

IDA AT WORK

Bosnia and Herzegovina: From Reconstruction to European Integration

Bosnia and Herzegovina (BH) is on the mend. Over the past 14 years, infrastructure and basic services have been restored to almost prewar levels, while the country and its people have made substantial progress in their overall economic and social development.

Country Indicators	1995	2008
GNI per capita (US\$)	780	4,500*
Average inflation (%)	39.5	1.5
Total public debt (% of GDP)	73	227.8
Fiscal balance (% of GDP)	-8.1	-4.0
FDI net inflows (US\$ millions)	67	774
Poverty incidence (%)	19.1 (2000)	14 (2007)
Gross primary school enrollment rate (%)	92.3 (1996)	96 (2004)
Under five child mortality (per 1,000)	19	14 (2007)
Infant mortality (per 1,000 live births)	16	13 (2007)
Population (millions)	3.4	3.8 (2007)

Source: BH statistics agencies, BH Living Standard Measurement Study 2004, HBS 2007, World Development Indicators database (July 2009), and World Bank estimates.

*(2008 preliminary data)

During the three and-a-half-year war that ended in late 1995, at least 100,000 people were killed or went missing, some two million people were displaced, land mines riddled the landscape, the infrastructure and economy were almost completely destroyed, and services devastated. In the intervening years, infrastructure and basic services have been restored, while the country and its people have made substantial progress in their overall economic and social development. Beyond reconstruction, the country's focus now is on deepening reforms, joining the EU and achieving a successful economic transition.

IDA has supported BH's reconstruction through significant investments and worked with the European Commission (EC) and many other donors towards mobilizing unprecedented levels of assistance for the war-torn country.



COUNTRY ACHIEVEMENTS

Three and a half years of war left a heavy toll but Bosnia and Herzegovina has achieved an impressive post-conflict recovery. The challenge now is integration in Europe.

BH exited from the war devastated and divided, riddled with mine fields, with police and military check points preventing even the essential freedom of movement. By the end of 1995, BH's output had fallen to just 10-30 percent of the prewar level. GDP had collapsed to less than US\$500 per capita, about 20 percent of its prewar level. Most of the basic infrastructure and services were shattered and more than 80 percent of the population received some form of food aid. The level of destruction was such that the total amount of war damages was never fully calculated. In Sarajevo alone, damages amounted to EUR 14 billion during the capital's record-long 1,417-day siege.

Nearly 14 years after the war, the country has made tremendous progress in post-conflict reconstruction, rehabilitation of basic infrastructure and services, social integration, and state building. BH today is in the process of integrating into Euro-Atlantic structures—something few would have dared to predict back in 1995 when the country lay in ruins. BH is working toward accession to the European Union (EU) and membership in the World Trade Organization. In December 2006, BH was invited to join NATO's "Partnership for Peace" program.

The country is also making important strides toward EU integration. BH reached an important milestone in June 2008 with the signing of a Stabilization and Association Agreement (SAA) with the European Union (EU), joining the other countries of the former Yugoslavia with formal accession contracts with the EU.

The country's capital base has been effectively restored to almost pre-war levels, with housing rebuilt, energy supply reestablished throughout the country and transport infrastructure restored. Schools and medical facilities have been reconstructed with a new family health care system put in place and educational reforms underway.

Before being affected by the international economic slowdown at the end of 2008, BH managed to triple its GDP compared to 1995, with real GDP growth averaging 5 percent since 2000. All this has been done while preserving peace and stability.

Some progress was made on poverty reduction, although economic growth has not been particularly pro-poor. BH, supported by a strong effort of the international community, showed good progress on the Millennium Development Goals (MDG).

Many challenges still remain. The complex institutional and political environment continues to slow the reform process and development of institutional infrastructure supportive of market economy and EU integration. As expected in a small open

A Turning Point

As the UNDP 2004 Millennium Development Goals for BH update report notes, BH is facing a turning point “...away from aid dependency towards a genuine ownership of the development process... BH must therefore mobilize all the resources at its disposal—physical, social and human endowments—to achieve equitable economic development and sound governance reform. Membership of the European Union is both central to achieving these objectives and an end in itself. The accession process presents both the opportunity and the means by which BH citizens can come to secure the same economic prosperity and the social entitlements enjoyed by other Europeans. The eight MDGs continue to help to deliver these objectives by providing a powerful framework for defining BH’s long-term strategic priorities and for measuring and evaluating its progress.”

economy, the global economic crisis spread quickly in BH from the end of 2008, reversing some of the effects of strong growth and putting at risk macroeconomic stability and important economic reforms. The crisis threatens to reverse also recent gains in household living standards. International assistance is also set to decrease markedly in the coming years. Thus BH is focusing now on mitigating and reversing the impact of the crisis (an agreement for an IMF program was reached in June 2009). In the medium term, with the post-conflict reconstruction phase largely completed, the country’s challenges come from the constitutional reform debate and the need to deepen reforms for joining the EU and achieving a fully successful and equitable economic transition.

