

The Dayton Peace Agreement created a complex institutional structure in Bosnia and Herzegovina that laid the foundations of the current governance[26] environment. This structure was designed to promote peace and stability, which it has achieved remarkably well, however, it has also had unintended consequences, such as undermining governments' efficiency, transparency and accountability. Complex and opaque institutional structures allow entrenched interests and informal networks along ethnic, professional and economic interests to thrive.

An international presence under UN auspices has been in place in BH since 1995. The High Representative has executive powers to impose legislation and remove officials (known as the "Bonn Powers"), which have been used extensively. Legislative work in Bosnia and Herzegovina's Parliamentary Assembly has been adversely affected by voting along ethnic lines and insufficient administrative resources. The election of BH's tripartite Presidency continues to be in contravention of European human rights protocols as it does not allow citizens not belonging to the three constituent people to stand as candidates and determines the ethnicity of each candidate elected from the Entities[27]. According to the European Commission, on a number of occasions, political parties have led negotiations on reform issues for which the government would normally be responsible[28]. Policy-making between the State and the Entities remains fragmented and State-level government structures have sometimes been unable to overcome internal conflicts and gridlocks, which has delayed reform implementation.

Several positive aspects of governance and recent progress should be noted, including the functioning of the supreme audit institutions, adoption of the new law on public procurement, a free and vibrant press and democratic elections. BH has recently ratified the UN Convention on Fighting Corruption and a National Anti-Corruption Strategy and action plan was adopted in 2006. However, implementation of anti-corruption measures has been slow, due in part to a lack of resources. Transparency International's index of corruption perception[29] for the past three years shows a high level of perceived corruption in BH. Strategic direction and commitment to tackle the governance agenda in a comprehensive manner appear to be lacking. Strategies and action plans are in place, but they are not properly implemented.

According to the World Governance Indicators, BH lags behind the averages of its income group in several aspects of governance and behind new EU member states in every aspect. Government Effectiveness and Regulatory Quality are very low (just above the 25th percentile), but have improved steadily since the end of the conflict. Voice and Accountability has also improved and is now near the midpoint of countries worldwide. Political Stability and Control of Corruption remain at levels found immediately after the war (the former near the 25th percentile, the latter just under the 50th percentile. Considerable and focused efforts will be needed to prevent BH falling behind its peers and to bring BH to levels acceptable to the EU.

In the analysis of governance, BH appears an outlier in 'state capture' which is captured by BEEPS surveys as: To what extent have unofficial payments to influence a) parliamentary votes; b) government decrees; c) local government votes and decrees had a direct impact on your business?

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[26] The World Bank defines governance as "the manner in which the state acquires and exercises its authority to provide public goods and services" and corruption as "misuse of public office for private financial gain." Corruption is a result of poor governance and a failure of accountability relationships in the governance system (Governance and Anti-Corruption Strategy, 2006)

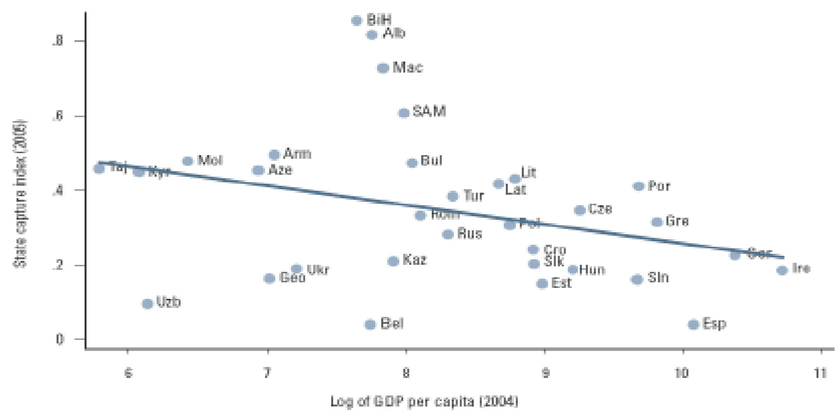
[27] European Commission Bosnia and Herzegovina Progress Report, 6.11.2007

[28] European Commission Bosnia and Herzegovina Progress Report, 6.11.2007

[29] http://www.transparency.org/policy_research/surveys_indices/cpi

Source: Anti-Corruption in Transition 3: Who is Succeeding and Why?

Figure 3.3 State capture and GDP per capita, 2005



Source: BEEPS 2005, World Development Indicators.

One possible explanation for this finding is the need to find balance between the various constituent peoples in BH. Transparency International (2007) writes, 'a disturbing fact is that the key positions in privatization agencies as well as in managing boards in public companies are held by persons whose most important qualifications are that they belong to a specific political party.' Obfuscation of accountability lines and low transparency allow this partial reform status quo to go unchallenged.

Both citizens[30] and business[31] consider state capture and dysfunctional and corrupt judiciary as major obstacles for good governance in the country, as well as revenue systems (tax and customs) and police. Citizens are also highly dissatisfied with the social benefits system and believe that education and medical systems are corrupt. A corruption barometer survey conducted by Transparency International in 2005 finds political parties, parliament, the legal system, police and customs to be perceived as the most corrupt institutions in BH.

Despite pinpointing the corrupt institutions in society, civil society is not well organized or strong in acting as an accountability mechanism to the government. There is little pressure from civil society to institute governance reforms. The Council of Ministers has signed an agreement on cooperation with the non-government sector. Civil society organizations tend to register at Entity level and few are therefore active country-wide. The World Bank has supported the Youth Voices group to engage on policy matters for some years. The Community Development Project with WBI support facilitates participatory budgeting at the local level.

The Doing Business survey implies that BH is a difficult environment for private enterprise to function. Starting a business, registering a property, paying taxes are all much more difficult than in regional comparator countries. BH's overall rank has fallen in the past two years from 91 in 2005 to 105 in 2007. While there has been no backsliding on reforms, there has been little progress either and other countries are reforming faster. Again, the ability of BH to implement reforms is hampered by the complex governance structure.

