

## VI. RISKS

103. **The principal risk in BH is continued political fragmentation and stalemate.** Based on the Bank's previous experience with policy lending in BH, the risk of policy reversal is significant. In particular, failure to advance with sensitive reforms in social assistance benefits agreed to under DPO I or an overall deterioration of the macroeconomic framework would lead to postponing or even cancelling DPOII. In this case the Bank will consider reallocating the remaining IBRD resources (about US\$50 million) to investment operations. Moreover, should completion of the reform of the social benefits system languish, fulfillment of expected outcomes in competitiveness and social inclusion would also be put at risk. It would undermine progress toward gains in fiscal stability and stall reductions in the labor tax wedge; and, most important, the goal of targeting scarce resources to the truly poor will be once again postponed. To help mitigate this risk, the Bank will engage in policy reforms under the DPO series only if there is demonstrated political willingness to undertake them. Technical assistance on benefit targeting is underway, and social inclusion is fully integrated into the Government's dialogue with the IMF. Finally, specifically related to Bank resources, the Bank is ready to reallocate the original amount of IBRD financing remaining from the FY08-FY11 CPS to high impact investment operations. The Bank will help mitigate the negative impact of a prolonged political stalemate to the operations through: strong partnership with the EC, *in primis*, the IFIs, and other development partners, and by adhering to the principle of the single economic space.

104. **Prolonged volatility and slow growth in the euro zone and neighboring countries may undermine BH's economic recovery.** In light of the concentration of BH' trade with Europe and neighboring countries, the implications of slow growth in these regions or of a deepening of the sovereign debt crisis in the Euro zone, may be great for the BH economy and put pressure on the currency board arrangement. While the mitigation of these risks is largely beyond the scope of this CPS, the Bank remains focused on monitoring the evolution of the crisis in Europe and in the ECA region to provide timely advice on the implications for the BH economy. Additionally, the CPS program is focused on removing some of the bottlenecks to competitiveness and productivity and on creating an effective and affordable safety net.

105. **Third, extreme weather events and growing variability in rainfall and temperature are already affecting the ECA region, and BH is among the most severely affected countries in the region.** Intensifying flooding and drought could undermine growth in a number of critical areas to BH's development, including agriculture, forestry and hydro-power. Planned operations in irrigation, regional flood control and catastrophe risk mitigation should help BH prepare for these potential challenges.