IDA CONTRIBUTIONS

IDA engaged early and extensively in the postwar reconstruction and development efforts. The first World Bank teams arrived in BH in 1995, even before the fighting fully stopped. IDA has since supported 59 projects to help reconstruction and development of virtually every segment of the war-torn country—housing, energy, transport, schools, etc. Since 1996, IDA has committed close to US\$1.3 billion to BH. The total value of these projects, including Bank-managed funds and counterpart funding, amounts to more than US\$3 billion.

A review carried out by the Independent Operations Evaluation Department (OED) in 2004 found the BH reconstruction program to be an example of “the Bank at its best.” Together with resources from the European Union, and other donors, exceptional levels of per-capita support have helped BH repair its infrastructure, develop economically and move towards deeper structural reforms. This exceptional post-conflict allocation represents some 53 percent of the total value of the financial aid package pledged by the entire international community to support the peace process. Due to BH’s initially weak absorptive and managing capacity, this financing for the first few post-war years was made under simplified procedures, yet fully respecting all basic professional principles.

The Reconstruction Phase

Consolidating a fragile new state. The Dayton Peace Accord left BH with a complex political and administrative system which represented a special challenge for IDA and other international partners operating in the country. The state comprises two entities with different institutional setups—one

centralized entity (Republika Srpska) and one federation of cantons (the Federation of Bosnia and Herzegovina)—with a weak and decentralized state government. Reconstruction efforts therefore required technical skills and political sensitivity.

IDA often acted as a catalyst and facilitator bringing together different local parties behind joint projects and endeavors. In this way, IDA contributed not only to the implementation of specific projects, but more generally to social reconciliation within the country.

Mediation

“In Bosnia in 1995, there was no way the warring parties could discuss reconstruction; they could not even agree where the discussion should be located,” recounted author Sebastian Mallaby in his book *The World’s Banker* (2004). *“It took the World Bank’s mediation to focus the Bosnians on practical problems: Should there be a central bank? How to reconcile conflicting tax and customs systems?”*

Strengthening communities, promoting social inclusion. The war and immediate post-war period in BH had a serious impact on the basic fiber of BH’s society, shaking its local communities. The Bank paid special attention to strengthening these communities—essential building blocks in BH’s reconstruction, reconciliation and development efforts. IDA financed a community development project which reached about a quarter of the country’s population through small infrastructure projects selected locally, as well as two local initiatives projects which introduced micro-financing to BH and helped sustain or create some 200,000 jobs. While social inclusion was not the main objective of these projects,

they have contributed to social inclusion in a number of ways.

Under the Bank’s micro-finance projects, 50 percent of borrowers were women. This has strengthened women’s role in the family and helped support female-headed households—an important contribution given that the war left many households without male heads of families.

Participatory decision-making introduced under the community development project facilitated greater involvement of minority groups (including returnees and Roma populations) and other vulnerable groups (for example, youth, women, disabled, people with special needs) in selecting development priorities in their respective communities.

Combining resources with analysis and policy advice. IDA’s financial assistance was often based on in-depth analytical work, which assessed existing conditions, challenges, needs and potential developments in a given sector. For example, the first two power sector reconstruction projects financed by IDA supported the preparation of power sector development strategies in BH which then underpinned the following two power sector projects, financed by IDA and many other donors.

A second Living Standard Measurement Study (LSMS) supported by IDA provided crucial data for a variety of activities in a country where local statistics agencies had not yet reached their full potential. Some of the most recent - and well-received - World Bank reports included a labor market study, a public expenditures and institutional review, pension study, assessment of social benefits, and local governance study.

Working on Many Fronts

In a country utterly devastated by war, IDA's ability to work across sectors and on many fronts has produced a wide range of results:

Housing, heating and gas. A majority of the country's population in 1995 lived in war damaged houses and apartments, without glass windows and with improvised heating. In the immediate post-war period, over 22,000 public apartment units and private houses were repaired under IDA housing and emergency reconstruction projects. Two other IDA projects helped revive Sarajevo's district heating system and rehabilitate the country's gas network so it would provide a reliable and safe gas supply.

Power and water systems. At war's end, most of the country had no regular water and power supply. The destruction of BH's power grid has not only left BH citizens without power supply, but has also disconnected the Southeastern Europe power grid from the rest of Western Europe. Damaged and neglected water systems suffered from significant water losses. Over the past decade, hundreds of kilometers of power and water lines, transmission stations, and thermo and hydro power plants were rehabilitated through four electrical power and three water reconstruction projects.