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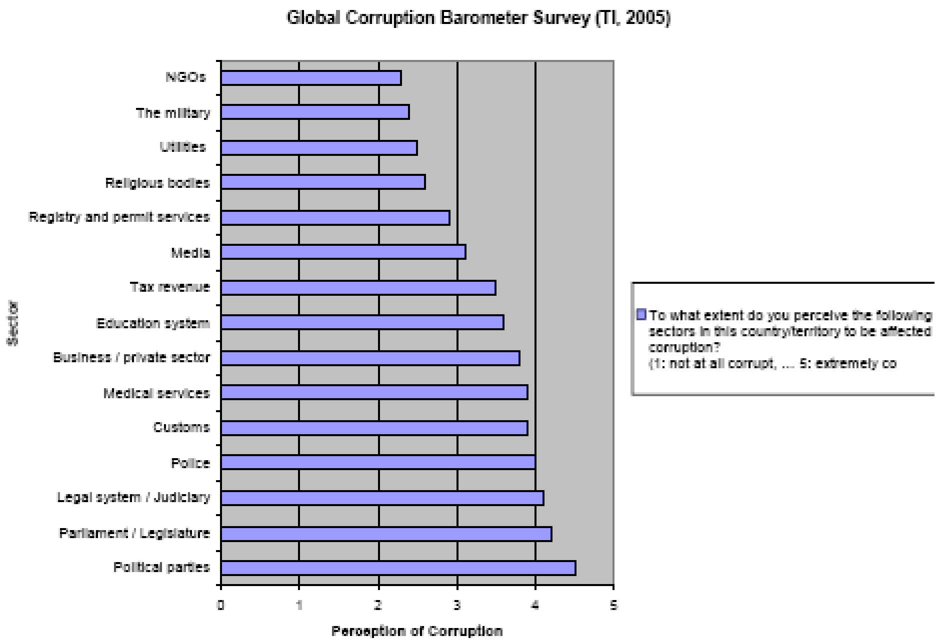
[30] Global Corruption Barometer Survey, Transparency International, 2005

[31] Business Environment and Enterprise Performance Surveys (BEEPS) 2002, 2005

The Bank-supported Business Adjustment Credit has played a significant role in improving the inspection and business license regime, which has reduced the burden on business. In the next CPS period, the Bank will support implementation of BH's Strategy and Action Plan on enhancing the corporate financial reporting environment.

Source: Global Corruption Barometer Survey, Transparency International 2005



EU accession is one of the key entry points for the Bank on governance reform in BH. To move towards EU accession, BH will need to create European administrative space, characterized by i) distinct separation between politics and administration; ii) clearly set accountability lines for the professional civil service, iii) clear administrative procedures, iv) solid management control of public funds, and v) overall strength of administrative and judiciary systems in applying and enforcing these arrangements. To do so will involve BH addressing major governance challenges. However, current EC governance interventions are concentrated on public administration reform to prepare the administration for particular tasks relating to EU accession. Other bilateral donors are also involved in governance-related areas in BH, including: SIDA, USAID and the Netherlands involvement in the Government Accountability Project; USAID's support for the Center for Investigative Journalism and tax administration reform; and DFID, SIDA and the Netherlands collaboration on public Administrative Reform.

In applying the Bank's Governance and Anti-Corruption strategy in BH during this CPS, the World Bank will identify sectors where governance reforms are possible and visible so as to create a demonstration effect, while also stimulating demand for good governance through local level accountability interventions and strategic communication. The Bank will work with the international community to agree on the key principles and priorities for supporting governance efforts in BH. As governance reform is not explicitly part of the governments' agenda, the Bank will approach reform directly through sectoral initiatives in the core lending program and through advocacy and communications in the non-core part of the program.

Annex 7: Private Sector Annex

Key opportunities and challenges

BH is making steady progress in its economic recovery from an aid-dependent to a self-sustaining economy. Economic expansion and growth have remained robust over the last few years, despite slow reform implementation. However, much remains to be done in order to achieve long-term, sustainable, private-sector led growth.

The private sector's contribution to GDP stands at 55 percent in BH, which is below regional averages. Serbia had an equivalent private sector contribution to GDP in 2005, Croatia's 60 percent and FYR Macedonia's 65 percent are relatively close, but Bulgaria and Poland with 75 percent or Hungary and the Czech Republic's 80 percent of GDP produced by private sector are far ahead. The current high share of public expenditure to GDP is crowding out private sector.

Privatization, restructuring and bankruptcy

According to the 2007 WBG enterprise survey, there were some 34,000 companies registered in BH in 2005, with a further 800 yet to be privatized (of which, some 130 are strategic companies). In 1999, the Government adopted a voucher privatization program, supported by the international community, resulting in large numbers of privatized SMEs. However, the program resulted in fragmented ownership and did not introduce new management or new capital. Many of these companies need further restructuring to make them commercially viable and to make them attractive to private buyers. Public and private companies alike have poor and deteriorating business performance. Productivity and capacity utilization is relatively low, export levels are still significantly below that of imports and many companies are indebted. Privatization and corporate restructuring are urgently needed to release the productive assets tied up in these companies into the economy.

Some key strategic companies still awaiting privatization are the large utilities, including power, telecommunication, railways etc. In addition to restructuring, successful privatization will also require sound legal and regulatory frameworks, tariff reform and improved corporate governance. The private sector should also be encouraged to participate in major infrastructure investments through public-private partnerships.

Financial sector

Reforms of the banking sector have advanced reasonably well, compared to other sectors. The banking sector is now majority private- and foreign-owned. However, progress in advancing non-bank privatization has been slow, particularly in the Federation**.** A consolidation of the banking sector might be appropriate.

Business Environment

The business environment in BH is not perceived to be conductive for investment, due to: a small and fragmented market; fragmented ownership structures; the slow pace of privatization; and perceived risks of regional instability. As part of the former Yugoslavia, BH specialized in raw materials, semi-finished products, heavy industry and energy production. The drivers of export growth are food processing, base metals, textiles, wood and chemicals.

