



# Project Information Document (PID)

Concept Stage | Date Prepared/Updated: 03-Aug-2020 | Report No: PIDC30232



**BASIC INFORMATION**

**A. Basic Project Data**

|  |   |  |   |
|--|---|--|---|
| Country<br>Bosnia and Herzegovina                    | Project ID<br>P174604   | Parent Project ID (if any)   | Project Name<br>BiH Firm Recovery and Support Project (P174604) |
| Region<br>EUROPE AND CENTRAL ASIA                    | Estimated Appraisal Date<br>Aug 13, 2020  | Estimated Board Date<br>Oct 29, 2020   | Practice Area (Lead)<br>Finance, Competitiveness and Innovation |
| Financing Instrument<br>Investment Project Financing | Borrower(s)<br>BiH Ministry of Finance and Treasury, RS Ministry of Finance, FBiH Ministry of Finance | Implementing Agency<br>RS Investment Development Bank, Federation BiH Development Bank |   |

**Proposed Development Objective(s)**

The Project Development Objective is to support recovery for private firms affected by the economic impact of COVID-19 through access to finance and consolidated firm-targeting public support programs.

**PROJECT FINANCING DATA (US\$, Millions)**

**SUMMARY**

|                           |       |
|---------------------------|-------|
| <b>Total Project Cost</b> | 63.54 |
| <b>Total Financing</b>    | 63.54 |
| <b>of which IBRD/IDA</b>  | 63.54 |
| <b>Financing Gap</b>      | 0.00  |

**DETAILS**

**World Bank Group Financing**

|  |       |
|--|-------|
| International Bank for Reconstruction and Development (IBRD) | 63.54 |
|--|-------|

Environmental and Social Risk Classification

Concept Review Decision



Moderate

Track II-The review did authorize the preparation to continue

Other Decision (as needed)

## B. Introduction and Context

### Country Context

- 1. BiH is an upper-middle income country with a per capita gross national income of US\$6,150 (The World Bank (WB) Spring Survey May 2020).** The country has been at peace for the past 25 years and, despite a complex political setup, has been able to achieve significant results. Much of the infrastructure destroyed in the war has been rebuilt, and institutions have been established to govern the country at all levels of authority. A framework for economic and fiscal management has been established that has brought lasting macroeconomic stability. Multiple reform efforts have improved economic links between the Federation of Bosnia and Herzegovina (FBiH) and Republika Srpska (RS), and some progress has been made in creating a better environment for private sector development and job creation. Still, much more needs to be done if BiH is to achieve sustainable prosperity for its citizens and fulfill its aspiration to join the European Union (EU).
- 2. The BiH economy is now confronted by the possibility of a deep recession as the coronavirus outbreak crimps economic activity.** In 2019, real gross domestic product (GDP) growth slowed from 3.6 percent in 2018 to an estimated 2.8 percent because of a less supportive external environment and political uncertainty. Slower growth in the euro zone, the largest BiH export market, and regional trade disputes contributed to a fall in exports, as did a slump in industrial production, resulting in part from temporary output disruptions at large exporting firms. Delayed formation of the government also delayed policy-making and impaired confidence in the economy. Consumption growth moderated adding 2.6 percentage points (pp) to economic growth in 2019, investment added 0.4 pp, but net exports subtracted 0.2 pp. More recent data for the first half of 2020 indicate a sharp broad-based slowdown of economic activity as a result of the current pandemic. The outlook is subject to significant uncertainty. The World Bank is estimating under baseline scenario that BiH will contract in 2020 by 3.2 percent, subject to further revisions due to unprecedented evolving situation.
- 3. Unemployment remains high and is expected to increase as a result of COVID-19.** The unemployment rate fell from 18.4 percent in 2018 to 15.7 percent in 2019 as employment<sup>1</sup> rose from 34.3 to 35.5 percent, though the activity rate was unchanged. However, the labor market still suffers from high structural unemployment, and the falling unemployment rate partly reflects the country's aging and shrinking workforce. Job creation has been minimal, and COVID-19 now threatens loss of a significant share of existing jobs, especially in the service industry. The BiH labor market presents a formidable challenge in the unfolding crisis, with approximately 17,500 (end June

<sup>1</sup> 2019 Labor Force Survey.



2020) jobs lost in BiH since the start of the pandemic. Based on latest data, the poverty rate in BiH is 16 percent.<sup>2</sup> Poverty is worse in rural areas (19 percent) compared to urban areas (12 percent).<sup>3</sup> Across entities, poverty increased slightly in FBiH from 2011 to 2015, from 15 percent to 17 percent, while it remained stable at about 14 percent in RS over the same period. Higher pensions and social assistance contributed to improving the welfare of the less well-off, while labor income had a small poverty-increasing effect. This effect may have shifted from 2015 to 2019, given the recent improvements in the labor market. Looking ahead, addressing structural rigidities will be crucial as BiH responds to the ongoing pandemic and is faced with the challenge of safeguarding private sector jobs in order to have a base from which to accelerate job creation in the medium term.

