ICR Review
Operations Evaluation Department

Report Number : ICRR11500

1. Project Data:		Date Posted :	05/21/2003	
PROJ ID :	P048461		Appraisal	Actual
Project Name :	Enter & Banking Priv	Project Costs (US$M)	50.0	65.0
Country:	Bosnia-Herzegovina	Loan/Credit (US$M)	50.0	50.0
Sector(s):	Board: FSP - Banking (55%), General industry and trade sector (36%), General energy sector (5%), Central government administration (4%)	Cofinancing (US$M)		15.0
L/C Number:	C3262			
		Board Approval (FY)		99
Partners involved :	Netherlands	Closing Date	06/30/2000	05/31/2002

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2. Project Objectives and Components

a. Objectives

The project's objective was to support the Government's PSD program and specifically : (i) the privatization of enterprises and banks (the first phase of the multi-year overall privatization program); and (ii) the implementation of policy reforms in the private and financial sectors .

b. Components

Actions to achieve the above objective were to be taken by the State of Bosnia -Herzegovina (State), and its two constituent Entities, the Federation of Bosnia -Herzegovina (Federation), and the Republika Srpska (RS). They were as follows:

a) maintenance of a **macro-economic framework** consistent with the reform program supported by the IMF;

b) satisfactory implementation of the **enterprise and bank privatization** program set forth in the Government's Letter of Private Sector Development (PSD) Policies to the Bank of February 25, 1999; and

c) completion of **specific actions** under the following areas:

(i) *privatization and restructuring of publicly -owned banks*: development of the design, legal framework and regulations, and building up of the institutional capacity and implementation of the program for the restructuring and privatization of solvent publicly -owned commercial banks and liquidation of insolvent ones;

(ii) *financial sector reforms*: improvement of bank supervision, strengthening of banking laws, establishment of deposit insurance systems, and limitation of public intervention in credit markets; and

(iii) *privatization of public enterprises and private sector development* : completion of the institutional and legal framework for enterprise privatization, rapid initiation of small enterprise privatization, and preparation for privatization of larger enterprises, holding companies and utilities; reforms of the legal and institutional framework necessary for PSD.

c. Comments on Project Cost, Financing and Dates

After approval of the Credit, the Government of the Netherlands provided US$ 15 million in grant, disbursed at the same time as the first tranche of the IDA Credit, bringing total costs and financing to US$ 65 million.
The closing date was postponed five times, about two years after the original date, for three main reasons : (i) the privatization process of banks and enterprises took much longer than expected; (ii) during project implementation, it became clear that some actions/reforms had to be taken at the State rather than at the Entity level for efficiency and/or institutional reasons; and (iii) the clarification of the solvency of the Federation largest public bank and its

subsequent privatization process proved much more complex than originally anticipated.

3. Achievement of Relevant Objectives:

The country maintained a satisfactory macro-economic framework consistent with the IMF Stand-By and made substantial progress in implementing its program, as submitted in its Letter of PSD Policies.

The following was achieved in terms of specific conditions for tranche release:

1) **At the State level.**

At Board approval, it was not anticipated that any tranche-specific action would have to be taken at the State level, except for the promulgation of the State Privatization Law. This was done. However, during project implementation, it became clear that, in two cases, actions were preferable at the State rather than at the Entity level. First, under the *financial sector reform* agenda, the State adopted a Law on a Deposit Insurance System because it had been determined that a deposit insurance scheme for each Entity would not be viable given the small banking sector in each one (this change caused some delay). A single Deposit Insurance agency was fully operational by the last quarter of 2002. Second, under the *privatization of public enterprises and private sector development* agenda, in the telecom sector, a single State-level Communications Regulatory Agency was established, covering the entire country.

2) **At the Federation level.**

Under the *bank privatization and restructuring* agenda: (i) a fully functioning Bank Privatization Unit (BPU) was established; (ii) after the privatization of the Federation Investment Bank (FIB) proved unsuccessful for lack of investor interest, it was transformed into a development agency (Federal Foreign Donor Funding Management Agency) operating under a non-bank mandate and not eligible to receive public domestic funds (this transformation also caused delay); (iii) the largest public bank was sold to a Special Purpose Vehicle, owned in approximately equal shares by IFC, a private investment group, and the Government; and (iv) a prospectus for the sale of two other public banks was issued.

Under the *financial sector reform* agenda: (i) no credit lines from budgetary resources were extended to banks other than to FIB; and (ii) no new publicly-owned bank was established or the capital of any existing one increased.