Creating an investor-friendly business environment and attracting FDI will be of particular importance given the large trade and current account deficits. Some progress has been made through the last CAS period. First stage reforms have been completed or are being implemented, including, but not limited to: improved access to financing through a pledge registry (BH is ranked 13th on "Getting Credit" indicator, due to the reforms done in this sector); modern and transparent bankruptcy system that improved the bankruptcy process; reform of the inspection regime that reduced the burden on business and improved the efficiency and effectiveness of inspections (the Bank's own survey showed that the inspections reform succeeded in bringing down the average number of inspection days per company to less than 9 days countrywide);.a new business registration system that already influenced some reduction in number of days and aims to further reduce the number of days required to register a business; strengthening of the legal framework for financial sector, in particular insurance and banking.

Overall, the business environment improved somewhat, but more remains to be done. There is an urgent need to speed up the pace of the reforms. With little reform changes recorded in the Doing Business reports, BH's relative rank in the Ease of Doing Business table has stagnated (ranking unchanged at 150) as other countries' reforms outpace those in BH. BH made improvements in the category "Trading across Borders", where the ranking improving from 67th to 53rd place is due to continued improvement in facilitation of cross-border flow of goods. But the report also identified problems with licensing, where BH is ranked very low.

BH should now move to second-stage reforms including: strengthening bankruptcy courts and capital markets; reforming licenses and permits; and reviewing and rationalizing different taxes and levies imposed on businesses by various levels of government. BH has to be able to attract more "brown-field" investment in order to fuel private sector growth. To do so, stronger and more regulated capital markets and better corporate governance are needed.

SMEs

According to the European Bank for Reconstruction and Development (EBRD) 2005 report, BH is at the bottom of South-East Europe (SEE) countries together with Serbia in fueling private sector development through strong SME growth. SMEs are likely to be the vehicle for short-term growth and employment. The introduction of VAT in 2006 has helped to formalize many small businesses.

Labor market

BH has high levels of unemployment and a low labor force participation rate. High taxes on wages raise the cost of formal sector employment, resulting in a large (perhaps one third of all jobs) informal sector. Wage-bargaining mechanisms are rigid, contributing to low job creation and low worker mobility. Labor mobility is further hindered by the lack of harmonization of labor policies between the two Entities.

Modernized and harmonized corporate (CIT) and personal income tax (PIT) laws were enacted in 2006 in the RS and in late 2007 in the Federation, setting the CIT rate at 10 percent and the PIT rates at 10 percent and 15 percent. This represents a major improvement over previous legislation and should help to start improving the demand for labor.

In summary, BH is faced with the following challenges in promoting sustainable private sector-led growth:

- A small and fragmented market;
- Serious indebtedness and low capacity utilization of enterprises, which seriously undermines real-sector competitiveness and corporate governance in the country;

- Enterprise assets that are not being released into productive use; this could be done either through privatization, restructuring or bankruptcy;
- Incomplete institutional and legal frameworks to promote private sector participation in infrastructure and to select investors through transparent, open and competitive processes;
- Poor corporate governance in the real sector, in particular lack of ownership concentration in voucher-privatized enterprises;
- A financial sector, which needs to be streamlined, strengthened and unified, including leasing, insurance, banking and financial markets; and
- Regulatory burdens on business operations (such as non-harmonized taxes, extensive time/cost/processing for obtaining certain permits and licenses, lengthy court enforcement time);
- Labor market rigidities and social pressures stemming from any adverse side-effects of large scale restructuring of enterprises.

The World Bank Group's role

The World Bank Group provides assistance on several of the challenges identified above. Through the last CAS period, the Bank supported a Business Enabling Environment Credit (BAC) that yielded several notable results, including improved access to finance, faster bankruptcy and a more efficient inspection regime.

However, another adjustment credit that focused on corporate restructuring was dropped due to a lack of commitment by the authorities. In this CPS period, an Enterprise Restructuring Grant from the European Union, administered by the Bank, will aim to move the corporate restructuring agenda forward with a restructuring of over a dozen Voucher-Privatized Enterprises and will pave the way for further corporate restructuring. In response to stated demand, technical assistance by the Bank will also be provided to strengthen financial markets, as well as to insurance sector. WBI and the Bank are cooperating on a joint project which promotes private sector led-growth through focusing on ICT and competitiveness.

Bank projects on labor redeployment and assistance to labor and social sectors can help to alleviate some problems in these sectors. Instances of such activities could involve dealing with the existing pool of 'fictitious' or 'waitlisted' workers and implement measures that would systematically resolve this issue in a financially prudent manner that does not create imbalances elsewhere in the economy. Similarly, the Bank could support efforts to reform the system of payroll contributions to strengthen both supply and demand-side incentives in the labor market.

The World Bank Group anticipates playing an important role helping the government to structure possible PPP transactions. During FY07, the Bank held a training seminar on PPPs that was very well attended by a cross-section of regulators and officials from BH. Follow-up activity has been requested and will be implemented through the CPS period. In addition, IFC is seeking opportunities to support private companies that would consider investing in the infrastructure through long term financing, including PPP in the road and energy sectors. In addition, FIAS/IFC's advisory services will continue to focus in 4 business lines: SMEs and linkages; business enabling environment; access to finance; and infrastructure advisory operations. In particular, sub-national competitiveness will focus on reducing burden to business in terms of obtaining some permits and licenses, while Alternative Dispute Resolution (ADR) program will somewhat address the stock of outstanding disputes, thereby releasing additional capital for investment.

