

**PROJECT INFORMATION DOCUMENT (PID)
APPRAISAL STAGE**

Report No.: AB2650

Project Name	COMMUNITY DEV SUPPLMT
Region	EUROPE AND CENTRAL ASIA
Sector	Other social services (20%);Roads and highways (20%);Water supply (20%);Sewerage (20%);Sub-national government administration (20%)
Project ID	P103703
Borrower(s)	STATE OF BOSNIA AND HERZEGOVINA
Implementing Agency	
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Environment Category	<input type="checkbox"/> A <input type="checkbox"/> B <input type="checkbox"/> C <input checked="" type="checkbox"/> FI
Date PID Prepared	November 6, 2006
Date of Appraisal Authorization	
Date of Board Approval	December19, 2006

1. Country and Sector Background

Bosnia and Herzegovina (BiH) has achieved substantial progress in economic reconstruction and state building and has experienced high rates of economic growth (5.3%) in the last decade which are consistent with post war recovery. Along with this progress BiH has begun the process of negotiations with the European Commission on a stabilization and association Agreement (SAA). While the post war construction agenda in BiH has been completed, the country is faced with a resource constraint for continuing investments which would further solidify social cohesion, enabling business growth and state building. The economic growth has been fueled largely by international donor assistance. However, this assistance has declined substantially, from a high of US\$750 million annually to less than US\$300 million in recent years. Growth has been concentrated in the more developed regions, cantons and municipalities

of the country, while poorer municipalities--which constitute the majority--continue to face a resource and capacity constraint. Poverty and unemployment rates remain high.

EU accession and the strengthening of the State and the local governments is firmly the development agenda for policy makers in Bosnia and Herzegovina over the next five to ten year horizon. This agenda will guide reform and integration in the country at all levels of governance. In a push towards national integration, constitutional reforms are underway which focus on strengthening municipal government and state level institutions. The focus is on strengthening a unified and central government and empowering municipalities to mobilize revenues and deliver services. Development efforts would need to be cognizant of these efforts and be focused on strengthening the state and local level government and institutions in line with EU standards and constitutional reforms when developing the framework for improving the delivery of public services. The current situation is however, characterized by a "governance gap" that exists at the state and municipal levels which is not only affecting overall macroeconomic policies but may affect the country's readiness for EU accession. This gap would need to be addressed by strengthening the capacity of municipalities to deliver services; govern in accordance to EU standards and principles; strengthen their capacity to absorb EU accession funds (particularly regional development funds which are earmarked for poverty reduction in underdevelopment regions); and creating a local environment which encourages business and economic growth.

The country is characterized by the two government entities of the Federation of Bosnia and Herzegovina (FBH) and Republika Srpska (RS). In the FBH there are ten cantons and 79 municipalities with an average of 7 municipalities per canton, while in the RS there is the entity level government and 57 municipalities. In addition to these, there is a district of Brcko as a separately administered local government unit. Over 60 percent of the country's population is concentrated in eight regions and approximately 60 municipalities within the five cantons in the FBH (Tuzla, Sarajevo, Zenica, Mostar, Bihac) and in three of the RS regions (Prijedor, Banja Luka and Doboje) around the company towns for steel, coal, heavy machinery such as Zenica, Tuzla and Prijedor. The Government structure is complex and the sharing and flow of revenues within entities between cantons and municipalities is complicated and inefficient.

There are 136 municipalities in the BH (79 in Federation and 57 in the RS). Over half of these (74-80) are under-developed and citizens are largely poor; another 20 are marginally better off; while approximately 30 are better off and are able to borrow for investments. In the poorest municipalities local level social assessments conducted under the Community Development Project point to the need for basic public infrastructure and services in need of repair, reconstruction or construction. Citizens express the high transaction costs for the poor in accessing basic services or having their voices heard and the problem of joblessness. They speak of the high transaction costs involved for accessing public services. These factors make investments in their localities for businesses difficult. The young in particular express frustration with the lack of opportunities and the need to migrate in search for jobs elsewhere. Redistribution of revenues is often inconsistent and progressive and result in smaller and poorer municipalities not receiving their due allocations. Some of the poorest municipalities have annual budgets of less than US\$1.0 million each and more than 50%-80% of these budgets are spent on covering administrative costs. This resource constraint translates into an inability and a lack of capacity to plan and address citizens increasing demand for basic services, rehabilitation

and maintenance of social infrastructure (libraries, parks, sports centers, youth centers, street lighting, garbage recycling, schools, clinics, citizen friendly municipal offices). While investments in the private sector are increasing, these areas of public common goods are not being financed. Responsibility for such investments rests with the municipalities. The financing of such investments will be through public sector investments.