Road and Transportation. Most of the bridges were destroyed during the war and the road network was damaged by military activities and lack of maintenance. About 2,300 kilometers of roads, 41 bridges, 3 tunnels and Sarajevo's International Airport were rebuilt through three IDA transportation reconstruction projects.

Education. IDA projects helped to restore, furnish and equip 82 war-damaged primary schools. The overall education system was modernized. Over 100 new textbook titles have been published and distributed to pupils across the country. The government's priority program for school reconstruction was estimated at US\$275 million—of which IDA financed US\$21.5 million.

Health. Five clinical centers and 15 hospitals, damaged in fighting, were rehabilitated, 24 medical facilities equipped, and health care professionals trained. The family medicine model was introduced and has spread rapidly, now covering about 25 percent of the country, thanks to four IDA health projects.

Forestry. One of the key economic activities in BH before the war, forestry, suffered due to war damages, lack of proper maintenance and extensive mine fields. After one IDA project helped clear mines, some 550 hectares of new trees were planted, 210 kilometers of existing forest roads were reconstructed and new ones were built under two subsequent forestry projects.

Employment. Two IDA employment projects stimulated job creation, a key challenge in post-war BH. In addition, 200,000 jobs have been created or supported under two local initiatives microfinance projects, under which some 350,000 microcredits were disbursed and sustainable microcredit industry was created. A social sector adjustment credit helped increase labor market flexibility, by supporting the reform of employment conditions and of unemployment and job placement legislation. A labor market study conducted by the Bank was also influential.

Banking sector. An enterprise and bank privatization credit helped shore up BH's banking system. Banks have seen their total assets increase by almost 100 percent over the four years preceding the global crisis, enjoy good level of confidence., and are weathering the global crisis better than in the rest of the region.

Public spending. A labor redeployment project set a model for the social integration of former soldiers into civilian life by providing employment services to over 7,000 ex-professional soldiers. At the same time, this has reduced political pressure on policy-makers and allowed them to maintain fiscal stability. In addition, two policy loans targeting public finance management have had a significant impact. Independent audit institutions and new treasury systems have been set up and the overall budget management was strengthened. Four health and one social sector projects supported initiation of health and pension reforms, which helped to improve effectiveness and reduce the share of public spending of these two sectors.

Lessons from a Successful Recovery

Bosnia and Herzegovina's successful reconstruction offers useful insights for international assistance in post-conflict countries:

- Engage early and strong. IDA and the EC mobilized resources even before the end of hostilities in late 1995. Altogether, donors pledged more than US\$5 billion at the Dayton conference. This financial package offered the prospect of reconstruction and a welcome return to normalcy, and helped seal a peace deal between warring parties.
- Maintain a strong field presence. Post-conflict situations are complicated and involve a multitude of players and organizations. Presence on the ground is essential to monitor projects, maintain coordination with other donors and respond quickly to eventual changes.
- Start structural reforms earlier. Although BH performed well on the basic reconstruction front, it was slower in undertaking key structural reforms and now lags behind other transition countries.
- Strengthen the government's capacity to formulate strategy and implement reforms.
- Adapt projects to local realities. Contrary to investment projects, which have had an excellent track record, some development policy loans proved to be too unwieldy for the already complex BH political and administrative apparatus. Policy loans need to be less complex and more targeted.

From Reconstruction to Development

Supporting policy reforms. With most of the basic reconstruction work completed and infrastructure levels raised to almost pre-war levels, a greater emphasis in recent years has been placed on fundamental structural reforms critical to the emergence of a market economy. IDA assistance has focused on providing financial and analytical support to foster private sector-led growth and employment, strengthening institutions and governance, reforming the public sector, and encouraging social sustainability.

Although a significant outstanding reform agenda still remains and policy discussions have not always proved easy, IDA support kick-started several important reforms in the country. These include the reform of the banking sector, which is now considered one of the strongest in the region; the early stages of pension system reform; and ongoing efforts aimed at improving the efficiency and transparency of the public land registration system.

In 2009, the Bank is supporting BH with a study on reforming social assistance transfers. BH spends 4 percent of GDP on non-insurance social protection cash transfers, mostly for programs based on defined benefits acquired during the war period. This is the second highest level in the World Bank's Europe and Central Asia (ECA) region. These transfers are neither fiscally sustainable nor well targeted to reach the poorest. The Bank has worked closely with authorities at both the State and Entity level to identify approaches to reform these payments and achieve greater sustainability and higher poverty impact.

Regional cooperation. IDA is helping BH implement lessons from a July 2008 Bank study on deepening regional and EU integration across the Western Balkans, which looks at long-term growth issues, including trade performance, regional integration, and the investment climate in the different countries of the region. The study urges countries in the Western Balkans to deepen regional and EU integration, further develop human capital

and reduce telecommunication costs in order to sustain economic growth. In this context, IDA is preparing to support BH and its regional neighbors reclaim the River Sava for navigability, which will permit passage of vessels of 3,000 tons between Sisak and Belgrade for the first time since 1990. The proposed project is supported by the EC and the Regional Cooperation Council, and involves the four riparian countries under the auspices of the International Sava River basin Commission.