Annex 8: Progress Towards the MDGs

Millennium Development Goals	1995	2000	2005	2006
Goal 1: Eradicate extreme poverty and hunger				
Income share held by lowest 20 percent	..	*9.5*	..	..
Malnutrition prevalence, weight for age (percent of children under 5)	..	4.1	..	0.4^^
Poverty gap at $1 a day (PPP) (percent)	..	..	0.0	0.0***
Poverty headcount ratio at $1 a day (PPP) (percent of population)	..	..	..	..
Poverty headcount ratio at national poverty line (percent of population)	..	*19.5*	..	..
Prevalence of undernourishment (percent of population)	9	..	*9*	..
Goal 2: Achieve universal primary education				
Literacy rate, youth total (percent of people ages 15-24)	..	..	*100*	*100^^*
Persistence to grade 5, total (percent of cohort)	..	..	..	99.8^^
Primary completion rate, total (percent of relevant age group)	..	..	..	87^^
School enrollment, primary (percent net)	..	..	..	98.4^^
Goal 3: Promote gender equality and empower women				
Proportion of seats held by women in national parliament (percent)	..	29	17	12***
Ratio of girls to boys in primary and secondary education (percent)	..	..	..	49^^
Ratio of young literate females to males (percent ages 15-24)	..	..	*100*	*100^^*
Share of women employed in the nonagricultural sector (percent of total nonagricultural employment)	..	..	40.0	40.0*
Goal 4: Reduce child mortality				
Immunization, measles (percent of children ages 12-23 months)	53	80	90	78^^
Mortality rate, infant (per 1,000 live births)	16	14	13	6*
Mortality rate, under-5 (per 1,000)	19	17	17	…
Goal 5: Improve maternal health				
Births attended by skilled health staff (percent of total)	..	100	100	100***
Maternal mortality ratio (modeled estimate, per 100,000 live births)	..	31	..	..
Goal 6: Combat HIV/AIDS, malaria, and other diseases				
Contraceptive prevalence (percent of women ages 15-49)	..	48	..	36^^
Incidence of tuberculosis (per 100,000 people)	84	63	52	..
Prevalence of HIV, female (percent ages 15-24)	..	..	..	..
Prevalence of HIV, total (percent of population ages 15-49)	..	..	0.1	..
Tuberculosis cases detected under DOTS (percent)	..	70	71	..
Goal 7: Ensure environmental sustainability				
CO2 emissions (metric tons per capita)	1.2	5.0	*4.9*	..

Annex 8: Progress Towards the MDGs

Forest area (percent of land area)	..	43	43	..
GDP per unit of energy use (constant 2000 PPP $ per kg of oil equivalent)	4.7	5.0	*5.3*	..
Improved sanitation facilities (percent of population with access)	..	..	*95*	*93^^*
Improved water source (percent of population with access)	..	..	*97*	*98.7^^*
Nationally protected areas (percent of total land area)	..	..	*0.5*	..
Goal 8: Develop a global partnership for development				
Aid per capita (current US$)	270	192	140	..
Debt service (PPG and IMF only, percent of exports of G&S, excl. workers' remittances)	..	12.6	8.1	8.9***
Fixed line and mobile phone subscribers (per 1,000 people)	70	227	656	735^
Internet users (per 1,000 people)	*0*	10	206	245^
Personal computers (per 1,000 people)	..	..	..	..
Total debt service (percent of exports of goods, services and income)	..	10.0	8.1	8.9*
Unemployment, youth female (percent of female labor force ages 15-24)	..	..	..	65.7**
Unemployment, youth male (percent of male labor force ages 15-24)	..	..	..	60.2**
Unemployment, youth total (percent of total labor force ages 15-24)	..	..	..	62.3**
Other				
Fertility rate, total (births per woman)	1.5	1.3	1.2	1.2***
GNI per capita, Atlas method (current US$)	*830*	1,420	2,942****	3,127****
GNI, Atlas method (current US$) (billions)	*2.8*	5.5	10.5	12.2*
Gross capital formation (percent of GDP)	20.0	21.2	19.2	16.2***
Life expectancy at birth, total (years)	73	74	74	74*
Literacy rate, adult total (percent of people ages 15 and above)	..	..	*97*	..
Population, total (millions)	3.4	3.8	3.9	3.9***
Trade (percent of GDP)	91.9	113.6	116.9	103.1*

Source: World Development Indicators database, April 2007 for 1995-2005 indicators

Sources of 2006 indicators: Official MDG indicators for 2006 have not been published. The 2006 data in the table are based on BH government agency publications and WB staff estimates

* BH Statistics Agency
** Labor Force Survey 2006
*** World Bank staff estimate
**** GNI for 2005 are 2006 are based on adjusted GDP, including 7 percent NOE
^ BH Telecommunications Regulatory Agency
^^ 2006 Study of the BH Department for Economic Planning and Entity Health Ministries

Annex A2: Bosnia and Herzegovina at a Glance

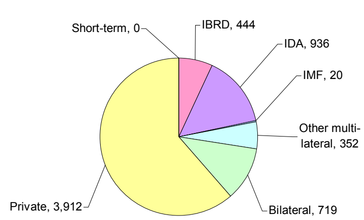
Bosnia and Herzegovina

Balance of Payments and Trade	**2000**	**2006**
(US$ millions)		
Total merchandise exports (fob)	1,130	3,371
Total merchandise imports (cif)	4,166	8,179
Net trade in goods and services	-2,577	-3,663
Current account balance	-396	-1,309
as a % of GDP	-7.4	-10.7
Workers' remittances and compensation of employees (receipts)	1,595	*1,844*
Reserves, including gold	486	3,497

Central Government Finance		
(% of GDP)		
Current revenue (including grants)	40.3	47.0
Tax revenue	21.8	38.2
Current expenditure	44.2	38.3
Overall surplus/deficit	-6.0	2.8
Highest marginal tax rate (%)		
Individual	..	15
Corporate	..	30

External Debt and Resource Flows		
(US$ millions)		
Total debt outstanding and disbursed	1,929	6,383
Total debt service	325	354
Debt relief (HIPC, MDRI)	–	–
Total debt (% of GDP)	36.1	52.1
Total debt service (% of exports)	10.2	5.4
Foreign direct investment (net inflows)	146	424
Portfolio equity (net inflows)	0	0

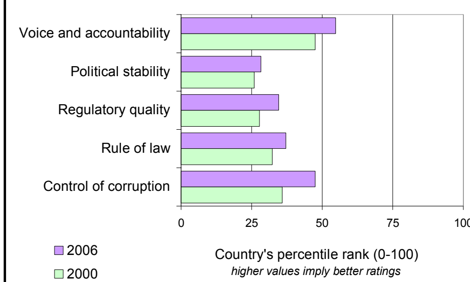
Composition of total external debt, 2006



US$ millions

Private Sector Development	**2000**	**2006**
Time required to start a business (days)	–	54
Cost to start a business (% of GNI per capita)	–	37.0
Time required to register property (days)	–	331
Ranked as a major constraint to business (% of managers surveyed who agreed)		
Access to/cost of financing	..	*34.9*
Economic and regulatory policy uncertainty	..	*33.3*
Stock market capitalization (% of GDP)	..	..
Bank capital to asset ratio (%)	*20.1*	*15.0*

Governance indicators, 2000 and 2006



Source: Kaufmann-Kraay-Mastruzzi, World Bank

Technology and Infrastructure	**2000**	**2005**
Paved roads (% of total)	*52.3*	..
Fixed line and mobile phone subscribers (per 1,000 people)	227	*507*
High technology exports (% of manufactured exports)	..	..