4. **COVID-19 poses the most serious social and economic challenge to the country since the 2008-09 global financial crisis (GFC).** The COVID-19 outbreak is testing health and public health systems, while measures to contain its spread are resulting in an economic slowdown and threaten the economic security of many of its citizens, particularly those with low-incomes. COVID-19 also risks accelerating BiH's high pace of outward migration, already the highest in the region. A third of those who renounced BiH nationality in 2018 were between 18 and 35 years old, with peaks for both the low and highly educated, indicating a high rate of loss of the country's current and future human capital. The complex political structure and weak mechanisms of BiH for inter-government cooperation also pose a challenge in responding rapidly and effectively to emergencies such as the COVID-19 pandemic. There is limited horizontal coordination, for example, between the FBiH and RS entity governments, as well as limited vertical coordination between the state-level organizations and the entity governments. Large swathes of firms are severely affected as they face the combined shocks of lower demand, activity restrictions, and supply chain disruption. Micro, small, and medium-sized enterprises (MSMEs)<sup>4</sup> and other segments that face credit constraints even in normal times (women-inclusive firms<sup>5</sup>, young firms<sup>6</sup>, enterprises in less developed regions<sup>7</sup>), are less likely to be able to access finance for much-needed liquidity, raising the risk of widespread layoffs and bankruptcies. There is also a risk of a second wave of community transmission, depending on the effectiveness of virus control measures, which may then necessitate even more restrictive measures over a longer period.

5. **The potential loss of employment and earnings could be devastating and may disproportionately hit women in work and marginal workers.** Although little data on impact is available yet in this emerging crisis, if unmitigated, the shock to firms is expected to force them to lay off employees in huge numbers. Early data on the US, for example, shows an unprecedentedly large rise in the unemployment rate. Its leisure and hospitality sector was by far the hardest hit, with employment declining by almost 3 percent in a single month, while many other industrial and service sectors saw employment declines. Globally, the International Labor Organization (ILO)

<sup>2</sup> BiH HBS 2015. More recent data not available.

<sup>3</sup> *ibid.*

<sup>4</sup> MSMEs are defined as firms with fewer than 250 employees, having an annual turnover not exceeding BAM equivalent of EUR 50 million, and/or a balance sheet with assets of less than BAM equivalent of EUR 43 million.

<sup>5</sup> Women-inclusive Enterprises are defined as: (i) more than 50 percent owned by women (i.e., with at least one female shareholder with properly documented representative and managing powers); or (ii) managed by women (i.e., with at least one female C-level manager or with at least 25 percent female representation in mid-level management); or (iii) employing a ratio of women that is higher than the average ratio observed in the respective sector; or (iv) has increased the share of women employment by at least 5 percent in the previous year.

<sup>6</sup> Young Enterprises are defined as enterprises with less than 5 years in operation.

<sup>7</sup> Enterprises in less developed regions will be defined in the Project Operations Manual in line with local legislation.



estimates that working hours will decline by around 7 percent in the second quarter of 2020. In BiH, depending on whether the crisis lasts one or two quarters, about 35,000 to 85,000 individuals are likely to fall into poverty.<sup>8</sup>

6. **The COVID-19 outbreak brought to the surface, with a growing sense of urgency, the structural deficiencies of the environment in which businesses operate in BiH.** There is an absence of streamlined, transparent, and efficient procedures for businesses and a lack of programs for firms to receive targeted support to equip them with better knowledge and capacity to upgrade and innovate. This will likely have an impact on how firms weather the aftermath of COVID-19. The current situation is an opportunity for BiH to address some of its vulnerabilities to external shocks and address the changes needed to transform its economic model.

## Sectoral and Institutional Context

### *Impact of COVID-19 pandemic on the BiH enterprise sector and vulnerable market segments*

7. **The COVID-19 pandemic globally and in BiH combines both supply and demand shocks for firms, on a scale which has not been seen in recent history.** The incidence of the virus, the behavioral changes it calls for, and required policy responses, such as movement restrictions, to slow its spread have disrupted supply and reduced demand for most parts of the economy, while the uncertainty is driving down investments. The effects on BiH's small and open economy (foreign trade is 81.3 percent of GDP) will impact almost every sector. Disruption in supply chains and lower demand from the EU will cause declines in both manufacturing and exports of goods and services. Compared to 2018, exports are projected to decline by 8.8 percent and imports by 6.5 percent as demand drops in both the EU and Western Balkan countries. Business operation restrictions aimed at limiting the spread of COVID-19 have severely affected in-person service sectors. Firms that remained open experienced a number of supply shocks, such as increased absences of workers, disruptions in supply chains both nationally and internationally, including delays in shipments, and increases in prices of scarce items or a lack of availability of certain inputs altogether. Consumer demand will be much lower for many goods and services, particularly in-person activities and those which cannot be provided remotely.

8. **These shocks are causing many firms to be in desperate need of liquidity to survive and adapt, and MSMEs – the backbone of the BiH economy - are the least able to access it.** Firms, especially MSMEs, are confronted by plunging incomes and disruptions in supply chains due to the pandemic. According to a recent survey conducted by Foundation 787<sup>9</sup>, 72.7 percent of respondents had already discontinued their operations, while 16.4 percent remained active by introducing an alternative form of business. In addition, 71.5 percent of the respondents reported that the crisis already had a very negative impact on their business and revenues. Women reported somewhat worse outcomes than men, with 73.3 percent of female respondents sharing a very

<sup>8</sup> Western Balkans Regular Economic Report No. 17, How COVID-19 could affect poverty and household welfare in the Western Balkans, Spring 2020.

