

PROGRAM INFORMATION DOCUMENT (PID)
APPRAISAL STAGE

December 17, 2013

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Operation Name	Development Policy Operation
Region	EUROPE AND CENTRAL ASIA (ECA)
Country	Bosnia and Herzegovina (BH)
Sector	General industry and trade sector (40%); agro-industry, marketing; trade (35%) and other industry (25%)
Operation ID	P146740
Lending Instrument	Development Policy Operation (DPO)
Borrower(s)	Ministry of Finance and Treasury of Bosnia and Herzegovina
Implementing Agency	Ministry of Finance of Republika Srpska and Ministry of Finance of Federation of Bosnia and Herzegovina
Date PID Prepared	November 28, 2013
Estimated Date of Appraisal	December 17-19, 2013
Estimated Date of Board Approval	February 20, 2014
Corporate Review Decision	December 12, 2013

I. Country Sector Background

The 1995 Dayton Peace agreement set up the political division of the country into two entities: The *Federation of Bosnia and Herzegovina* (FBH), which is further decentralized into ten cantons, and *Republika Srpska* (RS), with central functions such as foreign policy and defense the responsibility of the State level. In addition, Brcko District (BD) was established as a self-governing administrative unit in 1999. This framework has allowed each Entity to undertake important measures sometimes in parallel, but generally independently.

Bosnia and Herzegovina's macroeconomic position is stable, but vulnerabilities remain, especially due to slow growth in the Euro zone. The medium term growth potential of BH's economy is constrained by two main factors: a weak business environment still requiring substantial reforms; and fiscal policy remaining focused on income redistribution rather than growth. After negative growth in 2012, Bosnia and Herzegovina is experiencing a mild economic recovery with GDP forecast to grow by 0.8 percent in 2013. A stable exchange rate (maintained by the currency board), low inflation and relatively robust financial sector are conducive to maintaining a stable macroeconomic environment. The IMF's SBA has achieved satisfactory results.

The country's domestic market is small and neighboring countries are now EU members or on a path to accession. Bosnia and Herzegovina is rated one of the least favorable places to do business among the neighboring countries (rank 131 in *Doing Business 2014*). There is a critical need to accelerate reform in key areas such as Starting a Business, Dealing with Construction Permit, and Trading Across Borders.

II. Operation Objectives

This is a stand-alone development policy operation with an objective to improve Bosnia and Herzegovina's business environment through facilitating business start-up, streamlining investment procedures in inspections and construction, and simplifying the processes of cross-border trading. The reform areas to be supported under this DPO will contribute toward achieving the development goals under the Competitiveness Pillar of the BH Country Partnership Strategy FY12-FY15.

This operation supports key reforms to improve the country's business environment in both entities – FBH and RS. Key impediments to conducting business in BH will be addressed: strengthening competitiveness of the key export sectors, and promoting sustainable economic growth. Given BH's specific governance structures, and key economic challenges related to fiscal policy and business environment, the proposed DPO is designed around three pillars: 1) Facilitating Business Start-up, 2) Streamlining Investment Procedures in Inspections and Construction; and 3) Simplifying Processes of Cross-Border Trading. The suggested regulatory and legislative changes will have a positive impact on the economy and facilitate a coordinated, non-controversial approach throughout the country to help businesses thrive, despite the weak outlook.

III. Rationale for Bank Involvement

This operation focuses on the critical reforms, which would improve the country's business environment, strengthen competitiveness of the key export sectors, and promote sustainable economic growth. The authorities in BH requested the DPO to support their own reform efforts in a selected number of key reforms to improve the business environment. The entity governments are planning to introduce new laws, and amend existing laws to improve the business climate.

A substantial technical assistance program by the World Bank Group is complementing this operation. IFC TA supports trade facilitation, construction sector regulations, and preparations for the new company law and decree on notaries' fees in the FBH; World Bank TA covers other elements of the reform program, such as improvement to the inspections law and the business registration law.

This operation also benefits from a strong collaboration with the IMF and Delegation of the European Commission (EUD), including donor coordination with USAID, Swiss SECO, and Swedish Sida, who were consulted in the preparation of this program.