2. Objectives

A. Background

Through the Community Development Project (CDP) the World Bank has been an important source of financing for investments by the poorest municipalities and a critical leverage for municipal reform as well as for participatory processes for citizen involvement and planning. Municipalities have been the central partner for implementation of the CDP which focuses on the poorest municipalities. In taking this approach the project has financed stability at the community level; invested in long term sustainability of the peace process and has launched a process of long-term institutional change based on citizen participation. The Government has requested the World Bank to continue to finance the CDP. Additional financing of the CDP through a supplemental loan had been requested by the Governments of Both Entities, the State Ministry of Finance and Treasury and the participating municipalities and their local communities. The supplemental financing will address this request. The CDP is due to close on December 31, 2006. These municipalities will continue to require assistance. The CDP has reached over 1.30 million beneficiaries (334,900 households) or 25 percent of the country's population in the poorest municipalities. Average number of beneficiaries per project is 3,289 people.

The CDP has invested in the poorest communities with performance grants through municipal governments for non revenue generating investments. This approach has been characterized by citizen driven decision making through performance grants and participatory budget planning between municipal governments and citizens who agree to work amongst communal groups for common goods. Experience shows that local government is a critical site of empowerment. In BiH under the CDP, 74 municipalities were identified as the poorest municipalities (rural and semi urban) and by September 2006 over 88 (63 in the Federation and approximately 37-40 in the RS¹) were assisted through technical assistance and performance grants for non revenue generating physical and social infrastructure and capacity building for participatory budget planning. The CDP aimed to decrease transaction costs for citizens who were poor to participate in decision making for 397 community level municipal investments and governance. Because these 88 municipalities (more than half of the total number of municipalities) are the poorest in BiH, these performance grants can represent up-to 20 percent to 80 percent of total municipal financing. The project has achieved a high level of co-financing from municipalities and citizens.

This approach under the World Bank financed Community Development project focuses on citizens participation in municipal decision making for investments based on citizens identification of needs (for rural roads, water supply, electricity, schools, clinics, street lighting, parks, libraries, sports facilities, radio stations, agriculture cooperatives etc).

¹ due to changing profiles of poverty

The CDP original financing was a total of US\$17.63 of which IDA US\$15.0 million with counterpart financing of US\$2.63 million. IDA financing was on the World Bank's standard terms with a grace period 10 years; a commitment fee of 0.5%; years of Maturity of 35 years and a service fee of 0.75 %. The CDP loan was approved on June 26, 2001 and became effective: March 26, 2002. Both IP and PDO have been rated as Satisfactory throughout the implementation of the original project.

B. Project development objective

The objectives of the proposed project are:

- improvement of basic services and facilities (through investments in non-revenue generating socially oriented projects and programs) for low income and poor communities in underserved municipalities.
- improvement of governance and capacity of local governments to deliver services to the poor through better partnerships between poor communities and municipalities in investment identification and decision making. The project will build the capacity of municipalities to lead community development processes, thus increasing the voice of local communities in investment decisions.

3. Rationale for Bank's Involvement

A majority of municipalities in BiH, 88 of the total of 136 are covered by the CDP. Majority of CDP projects in these poorest municipalities prioritize social and community level infrastructure through participatory means of identification and budgeting which create the capacity for good governance and inclusion. Preliminary findings from the ongoing impact evaluation suggest that the CDP, in the post Dayton municipalities in particular, has had a significant role in building the capacity of municipal governments to plan budgets and deliver municipal services. In these municipalities in particular the CDP has had a significant impact on delivery of services and on enhancing economic opportunities for residents as well as encouraging the return of internally displaced people. Without CDP financing many of the communities would have been without services. Changes in the population figures for the year 2000 and more recently seem to indicate returns which could easily be attributed to accessible roads and services which made return possible after the war's destruction.