<sup>9</sup> Between March 26 and April 5, 2020, Foundation 787 conducted research on the impact of the Covid-19 crisis on businesses in BiH. A total of 1,364 entrepreneurs participated, of which 57.7 percent were women. A majority (87.2 percent) of the surveyed firms are micro-businesses (up to 10 workers), while owners of small and medium enterprises made up the rest, constituting 11.7 percent and 2.1 percent, respectively. The retail and wholesale sector constitute the largest share of surveyed firms (20.1 percent), followed by accommodation and food services (14 percent), professional, scientific, and technical activities (13 percent), and manufacturing industry (11.6 percent). A little over 20 percent of surveyed firms conduct business outside BiH. While the survey may not be representative of all businesses in BiH, with observations skewed towards the FBiH and micro, services, and younger firms, it provides important insights on how firms are affected and planning to deal with the crisis.



negative experience as opposed to 69 percent of males. Moreover, 11 percent of respondents had to deregister employees, while 51.9 percent said they may soon have to do so as well. More than half of the surveyed firms believed the negative effects of the crisis would last for more than six months, including 12.2 percent expecting it to last for two years or more. Financing needs have been further aggravated which - as a consequence - raises demand for additional financing, in particular for working capital loans. 23.1 percent of firms considered working capital shortage to be a major issue. When asked to list up to three major plans to continue their activities in the coming period, over 40.1 percent of the firms considered borrowing from banks or micro-credit institutions. At the same time, 23.5 percent businesses (of which 53.4 percent are women owned) rank one-time financial support of their operation highly.

9. **Access to finance conditions have been constrained for firms, particularly MSMEs, even prior to the COVID-19 crisis.** According to a recent WB survey<sup>10</sup>, 19 percent of MSMEs consider access to finance a major or severe obstacle to the development of their enterprise. This is especially the case for microenterprises, sectors with specific needs such as agriculture, and female led enterprises. Women entrepreneurs in BiH face constraints in access to assets like land, traditionally the collateral required by financial institutions, and are perceived to be disadvantaged in their ability to raise startup capital. 80 percent of companies managed by women required collateral to access loans, while only 65 percent of companies led by men had to provide collateral. The most recent Enterprise Survey 2019 found further sectoral constraints. While manufacturing has significant potential to contribute to economic growth and job creation - 16 percent of manufacturing firms identify accessing finance as a major constraint, significantly higher than firms operating in retail and services. Firms operating in manufacturing had to provide collateral for 262 percent of the value of the loan – versus 123 percent required of borrowers operating in retail.

#### *The banking sector's response to the increased demand for liquidity*

10. **Before the COVID-19 crisis, the BiH financial sector was gradually building up resilience with a better capital position and healthier balance sheet out of the aftermath of the GFC.** Overall, banks are sufficiently capitalized, liquid, and profitable, and the indicators have improved over time. As of 2019, bank capital adequacy stood at 18.1 percent, far above the regulatory minimum. Profitability as measured by return on assets and return on equity reached 1.4 percent and 11.1 percent respectively. The ratio of liquid to total assets stood at 29.6 percent and the loan-to-deposit ratio at 88.7 percent. Banks, which dominate the financial system in BiH, generally follow more traditional business models mainly funded by local deposits compared to their EU peers and financial intermediation remains low. At the same time, BiH is a small open economy with a foreign dominated banking sector, making it vulnerable to external shocks.

11. **Banks have primarily been financing households and large companies, with the COVID-19 crisis expected to tighten supply conditions for all sectors.** Even before the COVID-19 crisis, the banking sector was highly risk averse and tilted towards financing the needs of more profitable sectors such as households and large corporates rather than MSMEs. Year-on-year credit growth to households reached almost 8 percent at the end of 2019, while the corporate portfolio remained subdued. Commercial banks - focused on maintaining safety and

<sup>10</sup> BiH 2018 Access to Finance Gender Survey Report. <http://documents1.worldbank.org/curated/en/575941521232862413/pdf/124353-REVISED-BiH-Access-to-Finance-Gender-Full-Report-FINAL-formatted.pdf>



soundness in their lending – are expected to refrain from extending new loans to firms, amplifying procyclical behavior. According to the latest European Investment Bank (EIB) Bank Lending Survey<sup>11</sup>, from June 2020, the COVID-19 induced crisis is expected to exert a significant negative impact on supply conditions in the region over the next six months, thus determining a sharp tightening across the client spectrum. Many factors positively supporting supply conditions in the past are expected to enter into negative territory. In addition to the local and international macroeconomic environment, non-performing loans (NPLs), local capital conditions, groups' funding, and the regulatory environment are expected to exert significant negative pressure.

