

EXECUTIVE SUMMARY

i. **Bosnia and Herzegovina (BH) has accomplished a great deal since the 1995 Dayton Peace Accords helped bring an end to the worst bloodshed on European soil since World War II.** Most important, BH citizens and authorities have restored peace. Despite intense political debate and lingering ethnic division, there is no popular will for a return to violence. BH is a European Union (EU) potential candidate country and moving, though fitfully, toward alignment with EU *acquis* requirements. The authorities have also established a solid record of economic management. Between 1998 and 2008, per capita GDP nearly quadrupled and poverty dropped from nearly 20 to about 14 percent. Perhaps most impressive, a decade and a half after the end of fighting, BH's citizens have managed these achievements within a decentralized and highly complex political and institutional structure which frustrates decision making.

ii. **Critical development challenges remain.** First, the country is embarking on a new growth model dependent on exports in a period of slow growth and escalating financial volatility in Europe, while at the same time its neighbors are undertaking similar strategies. BH has to become more competitive. This will require upgrading in physical infrastructure, business environment and human capital. It will also require greater coherence in the country's highly decentralized administrative system to create a real "single economic space" *within* BH. Second, more needs to be done to complete the reform of the mostly "rights based" social benefit policy which diverts assistance from the truly poor and weakens the efficiency of the labor market. Third, BH is rich in natural resources and one of the most biologically diverse countries in Europe; but its natural resources need to be used sustainably. As throughout South East Europe, climate change threatens not only BH's natural beauty but key sources of growth, such as agriculture, forestry and hydropower.

iii. **Addressing these challenges will require overcoming the current political stalemate which is undermining coordination in key sectors and threatens the reform process.** A government coalition at the State (i.e. central) level has still not yet been agreed, nearly a year from the October 2010 national elections. Still, the Bank Team confirmed during extensive engagement with each Entity and at the State level that the authorities at all levels of government agree on the above challenges, and on proposed solutions. Moreover, for the past three years the State and Entity governments have been pursuing a jointly authored development strategy centered on macroeconomic stability and economic growth, employment and social cohesion, and sustainable development. Explicit in each of these pillars is the overarching goal of EU accession, which is identified as the strategy's guiding principle.

iv. **The Bank Group's objective during the FY12-15 CPS is to support BH through knowledge services and targeted financing, coordination with European financial institutions, and an expanding partnership with the EU, including EU co-financing of the Bank financed operations.**

- **Competitiveness:** Interventions in the early years of the CPS would include continuation of a Development Policy Operation (DPO) series to support macroeconomic stability, including public expenditure reform, and investments in irrigation, land registration, and regional transport, and through stimulating SMEs access to capital. In addition, IFC will continue to provide support through its advisory services in the areas of regulatory reform and regulatory simplification as well as investment policy work.
- **Social Inclusion:** The existing portfolio will continue to support improvement in living standards, including expanding access to primary health care through family medicine, as well as to basic public services; and on-going and new interventions, including, a DPO series, which will help reform the social assistance program to target benefits to the truly poor and strengthen pensions.
- **Environmental Sustainability:** BH is vulnerable to climate change. The Bank is supporting projects to help ensure the sustainable use of natural resources, such as water and forestry, with which BH is extravagantly endowed, and to prepare for growing risk of floods and droughts.

v. **World Bank Group support will be guided by four principles of engagement.**

- **Selectivity:** Limited financing and budget will place a premium on the strategic allocation of Bank resources. The CPS will see a major consolidation of the portfolio, which will free up resources for timely analytical products. Nevertheless, with fewer Bank-financed projects under implementation, staff will be able to meet the growing demand to implement externally (mostly EU) co-financed operations.
- **Flexibility:** A number of projects postponed from the previous CPS will absorb the bulk of new financing in the first years of the new CPS. The selection of interventions for the outer years will be determined at an early CPS progress review as reform priorities for the newly elected authorities evolve, and depending upon performance of the ongoing programs and availability of funds.
- **Results:** Notwithstanding a challenging environment in BH, the Bank Group is delivering significant results, with an efficiently disbursing portfolio meeting clear development objectives. This CPS has been developed to consolidate and build on these results.
- **Partnership:** Virtually all assistance will be designed to support BH's EU accession; and the Bank will continue to expand innovative partnerships with the EU and European financial institutions active in the Western Balkans to leverage external support and integrate programs.

vi. **The CPS is consistent with the Bank Group's regional strategy for Europe and Central Asia (ECA).** The Strategic Pillars of the ECA Strategy are: (i) Deepened Reforms for Improved Competitiveness; (ii) Social Sector Reforms for Inclusive Growth; and (iii) Climate Action for Sustainable Growth. This is appropriate as the challenges for ECA as a whole are similar for those in BH. The drivers of pre-crisis economic growth are unlikely to return quickly. Fiscal pressures and an increase in poverty have underscored the importance of efficient social spending. And while climate threats vary throughout the ECA region, BH, and southeast Europe in general, is highly vulnerable to climate change.

vii. **World Bank financing will remain constrained.** IDA credits are expected to amount to roughly US\$148 million, including IDA regional resources, and be allocated to five or six investment operations. Trust funds—particularly those financed by the EU—will complement and expand the scope of the WBG's operations.

viii. **IBRD financing during the CPS will focus on policy reform.** At present, IBRD resources would be limited to policy lending to leverage reforms initiated under the previous CPS. The current indicative plan, assuming an appropriate governance and macroeconomic policy framework, is to prepare the second in the DPO series (US\$100 million), which would aim at consolidating reforms in BH's social benefits system and advance reforms in public wages and pensions. Board presentation of this operation is tentatively planned for later in FY12. Additional IBRD lending to support the third DPO will depend on satisfactory country performance, demands from other IBRD borrowers, and IBRD's lending capacity.

ix. **IFC expects to increase financing to the private sector to a level of US\$80-\$100 million.** Financing will support competitiveness and sustainable development, with planned activities—direct financing and advisory services—in the financial sector, agribusiness and the energy sector. IFC also plans advisory services to promote PPPs in infrastructure services and support improvements in the country's business environment.

x. **The CPS is subject to two principal risks.** The first is continued political fragmentation; this would undermine crucial economic reforms, slow progress toward EU accession and disrupt the Bank's programmatic DPO series. Second, prolonged volatility and slow growth in the eurozone could stall BH's recovery and weaken efforts to implement Bank supported activities and undermine competitiveness.