IV. Tentative Financing

Source:	(\$m.)
Borrower	0
International Bank for Reconstruction and Development	50
Borrower/Recipient	
IBRD	
Others (specify)	
Total	50

V. Institutional and Implementation Arrangements

The Ministry of Finance and Treasury of the Bosnia and Herzegovina will perform the overall monitoring and evaluation of the implementation of the suggested operation. The Ministry of Finance of Republika Srpska and the Ministry of Finance of the Federation of Bosnia and Herzegovina will be responsible for implementation of the proposed operation and for coordinating actions among other concerned ministries and agencies in their jurisdictions. Other ministries involved include: (i) Ministry of Justice, Ministry of Energy, Mining and Industry, Ministry of Agriculture, Water Management and Forestry, and Ministry of Trade in the Federation of Bosnia and Herzegovina; and (ii) Ministry of Justice, Ministry of Economic Relations and Regional Cooperation, Ministry of Agriculture, Forestry and Water Management, Ministry of Trade and Tourism, and Ministry of Spatial Planning, Civic Engineering and Ecology in the Republika Srpska.

The World Bank will focus on monitoring progress towards the expected results of the programme. As part of the monitoring and evaluation process, the World Bank will track the baseline and outcome indicators provided in the policy and results matrix, and use the economic and legislative data provided by the government agencies and disclosed by official sources.

VI. Risks and Risk mitigation

Overall risk rating for this operation is substantial. Complex governance structures, political tensions, and a poor recent track record in implementing structural reforms pose a substantial risk to this operation. These risks are mitigated by the design of the DPO, which does not attempt to address any issue which is political contentious. Strong government commitment and ownership of the reform agenda is coupled with ongoing technical assistance by the World Bank and IFC.

- ***Governance and political risks:*** The proposed set of business environment reforms that is the subject of the DPO program are largely uncontroversial and are not expected to generate any ethnic polarization that could potentially be exploited for political purposes. It is expected that the Governments' commitment to these reforms will not be compromised.
- ***Delays in completing prior actions:*** Delays are possible in the FBH as a result of institutional stalemate and unclear parliamentary majority. The authorities will communicate and hold a dialogue on benefits of the proposed reforms in order to create an enabling environment for the legislative changes aimed at addressing bottlenecks in business environment.
- ***External and internal risks to the macroeconomic outlook:*** The authorities are cooperating closely with the IMF, via existing SBA, to ensure the program remains on track. The IMF SBA will help mitigate fiscal risks, which could arise in the event of slower-than-expected growth, or due to political reasons. The SBA also supports business environment reforms that complement the areas supported by the DPO.
- ***Operational risks:*** Absorption capacity of the public sector will be hard-pressed during implementation of the DPO-related measures. Different levels of progress against the prior actions identified by this operation may cause delays in implementation, affecting one of the entities. A separate and complimentary technical assistance by the Bank Group will be supporting areas of delayed progress and leveling of reforms' impact.

VII. Poverty and Social Impacts and Environment Aspects

Poverty and Social Impacts

This operation is expected to support higher economic growth and reduce high unemployment, which in turn will contribute to achieving shared prosperity. After the end of the war in 1996, BH experienced a robust postwar recovery for more than a decade. However, since 2007, the country has experienced low growth, which translated into record high unemployment of 27.5 percent, with unemployment among women reaching 29 percent. BH also has an extremely low employment rate of 31.6 percent. The deterioration of both indicators since the onset of the global crises in 2008 was further reinforced by the Euro crisis. To re-energize the economy and increase employment, the country needs new sources of growth.

Environment Aspects

The reforms envisaged under the DPO program are not likely to have significant effects on the environment and natural resources in BH. The Law on Physical Planning and Construction of Republika Srpska (Construction Law) makes references to environmental protection, sound environmental practices, protection of cultural heritage throughout the document and specific natural areas under specific protection regimes for the purposes of physical planning. The Law references these areas as mandated by specific laws governing each of the thematic areas. Furthermore, the Construction Law has a substantial section of it promoting and ensuring energy efficiency in new construction.

VIII. Contact point

World Bank

Contact: Wolfgang Fengler

Title: Sector Leader, ECSPF

Tel: +43-12170780

Fax: +43-12170701

Email: wfengler@worldbank.org

Borrower

Contact: H.E. Nikola Spiric

Title: Minister of Finance and Treasury BiH

Tel: +387 33 205 345

Email: nspiric@mft.gov.ba

IX. For more information contact:

The InfoShop

The World Bank

1818 H Street, NW

Washington, D.C. 20433

Telephone: (202) 458-4500

Fax: (202) 522-1500

Web: <http://www.worldbank.org/infoshop>