**12. Commercial banks are reluctant to expand their lending activity to the corporate sector – in particular MSMEs - due to an increased risk aversion, the banking sector's financing structure, and asset quality concerns.**

Private commercial banks have been cautious in intensifying their lending activity to the corporate sector. In fact, early data shows that after a period of recovery throughout the last couple of years, credit growth to private firms turned negative in April 2020 as a result of the crisis. Measures designed to support credit growth, such as the emergency credit guarantee programs have not yet been finalized and the system lacks a central bank liquidity window.<sup>12</sup> Increased uncertainty due to the crisis combined with a negative economic outlook means that banks adopt a more conservative approach, leading to severely rationed credit to the riskiest segments, i.e. MSMEs and other vulnerable groups. Commercial banks' reluctance to lend is amplified by large maturity mismatches between short-term liabilities and medium to long term assets, which widened in the last years. Banks' funding structures are dominated by deposits (80 percent); only around 25 percent being long term while long term loans present 80 percent of total loans. Although on a steady downtrend NPLs are still high in BiH at 7.4 percent at the end of 2019 and are expected to rise once regulatory forbearance measures are phased out (see Box 1)<sup>13</sup>

<sup>11</sup> [https://www.eib.org/attachments/efs/economics\\_cesee\\_bls\\_2020\\_h1\\_en.pdf](https://www.eib.org/attachments/efs/economics_cesee_bls_2020_h1_en.pdf)

<sup>12</sup> A number of limitations are related to the legal framework underpinning the currency board arrangement which requires all Central Bank of BiH (CBBH) domestic liabilities to be backed by foreign net assets. Also, the CBBH Law does not allow the CBBH to grant any credit or engage in money market operations "involving securities of any type," ruling out emergency liquidity assistance and a standing liquidity facility.

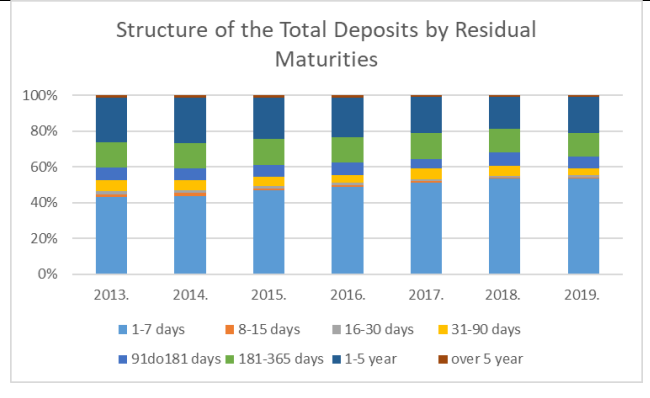
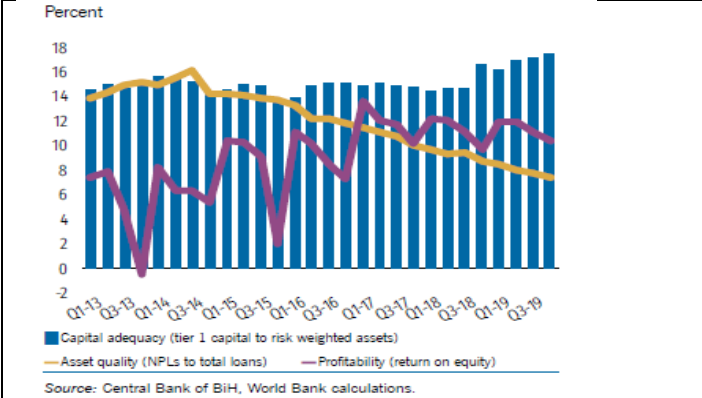
<sup>13</sup> A recent policy report by FinSAC on *Borrower Relief Measures in the ECA Region*, cautioned against relaxing regulatory definitions for NPLs and forborne exposures as this can undermine market discipline and distorts the reliability of banks' financial information. The paper suggested that policymakers need to prepare and set clear exit strategies. Public communication about the preconditions for revoking borrower relief measures is important to manage expectations. It ensures that the temporary nature of the measures is well understood by borrowers and banks alike. It is critical that in designing measures, policymakers have fully assessed how the measures are likely to impact the banking sector in the near term and ensured that proposed measures do not present an unacceptable risk to banks' safety and soundness. Techniques such as scenario analysis and stress-testing tools might be particularly useful to gauge the impact. The paper also stressed that it is essential that banks produce reliable, frequent, and comparable information regarding loans that have benefitted from borrower relief measures.



**Box 1: Select economic and financial indicators**

**Banks are generally sound and liquid but risk averse when it comes to expanding lending to MSMEs due to remaining asset quality concerns ...**

**...and the maturity structure of banking sector liabilities continues to decline.**

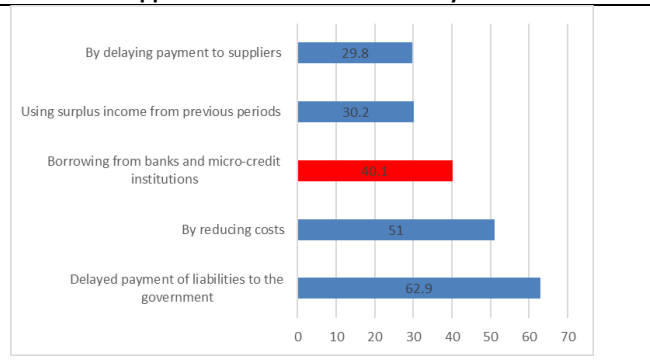
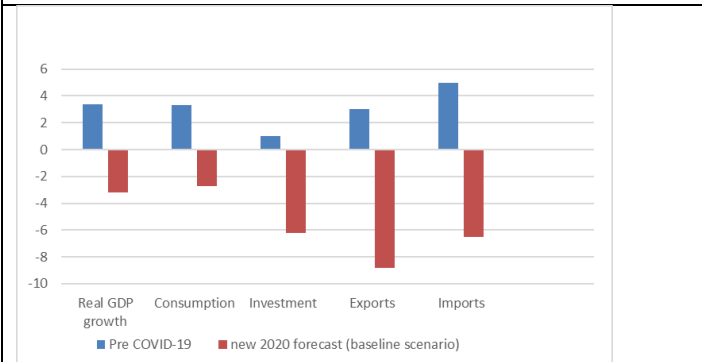


Source: Central Bank of Bosnia and Herzegovina (CBBH), WB calculations.

