

**PROGRAM INFORMATION DOCUMENT (PID)
CONCEPT STAGE**

November 12, 2015
Report No.: 106425

Operation Name	Bosnia and Herzegovina Public Finance DPL
Region	EUROPE AND CENTRAL ASIA
Country	Bosnia and Herzegovina
Sector	Macroeconomics and Fiscal Management
Operation ID	P149768
Lending Instrument	Development Policy Lending
Borrower(s)	GOVERNMENT OF BOSNIA AND HERZEGOVINA
Implementing Agency	MINISTRY OF FINANCE
Date PID Prepared	November 11, 2015
Estimated Date of Appraisal	January 2016
Estimated Date of Board Approval	April 2016
Corporate Review Decision	<i>[Following the corporate review, the decision was taken to proceed with the preparation of the operation.]</i>

I. Key development issues and rationale for Bank involvement

This Public Finance Development Policy Loan (DPL) supports the policy efforts of the government of Bosnia and Herzegovina (BiH) to lower fiscal risks and improve the medium-term sustainability of public finances. The DPL is central to the World Bank Group Country Partnership Framework (CPF) FY17-FY20 Focus Area 1 on increased public sector efficiency and effectiveness.

This proposed DPL addresses structural weaknesses in public finances in BiH. While the country's fiscal deficits and public debt levels have been moderate (annual average of 2.3 percent of GDP in 2008-2015 and 40 percent of GDP, respectively), BiH faces structural challenges in its public finances. BiH has one of the world's largest public sectors with general government expenditures at 46 percent of GDP and public enterprises adding even more to the overall government footprint on the economy. Pensions, social transfers, and public wages together amount to nearly a third of GDP and are the main causes for the excessive level of recurrent spending. Social transfers are poorly targeted and embody poor incentives with respect to informality and labor force participation. Not only is public spending high, but the quality of and control of spending is weak, leading to inefficient use of public resources and crowding out of private ones. Fiscal risks stem from the weak links among public investment, debt management, and medium-term budgeting as well as from the presence of public arrears, whose size and type remain undocumented.

With the support of the international community, the government of BiH took important steps towards joint engagement with entity governments in defining the key pillars of a medium-term economic reform programs. In July 2015, the Reform Agenda document was agreed and endorsed by the BiH Council of Ministers (CoM) and the FBiH and RS entity governments. Following the signing of the Reform Agenda document, the BiH CoM adopted a

Strategic Framework for BiH for the period 2015-2018, and both entities developed detailed time-bound Action Plans to implement the Reform Agenda.

The Reform Agenda aims to foster economic growth, create jobs, and improve the efficiency of social assistance, while setting a path towards fiscal consolidation and preserving macroeconomic stability. The Agenda targets six areas of reform. First, fiscal sustainability will be fostered through decreasing public debt, while creating room for public investment and reducing the size of the public sector in the economy. Second, business climate and competitiveness will be boosted through the elimination of barriers to investment, removing hidden subsidies, creating a more stable and accessible financial sector, improving bankruptcy procedures and addressing inconsistencies in the regulatory and tax framework. Third, the labor market will be reformed in order to unleash the potential of the workforce. Fourth, targeting of social assistance will be improved and pension systems will be put on a sustainable financial path. Fifth, the rule of law will be solidified through fighting organized crime, terrorism, and corruption. Sixth, public administration will be reformed to support the fiscal sustainability agenda, while ensuring the quality of public service delivery to citizens. EU accession and adherence to EU acquis will be the anchor for all aforementioned reforms, and progress on the implementation of the Reform Agenda will be necessary for a membership application to be considered by the EU.

The proposed DPL directly supports the authorities' priority to strengthen public finances in Bosnia and Herzegovina. The operation is anchored in the BiH institutions and entity-level governments' own development objectives related to the reforms envisioned under the Public Finance part of the Reform Agenda.

II. Proposed Objective(s)

This is the stand-alone DPL. The design of the operation recognizes the interlinked nature of the public finance challenges in the country. By improving reporting, transparency and coordination in the planning and execution of fiscal policy among the different multiple layers of fiscal management in BiH as well as by realizing spending efficiencies. This DPL has two pillars, both pillars ultimately contribute to reducing the fiscal risks and strengthening public finances in BiH.

III. Preliminary Description

This stand-alone DPL has two pillars seeking to strengthen public finances in BiH:

- i. Under Pillar I, the DPL aims to strengthen fiscal prudence through improved transparency and better execution of fiscal policy.** Fostering the links and complementarities of reforms related to medium-term fiscal planning, debt management, public investment management, documentation (and eventual clearance) of public arrears are among the policy measures through which the objective of Pillar is to be achieved.
- ii. Under Pillar II, the DPL seeks to strengthen regulatory frameworks for decreasing the fiscal burden of the public sector in the medium term** by tackling structural rigidities in pensions, public employment and public enterprises through reforms of the labor law, bankruptcy procedures, and pricing of pharmaceutical.

The two pillars of the operation also reinforce each other. For example, effective public investment management (which delivers on the medium-term development priorities at the state and the entity level) as well as recognition and clearance of public arrears requires financing to be incorporated in debt management strategies and its budgeting to be included within realistic medium-term fiscal frameworks. Recognizing and addressing the missing years of pension contributions for employees of public enterprises as well as establishing effective procedures for restructuring and exit can be an important step in their financial and corporate restructuring. In the absence of reforms addressing public employment rigidities and severance payments, these efforts may have limited impact on the financial health of the public enterprises, leading to significant fiscal costs and risks in the public sector.

IV. Poverty and Social Impacts and Environment Aspects

Poverty and Social Impacts

The reforms supported under the proposed operation are expected to be beneficial to poverty reduction and shared prosperity over the medium term. Policies aimed at strengthening the links between medium-term fiscal planning, medium-term public investment management, medium-term debt management, and arrears recognition should improve the government’s ability to manage risks, and improve its capacity to link public resources with strategic development goals. These reforms should also lead to better measurement of the impact of spending and, over the medium term, which should translate into improved service delivery for all, including the bottom forty percent and those socially excluded. Reforms related to reforming the labor regulations as well as those facilitating market exit of non-viable enterprises are expected to be beneficial to job creation. Pension reforms supported by the DPL should lead to improvements in the welfare of both the pensioners and younger cohorts, as well as incentivizing greater labor market participation, including among women. The reforms aimed at improving the efficiency of pharmaceutical procurement would benefit all households through lower prices and greater availability of medicines.

Environment Aspects

Overall the reform policies supported by the DPL is not likely to have significant adverse effect on the environment, forests and natural resources. Potential channels of impact will be examined during project preparation.

V. Tentative financing

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

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