Environment		
Agricultural land (% of land area)	42	42
Forest area (% of land area)	42.7	42.7
Nationally protected areas (% of land area)	..	*0.5*
Freshwater resources per capita (cu. meters)	..	9,086
Freshwater withdrawal (% of internal resources)	..	..
CO2 emissions per capita (mt)	5.0	*4.9*
GDP per unit of energy use (2000 PPP $ per kg of oil equivalent)	..	..
Energy use per capita (kg of oil equivalent)	1,044	*1,203*

World Bank Group portfolio	**2000**	**2006**
(US$ millions)		
IBRD		
Total debt outstanding and disbursed	518	444
Disbursements	0	-40
Principal repayments	0	24
Interest payments	33	23
IDA		
Total debt outstanding and disbursed	522	936
Disbursements	44	26
Total debt service	3	11
IFC *(fiscal year)*		
Total disbursed and outstanding portfolio	30	95
of which IFC own account	30	93
Disbursements for IFC own account	5	19
Portfolio sales, prepayments and repayments for IFC own account	1	10
MIGA		
Gross exposure	21	216
New guarantees	21	0

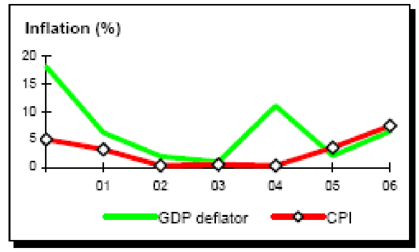
Note: Figures in italics are for years other than those specified. 2006 data are preliminary. 9/27/07
.. indicates data are not available. – indicates observation is not applicable.

Development Economics, Development Data Group (DECDG).

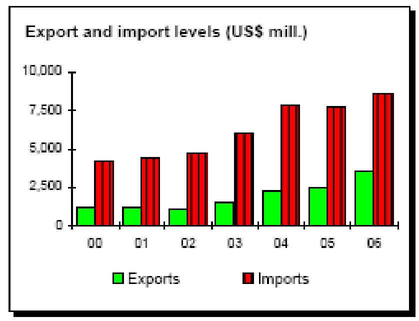
Annex A2: Bosnia and Herzegovina at a Glance

Bosnia and Herzegovina

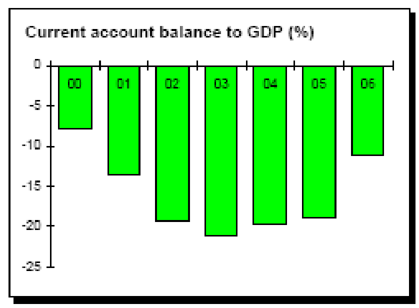
PRICES and GOVERNMENT FINANCE	1986	1996	2005	2006
Domestic prices				
(% change)				
Consumer prices	..	7.7	3.6	7.5
Implicit GDP deflator	..	-17.1	2.1	6.5
Government finance				
(% of GDP, includes current grants)				
Current revenue	..	36.6	46.6	47.0
Current budget balance	..	-3.8	6.2	8.8
Overall surplus/deficit	..	-4.4	1.3	2.9



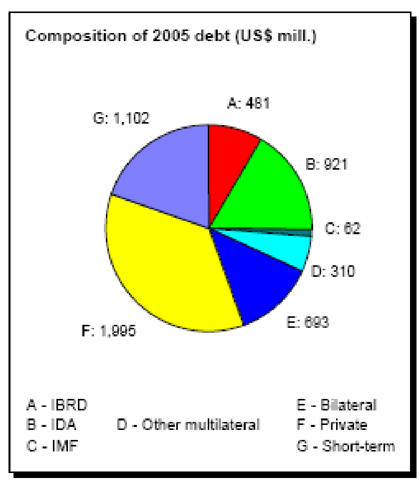
TRADE	1986	1996	2005	2006
(US$ millions)				
Total exports (fob)	..	336	2,462	3,539
Commodity 1	..	..	320	389
Commodity 2	..	..	602	891
Manufactures	..	..	1,490	2,199
Total imports (cif)	..	2,077	7,690	8,587
Food	..	..	1,260	1,248
Fuel and energy	..	..	..	..
Capital goods	..	..	1,839	1,679
Export price index *(2000=100)*	..	..	..	..
Import price index *(2000=100)*	..	..	..	..
Terms of trade *(2000=100)*	..	..	..	..



BALANCE of PAYMENTS	1986	1996	2005	2006
(US$ millions)				
Exports of goods and services	..	658	3,367	4,709
Imports of goods and services	..	2,337	7,626	8,555
Resource balance	..	-1,679	-4,258	-3,846
Net income	..	-222	430	485
Net current transfers	..	1,094	1,804	1,986
Current account balance	..	-807	-2,025	-1,375
Financing items (net)	..	1,050	2,470	2,186
Changes in net reserves	..	-243	-445	-811
Memo:				
Reserves including gold *(US$ millions)*	..	..	2,548	3,671
Conversion rate *(DEC, local/US$)*	..	1.5	1.6	1.6



EXTERNAL DEBT and RESOURCE FLOWS	1986	1996	2005	2006
(US$ millions)				
Total debt outstanding and disbursed	..	..	5,564	..
IBRD	..	589	481	466
IDA	..	109	921	983
Total debt service	..	..	267	..
IBRD	..	205	41	47
IDA	..	0	7	11
Composition of net resource flows				
Official grants	..	..	291	..
Official creditors	..	..	98	..
Private creditors	..	..	282	..
Foreign direct investment (net inflows)	..	..	299	..
Portfolio equity (net inflows)	..	..	..	..
World Bank program				
Commitments	..	0	27	0
Disbursements	..	110	56	27
Principal repayments	..	25	24	27
Net flows	..	85	32	-1
Interest payments	..	180	25	31
Net transfers	..	-95	7	-31