Source: CBBH.

**The impact of the COVID 19 crisis on the economy will be large...**

**...and working capital and investment finance are urgently needed to support firm survival and recovery...**

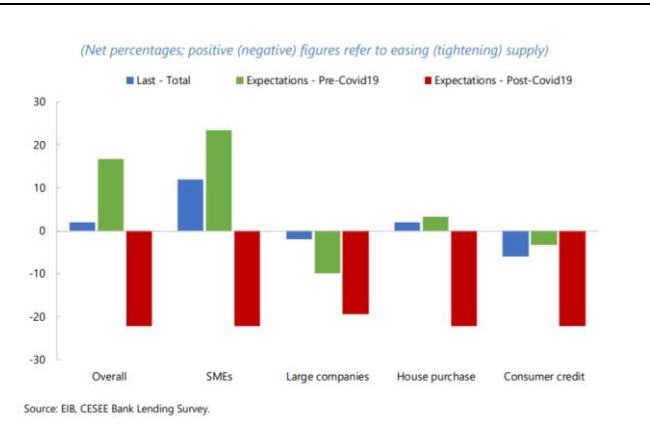
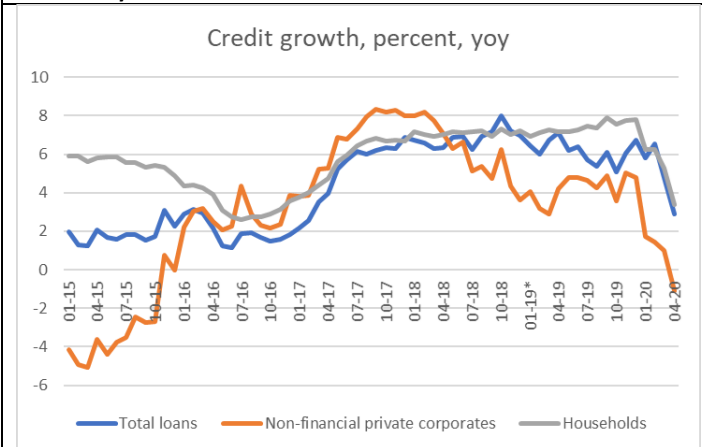


Source: WB staff calculations

Source: Foundation 787 Survey

**...credit growth to private firms has already been significantly affected by the crisis...**

**... and supply conditions are expected to tighten further.**



Source: CBBH, WB calculations.

Source: EIB, CESEE Bank Lending Survey

**State of program support for firms in BiH**





13. **The COVID-19 pandemic has brought the structural deficiencies of the environment in which businesses operate in BiH to the surface with a growing sense of urgency.** The compendium of business environment challenges and lack of sufficient programs targeting upgrading capabilities of existing firms and their internationalization will likely have an impact on how firms will weather the aftermath of COVID-19. The institutional and policy framework in support of enterprises requires strengthening. The current policy mix and related government support programs in the FBiH and RS need to be adjusted to address the adoption of international quality standards and productivity improving technologies, which have been identified as areas with key potential for private sector productivity growth and internationalization. The beneficiaries of I&E instruments are primarily the MSMEs (enterprises and entrepreneurs) [41 percent] and research and academic organizations [30 percent]. Many of these programs are in the FBiH. Although the FBiH has provided competitive grants to support digital and technological adoption, the innovation and entrepreneurship (I&E) policy instruments supporting productivity improvements among existing firms represented only about 17 percent of the total I&E budget in the Ministry of Development, Entrepreneurship and Crafts from 2015 to 2018. RS has so far invested less effort and resources on this aspect.

14. **The needs of the private sector are not being fully addressed by the existing mix of policies targeting enterprise support.** Prior to the COVID-19 outbreak, there was significant interest among BiH firms in incremental innovation and transfer of modern technologies. In 2018, 56 percent of BiH firms mentioned having introduced new or improved products or services in the last three years<sup>14</sup>. However, this is yet to be translated into sustained growth improvements. The 2019 WB assessment of BiH's private sector performance<sup>15</sup>, identified upgrading technology through the adoption of international quality standards and the adoption introduction of productivity improving technologies (including digital) as key areas of potential for private sector productivity growth and internationalization. Over one-fifth of manufacturing firms use foreign technology and close to one-third of firms have an international quality certification. The latter can be a sign of increasing integration of firms into foreign supply chains. While ranking above average, these capabilities have not however translated to more competitive entrepreneurial outcomes. Firm-level cooperation in innovation activities is another channel for knowledge transfer, yet in BiH, these types of cooperation inside and outside firms are lackluster.