4. Description

The additional financing through the supplemental loan is expected to further strengthen the results and outcomes achieved under the CDP by a continued focus on financing investments which strengthen local government abilities to leverage and mobilize resources while increasing the participation of citizens in budget planning and decision making. The project would continue to finance investments focused on the improvement of the quality of basic infrastructure and services in poor communities within low-income municipalities, while seeking to strengthen the

institutional and financial capacity to manage such services over the long-term. The project would have three components: (1) Performance Based Grants; (2) Institutional Capacity Building; (3) Project Implementation.

Component 1-Performance Based Grants:

The proposed operation would provide grants as a mechanism to target non revenue generating investments to low-income municipalities and their poor communities with a focus on improving service delivery, cost recovery, the financial management capacity of local governments; and public accountability/community participation. The supplemental loan will finance a subset of the same municipalities which participated in the CDP (poorest municipalities). These requests for community investment financing were made over the past year by participating municipalities and could not be financed under the original loan due to limited availability of financing. The supplemental loan would finance the pipeline of subprojects that were unable to be financed under the existing CDP loan. This pipeline of projects would be selected for the supplemental loan financing in coordination and cooperation with the Regional Development Agencies (RDAs). There are five RDAs (Sarajevo macroeconomic region – SERDA; Northeast region – NERDA; Northwest region – ARDA; Central Bosnia – REZ; and Hercegovina region RDA). The RDAs were established by local governments from these respective regions in order to promote a harmonized and balanced development and increase the capacity of local governments to absorb regional funds (once available) in the process of the EU accession.

Component 2-Institutional Capacity Building:

The project would increase the capacity of municipalities to improve service delivery through technical assistance and training. Capacity for municipalities would be developed in the areas of participatory inclusive procedures such as citizens score cards. This component will be implemented in close cooperation with the World Bank Institute.

Component 3-Project Implementation:

The project implementation arrangements would remain the same as for the CDP. The project would be implemented in partnership between PIUs, municipalities and citizens associations and NGOs. In the FBH, the PIU responsible for the implementation will operate as a part of the Federation Foundation for Sustainable Development (ODRAZ). In the RS, the Development and Employment Fund (DEF) will be responsible for project management.

5. Financing US\$ 5.0 million IDA

6. Implementation

The Supplemental Credit would continue with the CDP implementation arrangements. In the FBH the project would continue to be implemented through ODRAZ Foundation while in the RS it would continue to be implemented by the DEF. The project partners would continue to be the poorest municipal governments in BiH and in achieving project objectives the project teams will work in close partnership with the five regional development agencies.

The procurement under the Supplemental financing agreement should be guided by May 2004 Procurement Guidelines

7. Sustainability

The project is focused on those municipalities which are unable to self finance or to borrow from commercial sources for capital investments. The CDP has played a significant role in building the necessary conditions which would enable these municipalities to attract private sector investments in the future and to plan towards credit worthiness. The process towards sustainability is evidenced by the significant co-financing from citizens which in the FBH reached 17 percent of total financing and 26 percent of IDA financing. In the RS it is 9 percent of total financing and 13 percent of IDA financing. In the FBH, municipal governments' and community and citizen organizations co-financing together signify 47.8 percent of IDA while in the RS this amount is 41.0 percent of IDA.

8. Lessons learned from past operations in the country/sector

The Impact Evaluation of the CDP provides several key lessons which guide the concept of the supplemental loan. Experience in the CDP with 88 of the 136 municipalities in BiH shows that the approaches which work and which are cost effective and sustainable include: 1) participatory approaches focused on inclusion of citizens regardless of gender, age or belief in decision making; 2) clusters of municipalities coming together for resolving service delivery; and 3) nuancing financial support (grants and credits) according to wealth-- regions experiencing economic growth and those which have not taken off yet

9. Program of Targeted Intervention (PTI) Y

10. Environment Aspects (including any public consultation)

Issues: The Additional Financing for the CDP would have a range of non revenue generating community level investment projects which would be assessed for their environment impact under each subproject appraisal. Terms of References for environmental assessments during sub project appraisals are included in the operational manuals for of the project implementation units.

11. Contact Point:

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