Enhancing the role of the private sector.

IDA has played an important role in improving BH's business environment. IDA supported lines of credit with components to strengthen participating financial institutions; adjustment credits to strengthen banking reform; and guarantee operations to support the establishment of an insurance agency to underwrite private investments and exports. Important progress has also been achieved in business registration, inspections, licensing and bankruptcy procedures. This support has contributed to a sharp jump in export performance, with export growth surpassing that of all other countries in the Balkans. Exports growth was 36 percent in 2006, 15 percent in 2007 and 13 percent in 2008.

PARTNERSHIPS

IDA, together with the EU, chaired five international donor meetings which eventually mobilized US\$5.1 billion for BH in the post-war period. This financial package was central to the quick and successful reconstruction of BH's basic infrastructure and services.

In addition to this over-arching donor coordination role, IDA often acted as a focal point for donor coordination in specific sectors. In the power sector, for example, through three

finalized and one continuing project (ECSEE APL3), IDA financing of about US\$130 million was able to leverage a total of almost US\$880 million from other sources, including Austria, Belgium, the BH government, Canada, the Czech Republic, the European Bank for Reconstruction and Development, the EC, the European Investment Bank, France, Germany, Ireland, Japan, the Netherlands, Norway, Spain, Switzerland, the UK and the USA, for a coordinated program of investments and associated sector reforms.

With BH now set on joining the EU, supporting the integration process has become the overarching theme of IDA's country partnership strategy, along with job creation and the improvement of public services. IDA has tailored its support to complement EU efforts to build the country's capacity in this accession process.

CHALLENGES AHEAD

In the short-term: mitigating the impact of the global slowdown. BH has met many of the most intractable challenges related to post-war reconstruction. It has taken important strides toward further reconciliation and development and poverty reduction. New challenges are emerging, however. As with most of the countries in the ECA region, the global economic crisis of late 2008 and 2009 is reversing some of the progress made possible by the strong economic growth of the 2000s and putting at risk macroeconomic stability and important economic reforms.

In July 2009, the IMF Board agreed to support a new US\$1.57 billion Stand-by Arrangement (SBA) to help support an economic program to mitigate the effects of the global financial crisis.

Following extensive policy dialogue, the authorities asked IDA to complement this program with policy lending and technical support to reform the country's social transfers system.

The crisis is placing in even sharper relief the longstanding—and unique—institutional challenges BH faces as a result of the war and its aftermath. Further economic integration of the Federation of Bosnia and Herzegovina and the Republika Srpska into a single economic space is a prerequisite for attracting more investments and making progress in the country's EU accession process.

Becoming a dynamic, self-sustaining economy integrating in Europe. Although BH still requires further investments in many sectors, from urban infrastructure to health, education and transport, the main challenge for BH in the medium-term will be to complete the transition from a largely aid-dependent country to a dynamic and self-sustaining economy, integrated into Europe.

Due to the war and post-war reconstruction, BH has lost more than a decade in terms of transition reforms compared to other countries in Eastern and Central Europe. Thus, faster reforms, especially reforms of the public sector -- to create new job opportunities, improve competitiveness and foster private sector-led growth -- are needed for BH to compete with other transition economies. The EU accession process will also mandate shoring up state level institutions, procedures and financial management.

Rationalizing and streamlining government spending will be needed to help cope with the pressures of building state institutions, creating an efficient social safety net, and

increasing much-needed capital outlays by the government for infrastructure. Reducing the external deficit further by sustaining fiscal discipline, curbing credit growth, and accelerating structural reforms is also paramount. Keeping corruption in check is also essential to the success of economic reforms.

IDA, looking to the future.

BH is preparing to graduate from IDA, and in November 2008 received its first loan from the International Bank for Reconstruction and Development (IBRD), the nonconcessional lending arm of the World Bank which serves middle-income and creditworthy low-income countries.

Against this background, IDA's current strategy in BH is to be a catalyst for the inclusive and sustainable integration of BH's economy in Europe. In the short-term however, IDA is striving to help BH mitigate the impact of the global economic crisis, particularly on the most vulnerable BH citizens. The MDGs continue to help to deliver these two objectives by providing a powerful framework for defining the country's strategic priorities and for measuring and evaluating progress.

As poverty in BH is strongly correlated with formal employment, the IDA's focus is on poverty elimination through economic growth, improvement of the business environment and job creation. Finally, IDA will continue to support improvements in targeting and management of social programs to help reduce poverty through increased efficiency of government spending, particularly when it is directed to the most vulnerable.

July 2009.

<http://www.worldbank.org/ida>