15. **The private sector in particular lags in terms of adopting existing technologies to enhance productivity.** Firm managerial and technical capability is low, preventing the adoption of new technology and the digital economy business model. The country's innovation system is nascent and characterized by low innovation performance and outputs (compared to regional and structural peers), low public and private research and development spending<sup>16</sup>, and a severe brain drain<sup>17</sup>. Further, firm-level cooperation in innovation activities inside and outside firms (an important channel for knowledge transfer) is limited<sup>18</sup>. Upgrading support programs for existing firms across BiH include adoption of technology and certification standards, though less so in RS<sup>19</sup>. The FBiH provided competitive grants to support technological adoption as part of its support for the development of

<sup>14</sup> Regional Cooperation Council 2018.

<sup>15</sup> <http://documents.worldbank.org/curated/en/796741560348129202/Towards-a-Private-Sector-led-Growth-Model>

<sup>16</sup> BiH has the lowest gross expenditure in research and development intensity among peers at 0.2 percent of GDP (UNESCO 2016)

<sup>17</sup> 29 percent of the total expenditure, compared to 69 percent in Slovenia and 47 percent in Croatia

<sup>18</sup> Towards a Private Sector led Growth Model. BiH: Innovation and Entrepreneurship Assessment. The World Bank. June 2019.

<sup>19</sup> World Bank. 2019. *Bosnia and Herzegovina - Innovation and Entrepreneurship Assessment: Towards a Private Sector led Growth Model (English)*. Washington, D.C: World Bank. <http://documents.worldbank.org/curated/en/796741560348129202/Towards-a-Private-Sector-led-Growth-Model>.



entrepreneurship. However, a WB assessment in mid-2019 found that many firms are disengaged from the global economy, inhibiting further prospects for learning and upgrading of capabilities.

16. **COVID-19 brings to the forefront the need to ensure firms understand working in the “new normal” and that by adopting new technologies, their potential for growth increases as does their competitiveness in the recovery phase.** Only a small percent of firms surveyed<sup>20</sup> in BiH during the COVID-19 outbreak (around 12 percent) report that they were able to do their business online, using digital technologies. They are therefore missing out on the potential to adapt their business operation to the changed behavior and spending practices of consumers. The adoption and use of technology will impact the ability of firms to adapt and innovate their business model<sup>21</sup> to adjust to, recover from, and become more resilient during the COVID-19. At the same time, policymakers worldwide are learning the value of increasing firm managerial capabilities in closing the productivity gaps and restarting the productivity engine<sup>22</sup>. As firms struggle to adjust to the new economy, development of advanced management capabilities will come to the forefront, especially the use of technologies, workers training, lean manufacturing, performance-based HR incentives, target setting, and operational management. The array of available policies needs to be streamlined and refocused to help firms understand how technology adoption can assist them to cope with movement and social interaction restrictions while continuing their operation.

17. **In light of the COVID-19 crisis and the need for firms to adapt to changes in consumer behavior during and in the aftermath of the pandemic, there is a need to review existing policies for firm support.** The current policy mix in the FBiH and RS could be streamlined to better respond to the emerging needs of the private sector. Specifically, this would include how the current policy mix in the FBiH and RS Ministries of Entrepreneurship can better plan and allocate resources to programs targeting tech and digital adoption for firms in BiH. While the full extent of the devastating effect of COVID-19 on jobs and firms is unknown, what we do know is that it damages healthy firms that will require support to remain viable, particularly in the environment of raising uncertainties and budget and movement restrictions. In such a constrained environment, firm support programs would need to take into account the firm types, other available support programs for firm recovery, and capacity for implementation and monitoring and evaluation (M&E). Some of these are not that novel and may require scaling up and further institutionalization, such as pre-COVID-19 programs that supported firm upgrading, digitization, and adoption of technologies.

18. **Finally, implementation of these programs requires M&E systems able to generate adequate data to monitor results.** A robust M&E framework will help maintain feedback loops and institutionalize firm support programs and governance of such programs. As a minimum, such systems should include logical frameworks – particularly indicators at the input, output, and outcome stages (information systems to systematically track these indicators can be adopted for efficiency purposes). For example, input indicators can measure costs (payroll and operational costs) relative to actual support provided to beneficiaries on a per-instrument basis. Institutions can monitor which instruments are cost-effective and which are inefficient. Tracking the use of inputs across instruments is especially important given the limited resources to support entrepreneurship in BiH, especially during the pandemic. Output indicators measure how many beneficiaries are supported by the instrument, while

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<sup>20</sup> IFC survey, June 2020.

<sup>21</sup> UNDP. Economic Impact Assessment of COVID-19 in Bosnia and Herzegovina, May 2020.

<sup>22</sup> Bloom, N. and Sadun, R. and Van Reenen, J., 2016, “Management as a Technology?” NBER Working Paper No. w22327.



outcome indicators measure the impact of the program (for example, number of jobs created and productivity growth of firms)<sup>23</sup>.