Under the *privatization of public enterprises and private sector development* agenda: (i) the Law on Enterprise Privatization was amended to be in conformity with the State Law; (ii) the Law on Management Companies and Privatization Investment Funds was adopted; (iii) the Cantonal privatization agencies were established and fully operating; (iii) 199 small-scale enterprises and 2000 assets of small enterprises, including 700 business premises, were privatized; (iv) the initial public offering for more than 100 large-scale enterprises was launched; (v) the prospectus for the sale of a holding company (Unionvest Holding) was issued; and (vi) the regulatory framework for the privatization of the energy sector was established.

3) **At the Republika Srpska (RS) level**.

Under the *bank privatization and restructuring agenda and the privatization of public enterprises and private sector development* agenda, a Law on Opening Balance Sheet providing for a secure basis for the rapid privatization of banks and enterprises was adopted.

Under the *bank privatization and restructuring* agenda: (i) a fully functioning BPU was established; (ii) the Law on Bank Privatization was adopted; and (iii) four publicly-owned banks were sold while three insolvent ones were under provisional administration or liquidation.

Under the *financial sector reform* agenda: (i) no credit lines from budgetary resources were extended to banks; and (ii) no new publicly-owned bank was established or the capital of any existing one increased.

Under the *privatization of public enterprises and private sector development* agenda: (i) the Law on Enterprise Privatization was adopted; (ii) 115 out of a total of 283 (41% of total against a target of 30%) small-scale enterprises were privatized; (iii) international tenders were issued for the privatization of majority stakes in 21 large enterprises against a target of 3; and (iv) a prospectus for the privatization of parts of the Jelsingrad Holding Company was issued.

4. Significant Outcomes/Impacts:

Four significant outcomes: (i) the country has now a strong legal and institutional framework for the privatization of enterprises and banks; (ii) the reform of the financial sector has considerably contributed to the restoration of confidence in the banking sector, both internally and externally, as demonstrated by the interest of some foreign banks in entering the market; (iii) by establishing a legal and institutional framework for the privatization of enterprises, the project has facilitated private sector development; and (iv) 90 % of the assets of the banking system and 50 % of small enterprises were privatized.

5. Significant Shortcomings (including non-compliance with safeguard policies):

(i) There was a significant shortcoming with respect to expected outcome : actions under the project took much longer than anticipated at appraisal. The closing date had to be postponed 23 months to 5/31/02 to allow for all conditions to be met. The delay was mainly due to a longer-than-expected preparatory phase in the privatization process and to the establishment of new governments following the fall 2000 elections.

(ii) The largest bank in the Federation, Privredna Banka Sarajevo (PBS), was not liquidated as originally agreed. The Bank waived that condition in exchange for agreeing to an action program for reducing the liabilities of the banks that constituted PBS. Eventually, PBS was privatized by sale to a Special Purpose Vehicle.

(iii) FBI was not sold as originally agreed.

6. Ratings:	ICR	OED Review	Reason for Disagreement /Comments
Outcome:	Satisfactory	Satisfactory	
Institutional Dev .:	Substantial	Substantial	
Sustainability :	Likely	Likely	
Bank Performance :	Satisfactory	Satisfactory	
Borrower Perf .:	Satisfactory	Satisfactory	
Quality of ICR :		Unsatisfactory	

NOTE: ICR rating values flagged with ' * ' don't comply with OP/BP 13.55, but are listed for completeness.

7. Lessons of Broad Applicability:

In spite of a difficult post-conflict situation, if there is commitment to reform at the highest level, even a complex adjustment operation may be quite successful.

In complex bank or enterprise privatization cases, it pays to resort to specialized outside expertise early on in the process.

8. Assessment Recommended? ● Yes ○ No

Why? As part of a cluster of PSD operations, including TA projects, which followed the project reviewed here. This would allow for a judgment on PS and banking sector progress /performance over a longer period.

9. Comments on Quality of ICR:

The ICR is rated unsatisfactory because: (i) the key sections on achievements and outcomes are poorly organized and difficult to follow (poor structure, poor English, poor punctuation, and unnecessary repetitions - it would have been easier and much clearer to discuss achievements systematically in the same order as in the Credit Agreement); as a result, the thread of the analysis is easily lost; (ii) there is no clear and comprehensive discussion of the reasons for the delay in meeting tranche release conditions while the President's Report expected full disbursement within a year - the dates on which the tranches were released are not even mentioned; and (iii) the cost table in annex is wrong and there is no table on disbursement.