Note: This table was produced from the Development Economics LDB database. 9/28/07

Annex B2: Select Indicators of Bank Portfolio Performance and Management

Indicator	2005	2006	2007	2008
Portfolio Assessment				
Number of Projects Under Implementation [a]	17	17	16	16
Average Implementation Period (years) [b]	2.2	2.7	3.1	3.2
Percent of Problem Projects by Number [a, c]	23.5	23.5	6.3	6.3
Percent of Problem Projects by Amount [a, c]	33.1	20.5	3.3	3.3
Percent of Projects at Risk by Number [a, d]	23.5	23.5	6.3	6.3
Percent of Projects at Risk by Amount [a, d]	33.1	20.5	3.3	3.3
Disbursement Ratio (%) [e]	42.7	18.0	15.4	2.6
Portfolio Management				
CPPR during the year (yes/no)	No	Yes	No	Yes
Supervision Resources (total US$)	2,225	1,702	1,379	1401F
Average Supervision (US$/project)	97	95	77	10A

Memorandum Item	Since FY 80	Last Five FYs
Proj Eval by OED by Number	42	16
Proj Eval by OED by Amt (US$ millions)	784.1	144.5
% of OED Projects Rated U or HU by Number	12.2	0.0
% of OED Projects Rated U or HU by Amt	14.3	0.0

a. As shown in the Annual Report on Portfolio Performance (except for current FY).
b. Average age of projects in the Bank's country portfolio.
c. Percent of projects rated U or HU on development objectives (DO) and/or implementation progress (IP).
d. As defined under the Portfolio Improvement Program.
e. Ratio of disbursements during the year to the undisbursed balance of the Bank's portfolio at the beginning of the year: Investment projects only.
* All indicators are for projects active in the Portfolio, with the exception of Disbursement Ratio, which includes all active projects as well as projects which exited during the fiscal year.

Annex B3: IBRD/IDA Program Summary

Proposed IDA Base-Case Lending Program [a]

Fiscal year	*Proj ID*	*US$(M)*	*Strategic Rewards b (H/M/L)*	*Implementation b Risks (H/M/L)*
2008	ROAD INFRASTRUCTURE AND SAFETY PROJECT	25.0	M	L
	SOLID WASTE II	25.0	M	L
	Result	50.0		
2009	MUNICIPAL GROWTH	25.0	H	L
	SAVA RIVER/BRCKO PORT	25.0	H	not known
	Result	50.0		
2010-2011	TO BE DETERMINED	88.0	-	-
	Result	88.0		
Overall Result		188.0		

Annex B3: IFC and MIGA Program Summary

IFC Program Summary

	2005	2006	2007	2008*
Commitments (US$m)				
Gross	29.07	34.11	43.02	
Net**	29.07	34.11	43.02	
Net Commitments by Sector (%)				
EQUITY	14.31		17.83	
LOAN	85.69	100	82.17	
Total	100	100	100	0
Net Commitments by Investment Instrument (%)				
Equity	14.31		17.83	
Loan	85.69	100	82.17	
Total	100	100	100	0

* As of March 31, 2008
** IFC's Own Account only

MIGA Program Summary

MIGA Outstanding Exposure (Gross Exposure, $ milllion)

As of end of fiscal year	FY2002	FY2003	FY2004	FY2005	FY2006	FY2007
Sectoral Distribution						
Finance	43.8	79.2	190.9	268.1	246.6	202.8
Agribusiness/Manufacturing/Services	1.5	1.7	12.4	2.5	2.6	0.0
	45.3	80.9	203.3	270.6	249.2	202.8
MIGA's Risk Profile						
Transfer Restriction	26.6	43.6	156.5	245.8	228.7	202.8
Expropriation	44.4	74.5	190.7	262.4	228.7	202.8
War & Civil Disturbance	35.7	55.3	91.3	69.0	48.5	51.8
Breach of Contract	0.8	0.9	2.5	2.5	2.6	0.0
MIGA's Gross Exposure in BH	45.3	80.9	203.3	270.6	231.3	202.8
% Share of MIGA's Gross Exposure	0.9%	1.6%	3.9%	5.3%	4.3%	3.8%
MIGA Net Exposure in BH	43.9	75.8	158.9	160.9	143.8	131.6
% Share of MIGA's Net Exposure	1.4%	2.4%	4.9%	5.1%	4.3%	4.1%

Annex B4: Summary of Non-Lending Services

CAS ANNEX B4 - Summary of Nonlending Services - Bosnia and Herzegovina

As Of Date 11/07/2007

Product	*Completion FY*	*Cost (US$000)*	*Audience* [a]	*Objective* [b]
Recent completions				
Environment Mgmt. Benchmarks	2005	70	Bank/Gov.	
CEM	2005	272	Gov.	
Youth Strategy	2005	120.5	Public/Gov.	
Program Poverty Work	2006	128.6	Gov.	
Pension TA	2006	100.1	Gov.	
FSAP Preparation TA	2006	37.5	Gov.	
PEIR	2006	291.7	Gov.	
Labor Market	2006	59.8	Gov.	
Pension System Note	2007	131.2	Gov.	
CFAA - CPAR Update	2007	149.1	Gov.	
Road Safety Capacity	2007	75	Gov.	
Bosnia Policy Notes	2007	79.2	Gov.	
Underway				
Rev. of Financial Oversight & Proc. in SOES	2008	73.8	Gov.	
Strengthening Local Governance	2008	150.9	Gov.	
Transport Sector Rev	2008	464.2	Bank	
Planned				
Bosnia Investment Climate Assessment	2008	10	Bank/Gov.	
CEM	2008	272	Gov./Bank	
Poverty Assessment	2009			

a. Government, donor, Bank, public dissemination.

b. Knowledge generation, public debate, problem-solving.