### ***Government policies to mitigate the economic impact of COVID-19***

**19. An outbreak of the coronavirus disease (COVID-19) caused by the 2019 novel coronavirus (SARS-CoV-2) has been spreading rapidly across the world since December 2019, following the diagnosis of the initial cases in Wuhan, Hubei Province, China.** Since the beginning of March 2020, the number of cases outside China has increased thirteenfold and the number of affected countries has tripled. On March 11, 2020, the World Health Organization (WHO) declared a global pandemic as the coronavirus rapidly spreads across the world. As of July 14, 2020, the outbreak has resulted in 12,964,809 confirmed cases and 570,288 deaths in 216 countries and territories. More than 7,85 million people have recovered from the disease.<sup>24</sup>

**20. As of July 19, 2020, 8,452 COVID-19 cases have been confirmed in BiH with 250 COVID-19 associated deaths<sup>25</sup>.** Globally, the pandemic COVID-19 has caused a massive health crisis, while measures to contain its spread resulted in an economic slowdown and threaten the economic security. In response to the COVID-19 outbreak FBiH has issued a preparedness and response plan, and RS has initiated an action plan to respond to the pandemic. After both entities declared a state of emergency, entity authorities gradually banned public gatherings, closed education and hospitality facilities, and imposed travel restrictions, lockdown and stay-at-home orders. The restrictions were gradually eased from beginning of May as the epidemiological situation improved allowing for opening of closed businesses in stages. By late May, the emergency status was lifted in both entities. However, due to the renewed spike in numbers of infected population in late June and July, FBiH declared an epidemic again in mid-July but had not imposed lockdown or travel restrictions. The main reason for the epidemic declaration was to allow the relevant government institutions and agencies to be more agile in implementing measures preventing the spread. Social distancing measures remain in place across BiH.

**21. Supporting otherwise profitable MSMEs and other underserved segments with liquidity over this challenging period will be critical to contain the fallout from the COVID-19 crisis while preparing for the recovery.** MSMEs in BiH risk being caught in a vicious cycle of a supply shock, demand shock, decline in working capital, and an increase in insolvencies. At the same time, tightened credit conditions affect their ability to access liquidity, setting in motion a downward spiral that can significantly impair the backbone of the economy and employment. The direct impacts of the COVID-19 shocks are bad enough. However, if firms begin to go bankrupt in large numbers and employment losses ensue, the negative impacts will be magnified via the knock-on effects of lower demand, debt defaults, and much elevated unemployment levels. While the authorities have undertaken a series of steps to provide immediate relief for firms in BiH including tax deferrals, wage subsidies, and contributions to help firms “keep the lights on” (see Box 2), the focus going forward should be on restoring credit flows to boost investment and maintain firms’ operations and jobs. The needs of MSMEs and other underserved groups most affected by credit rationing, as mentioned above, will be greatest. In that respect, a credit line intermediated by the banking sector that specifically supports MSMEs and other vulnerable firms (i.e., women-

<sup>23</sup> <http://documents.worldbank.org/curated/en/796741560348129202/Towards-a-Private-Sector-led-Growth-Model>

<sup>24</sup> <https://www.statista.com/statistics/1087466/covid19-cases-recoveries-deaths-worldwide/> [accessed on July 15, 2020]

<sup>25</sup> Ministry of Civil Affairs of BiH, <http://mcp.gov.ba/publication/read/epidemioloska-slika-u-bih-covid-19-dnevni-izvijetaj-za-svjetsku-zdravstvenu-organizaciju?pagelid=3> [accessed on July 21, 2020]



inclusive, young firms, and those located in less developed regions) that have been significantly affected by the crisis would be an appropriate mechanism to provide targeted support that ensures additionality.

**Box 2. The BiH authorities' response to the economic impact of the COVID-19 crisis**

**Authorities in BiH have responded to COVID-19 with an array of measures to protect citizens, affected economic sectors, and households and to strengthen health sector resilience.** By June 2020, the entity governments allocated about BAM 100 million (0.28 percent of GDP) for pandemic-related health spending. Measures included: BiH joining the Central European Free Trade Agreement's green line; the BiH Presidency endorsing the EU April 9 agreement on joint procurement of medical equipment; and the entities extending tax application deadlines to April 30 (May 31 for entrepreneurs in FBiH).

The RS Government has also subsidized personal income tax and social security contributions (SSC) for about 40,000 workers in those sectors that were closed by government decision for March, April, and May. Payment of profit tax and all liabilities for 2019 is delayed until June 30, 2020. In addition, the RS also set up a temporary credit guarantee scheme with an allocated budget of up to BAM 50 million aimed at providing additional lending through commercial banks.

In rebalancing its budget (with additional expenditures increasing the deficit by 3pp of GDP to 3.7 percent), the FBiH Government announced that a total of about BAM 1 billion (3 percent of GDP) will be secured to support the economy, through setting up special funds to (1) stabilize the economy, mainly by supporting exporting companies; and (2) maintain and improve the liquidity of companies and prevent loss of jobs through a new guarantee scheme for up to BAM 100 million in the FBiH. As a consequence, the FBiH Parliament adopted the Law on Mitigation of Negative Economic Consequences of the COVID-19 Pandemic enacted on May 7, and the FBiH Government adopted a Decree on the operation of the Guarantee Fund (June 18) and a Program for Economic Stabilization and Recovery of FBiH (June 18) for the period 2020-2021. Based on the law, all taxpayers that have a 20 percent or more drop in turnover compared to the same month in 2019 are eligible for a subsidy of the SSC. Nine cantons also followed suit and prepared subsidy programs to support firms affected by COVID-19.

In March 2020, in a coordinated response to the COVID-19 crisis, the Banking Agencies in FBiH and RS introduced a decision on a 6-month moratorium on credit repayments of COVID-19 affected borrowers as well as measures to preserve banks' capital. The measures are voluntary and are only to be offered by banks to clients affected by the crisis. The measures are selective, and therefore minimize the risks of developing a non-payment culture throughout the country. In addition, they seek a model of "controlled neutrality" in the credit risk classification ensuring that measures are neutral from a credit risk perspective prohibiting the reclassification of underperforming loans or NPLs to a performing status.

Relationship to CPF

**This Project is in line with the policy objectives set in the current WBG Country Partnership Framework (CPF) for BiH (2016-2020).** Supporting a competitive business environment and access to finance are listed under Focus Area II (Creating Conditions for Accelerated Private Sector Growth). In addition, the Systematic Country Diagnostic (SCD) Update (June 2020) concludes that priority areas for BiH remain largely the same as those identified in 2015 and the summary of reform priorities maintain that in order to make it easier to do business in BiH, maintaining financial stability and expanding access to finance, along with improving entrepreneurship is crucial.

**C. Proposed Development Objective(s)**

The Project Development Objective is to support recovery for private firms affected by the economic impact of COVID-



19 through access to finance and consolidated firm-targeting public support programs.

#### Key Results (From PCN)

The key results of the project will be supported access to finance for the MSMEs that have been affected by the COVID-19 as well as underserved (young and in lagging regions) and women-inclusive MSMEs; and a strengthened program framework better targeted to support the MSMEs. The key expected results for the proposed project will be measured by three PDO indicators: (i) number of firms financed under the project; (ii) volume of credit line disbursed under the project; (iii) number of government programs targeting tech and digital adoption.

#### D. Concept Description

**In order to respond to this unprecedented crisis that has hit hardest those most vulnerable, and in light of uncertainties that lie ahead, this project aims to increase liquidity support to MSMEs including underserved segments of the economy while helping firms adjust to the new normal through tech adoption and digitalization.** The Project focuses on MSMEs that are hit hard by the crisis, are in the lagging regions and are part of the vulnerable and underserved segments that would face challenges accessing working capital and investment financing. The unique design ensures a targeted approach, combining working capital and investment financing to support COVID-19 affected and undeserved MSMEs throughout the recovery phase. The participation of microcredit and leasing institutions in the line of credit component is particularly important for reaching those underserved by the traditional banking products and those in lagging regions, as well as reducing some of the existing constraints with regards to collateral requirements. Furthermore, the Project will support the authorities in the design of targeted support programs focused on tech adoption and digitalization aimed at helping firms adjust to the post COVID-19 world.

#### The project will consist of three components:

**Component 1 - Line of credit:** will consist of a line of credit aimed at providing financial firepower to privately-owned MSMEs affected by the COVID-19 outbreak. The Project financing will be channeled via intermediaries – Participating Financial Intermediaries (PFIs) that meet the eligibility criteria for participation – and administered through Project Implementation Units (PIU) in the RS the Investment Development Bank (RS IDB) and the FBiH Development Bank. Specifically, the component will focus on firms' immediate working capital and investment needs, thereby ensuring that firms weather the crisis and regain regular operation and growth in the aftermath. The project will target MSMEs that were affected by the COVID-19 crisis but that remain financially viable and are likely to survive the crisis if provided financing to meet temporary liquidity needs.

Key target groups to be financed will include:

- Target Group 1 – Highly Impacted Enterprises: Firms that experienced at least a [20] percent drop in gross sales/turnover in Q2 2020 compared to Q2 2019.
- Target Group 2 – Underserved Enterprises: High-risk perception towards certain categories of enterprises including women-inclusive enterprises and young enterprises results in higher credit rationing to these groups even in normal times. These firms are expected to be impacted heavily by the COVID-19 crisis and will therefore be eligible for



support under the proposed Project, irrespective of firm level impact.

**Component 2 - Strengthen the institutional and program framework in support of firm recovery and growth – via performance-based conditions (PBCs).** The objective of this component is to refocus government programs in support of firm growth and help build capabilities aimed at raising productivity, furthering recovery and building resilience of MSMEs in the aftermath of COVID 19. This would include streamlining existing entrepreneurship and innovation programs through better targeting, outreach and selection and establishment of systematic monitoring and evaluation (M&E) mechanisms to assess their operations and effectiveness. The improved alignment and targeting of policy instruments will aim to improve the competitiveness and productivity of BiH enterprises and opportunities for entrepreneurs in the post-COVID-19 new normal. The project will focus on getting firms to adopt new technologies, including digital operation to operate in the new normal that requires physical distancing and includes movement restrictions for the foreseeable future. Moreover the development of appropriate M&E mechanisms are key including systemic reporting and collection of data on specific input and output indicators related to the implementation of the innovation and entrepreneurship (I&E) support programs. This data is instrumental to monitoring the progress of the instruments towards achieving their stated objectives; alternatively adjusting the design, targeting, or selection for that purpose.

**Component 3 - Project Management:** There will be a small project management component, needed for the full operation of the project PIUs. The component will finance operation of the two PIUs and will include operational, procurement, environmental and social safeguards and project audits.

| Legal Operational Policies   | Triggered? |
|--|------------|
| Projects on International Waterways OP 7.50                        | No         |
| Projects in Disputed Areas OP 7.60                                 | No         |
| Summary of Screening of Environmental and Social Risks and Impacts |            |

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