Annex B6: Key Economic Indicators

Bosnia and Herzegovina - Key Economic Indicators

Indicator	Actual			Estimate			Projected		
	2003	2004	2005	2006	2007	2008	2009	2010	2011
National accounts (as % of GDP)									
Gross domestic product[a]	100	100	100	100	100	100	100	100	100
Agriculture	10	11	11	10	10	10	10	10	9
Industry	26	25	25	25	25	25	25	25	25
Services	64	64	64	65	65	65	66	66	66
Total Consumption	127	122	120	114	117	114	111	108	106
Gross domestic fixed investment	19	17	22	21	19	20	21	21	21
Government investment	10	7	7	6	6	7	6	6	6
Private investment	9	11	15	15	12	13	14	15	15
Exports (GNFS)[b]	26	29	33	37	39	41	43	44	46
Imports (GNFS)	72	71	75	66	74	75	74	74	73
Gross domestic savings	-27	-22	-20	-14	-17	-14	-11	-8	-6
Gross national savings[c]	-1	2	2	6	2	4	5	8	9
Memorandum items									
Gross domestic product (US$ million at current prices)	8370	10023	10765	12255	14199	15409	16549	17605	18728
GNI per capita (US$, Atlas method)	1990	2500	2950	3240	3540	3960	4330	4590	4870
Real annual growth rates (%, calculated from 96 prices)									
Gross domestic product at market prices	4.0	6.1	5.0	6.0	6.0	6.5	5.5	4.5	4.5
Gross Domestic Income	3.1	17.8	4.5	5.3	5.5	6.9	5.6	4.6	4.7
Real annual per capita growth rates (%, calculated from 96 prices)									
Gross domestic product at market prices	3.9	6.1	4.7	4.2	6.0	6.5	5.5	4.5	4.8
Total consumption	2.5	23.3	1.4	-2.3	7.1	4.2	3.0	1.8	2.8
Private consumption	2.6	19.3	1.2	-2.3	7.3	3.6	2.4	1.0	2.3
Balance of Payments (US$ millions)									
Exports (GNFS)[b]	2184	2947	3550	4485	5518	6314	7043	7822	8526
Merchandise FOB	1471	2082	2596	3371	4255	4963	5611	6317	6947
Imports (GNFS)[b]	5996	7083	8040	8149	10553	11492	12314	12962	13587
Merchandise FOB	5614	6649	7578	7644	9987	10888	11676	12294	12887
Resource balance	-3813	-4136	-4490	-3663	-5035	-5178	-5271	-5140	-5061
Net current transfers	1650	1861	1902	1892	2110	2195	2286	2383	2403
Current account balance	-1629	-1792	-2135	-1309	-2395	-2497	-2551	-2403	-2375
Net private foreign direct investment	381	662	522	424	1695	1733	829	765	799
Long-term loans (net)	270	6	112	85	651	235	760	610	315
Official	51	103	104	34	80	124	96	58	45
Private	219	-97	8	51	571	111	664	552	270
Other capital (net, incl. errors & ommissions)	1161	1554	1971	1573	1143	1373	1385	1371	1352
Change in reserves[d]	-182	-430	-470	-773	-1093	-844	-422	-343	-91
Memorandum items									
Resource balance (% of GDP)	-45.6	-41.3	-41.7	-29.9	-35.5	-33.6	-31.9	-29.2	-27.0
Real annual growth rates (YR96 prices)									
Merchandise exports (FOB)	..	..	..	..	..	..	..	..	..
Primary	..	..	..	..	..	..	..	..	..
Manufactures	..	..	..	..	..	..	..	..	..
Merchandise imports (CIF)	..	..	..	..	..	..	..	..	..

(Continued)

Bosnia and Herzegovina - Key Economic Indicators (Continued)

Indicator	Actual			Estimate		Projected			
	2003	2004	2005	2006	2007	2008	2009	2010	2011
Public finance (as % of GDP at market prices)[e]									
Current revenues	37.9	44.7	46.6	47.0	45.3	44.9	44.3	44.0	43.3
Current expenditures	36.6	40.2	40.4	38.3	40.2	40.1	40.1	40.0	40.0
Current account surplus (+) or deficit (-)	1.3	4.5	6.2	8.7	5.1	4.8	4.2	4.0	3.3
Capital expenditure	10.3	9.5	9.1	5.9	6.3	6.8	6.5	6.4	6.1
Foreign financing	4.7	6.0	4.8	3.1	1.5	2.0	1.6	1.2	0.7
Monetary indicators									
M2/GDP	37.9	43.3	47.7	52.7	58.8	62.5	66.7	71.4	76.9
Growth of M2 (%)	10.0	24.3	18.2	24.7	21.2	15.3	14.6	14.0	14.6
Private sector credit growth / total credit growth (%)	108.9	96.6	106.8	120.1	220.9	112.0	106.1	105.7	104.3
Price indices(YR96 =100)									
Merchandise export price index	..	..	..	..	..	..	..	..	..
Merchandise import price index	..	..	..	..	..	..	..	..	..
Merchandise terms of trade index	..	..	..	..	..	..	..	..	..
Real exchange rate (US$/LCU)[f]	1.0	1.0	1.0	1.0	..	..	..	0.0	0.0
Real interest rates									
Consumer price index (% change)	0.6	0.3	3.6	7.5	2.9	1.4	1.6	1.7	1.6
GDP deflator (% change)	1.5	2.6	2.1	6.5	2.5	1.9	1.8	1.8	1.8

a. GDP at factor cost
b. "GNFS" denotes "goods and nonfactor services."
c. Includes net unrequited transfers excluding official capital grants.
d. Includes use of IMF resources.
e. Consolidated central government.
f. "LCU" denotes "local currency units." An increase in US$/LCU denotes appreciation.

Annex B7: Key Exposure Indicators

Bosnia and Herzegovina - Key Exposure Indicators

Indicator	Actual			Estimate			Projected		
	2003	2004	2005	2006	2007	2008	2009	2010	2011
Total debt outstanding and disbursed (TDO) (US$m)[a]	5043	5632	5114	6383	7119	7300	8026	8631	8946
Net disbursements (US$m)[a]	482	6	112	284	633	233	760	610	315
Total debt service (TDS) (US$m)[a]	191	382	411	354	496	847	651	783	901
Debt and debt service indicators (%)									
TDO/XGS[b]	127.0	114.9	92.6	96.8	91.7	84.4	84.9	84.1	81.3
TDO/GDP	60.3	56.2	47.5	52.1	50.1	47.4	48.5	49.0	47.8
TDS/XGS	4.8	7.8	7.4	5.4	6.4	9.8	6.9	7.6	8.2
Concessional/TDO	..	..	..	..	..	..	..	0.0	0.0
IBRD exposure indicators (%)									
IBRD DS/public DS	24.2	24.1	29.1	27.2	26.8	28.8	28.0	28.2	27.6
Preferred creditor DS/public DS (%)[c]	63.7	64.9	84.9	84.2	66.4	63.3	64.8	63.9	63.2
IBRD DS/XGS	1.1	0.8	0.7	0.7	0.6	0.6	0.5	0.5	0.5
IBRD TDO (US$m)[d]	546	481	507	444	435	440	444	448	453
Of which present value of guarantees (US$m)									
Share of IBRD portfolio (%)	0	0	0	0	0	0	0	0	0
IDA TDO (US$m)[d]	816	847	966	933	996	1004	1008	1009	1001
IFC (US$m)									
Loans									
Equity and quasi-equity /c									
MIGA									
MIGA guarantees (US$m)									

a. Includes public and publicly guaranteed debt, private nonguaranteed, use of IMF credits and net short-term capital.
b. "XGS" denotes exports of goods and services, including workers' remittances.
c. Preferred creditors are defined as IBRD, IDA, the regional multilateral development banks, the IMF, and the Bank for International Settlements.
d. Includes present value of guarantees.
e. Includes equity and quasi-equity types of both loan and equity instruments.

Annex B8: Operations Portfolio

CAS Annex B8 - Bosnia and Herzegovina
Operations Portfolio (IBRD/IDA and Grants)
As Of Date 11/07/2007

Closed Projects	**42**
IBRD/IDA *	
Total Disbursed (Active)	118.38
of which has been repaid	0.00
Total Disbursed (Closed)	694.78
of which has been repaid	5.10
Total Disbursed (Active + Closed)	813.17
of which has been repaid	5.10
Total Undisbursed (Active)	196.64
Total Undisbursed (Closed)	0.00
Total Undisbursed (Active + Closed)	196.64

Active Projects

Project ID	Project Name	Last PSR Supervision Rating: Development Objectives	Last PSR Supervision Rating: Implementation Progress	Fiscal Year	Original Amount in US$ Millions: IBRD	IDA	GRANT	Cancel.	Undisb.	Difference Between Expected and Actual Disbursements [a/]: Orig.	Frm Rev'd
P101213	AGR./RURAL DEVELOPMENT	S	S	2007		21			21.111792	0.575	
P100415	AVIAN FLU - BA	#	#	2007		5			5.048472		
P071001	BUS ENABLG ENV SAC	MS	MS	2002		44			30.462957	23.94056	
P070995	COMM DEVT	S	S	2001		20			5.2506118	-2.042393	-1.724596
P090666	ECSEE APL3-BiH	S	S	2006		36			38.548329	2.1	
P079226	EDUC RESTRUCTURING	MU	MU	2005		10			9.6158562	5.0625	0.8125
P058521	ELEC PWR 3 RECN	S	S	2001		35			5.5647253	1.3672993	
P084596	EMPLYMT 2	S	S	2004		12			5.0557875	1.4840648	-1.365935
P079161	FOREST DEVT/CNSRV TA	MS	MS	2003		7.09			4.1683355	0.2300068	-0.250156
P088663	HLT SEC ENHANC	MS	MS	2005		17			13.093093	7.8406954	3.8906954
P096200	LAND REGISTRATION	S	S	2006		15			14.879948	-0.577582	
P085112	QUALITY PROTECT (GEF)	S	S	2005			8.9		8.4630674	4.9080674	
P055434	SM SC COM AGRIC	S	S	2003		12			4.0048148	-2.21727	
P071004	SOC INS TA	MS	MS	2003		7		2.046268	2.8125465	1.9620594	
P057950	SOLID WASTE MGMT	S	S	2002		26			19.092094	7.2963946	-0.001939
P083353	URB INFRA & SERV DEL	S	S	2005		25			17.935449	0.7319035	
Overall Result						292.09	8.9	2.046268	205.10788	52.661307	1.3605688

Annex B8: Statement of IFC's Held and Disbursed Portfolio

Committed and Disbursed Outstanding Investment Portfolio
As of 9/30/2007
(In USD Millions))

		Committed					Disbursed Outstanding				
FY Approval	Company	Loan	Equity	**Quasi Equity	*GT/RM	Partici pant	Loan	Equity	**Quasi Equity	*GT/RM	Partici pant
1999/05	Bosnalijek	8.1	1.42	0	0	0	8.1	1.42	0	0	0
2006	Eki bosnia	4.24	0	0	0	0	4.24	0	0	0	0
1985	Energoinvest	10.88	0	0	0	0	10.88	0	0	0	0
1997	Enterprise fund	0	1.41	0	0	0	0	0.82	0	0	0
2002	Fcl	9.42	0	0	0	1.28	9.42	0	0	0	1.28
5/7/2004	Hvb cpb	9.97	16.9	0	0	0	9.97	14.65	0	0	0
2006	Mi-bospo	2.83	0	0	0	0	2.83	0	0	0	0
2006	Nova banka	14.13	6.85	0	0	0	11.31	3.73	0	0	0
0/02/05	Raiffeisen-bos	49.42	0	0	0	0	49.42	0	0	0	0
2007	Sisecam bosnia	33.92	0	0	0	0	25.44	0	0	0	0
0	Wood konjuh	1.22	0	0	0	0	0.86	0	0	0	0
Total Portfolio:		**144.13**	**26.58**	**0**	**0**	**1.28**	**132.47**	**20.62**	**0**	**0**	**1.28**

* Denotes Guarantee and Risk Management Products.
** Quasi Equity includes both loan and equity types.

Map of Bosnia and Herzegovina