

## IDA AT WORK

# Bosnia and Herzegovina: From Reconstruction to Development

**B**osnia and Herzegovina is on the mend. 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 past decade, refugees have returned in great numbers, infrastructure and basic services have been restored to almost pre-war levels, 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.

Country Indicators	1995	2005
GDP per capita (US\$)	780	2,600
Average inflation (%)	39.5	2.8
Total public debt (% of GDP)	73.2	45.4
Fiscal balance (% of GDP)	-8.1	+0.7
F.D.I. net inflows (US\$ millions)	67	522
Poverty incidence (%)	19.1 (2000)	17.8 (2004)
Gross primary school enrollment rate (%)	92.3 (1996)	96 (2004)
Under-five child mortality (per 1,000)	12.1 (1998)	8.5 (2004)
Maternal mortality (per 100,000 live births)	9.4 (1990)	2.9 (2002-04).
Population (millions)	3.4	3.8

Sources: BH statistics agencies, Living Standard Measurement Study, UNICEF and World Bank estimates.

The International Development Agency (IDA), the World Bank's fund for the world's poorest countries, supported Bosnia and Herzegovina'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

### **Bosnia-Herzegovina has achieved an impressive post-conflict recovery.**

#### **Three and a half years of war left a heavy toll.**

Bosnia and Herzegovina (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 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. A recently published local study claims that in Sarajevo alone, damages amounted to 14 billion euros during the capital's record-long 1,417-day siege.

#### **Reconstruction efforts have paid off.**

Eleven 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'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.

Since 1995, extreme poverty has been eradicated, GDP has tripled, and merchandise exports are up tenfold, while price stability has been maintained with inflation rates below 1 percent in 2004 and 2005, based on a currency board arrangement. All this has been done while preserving peace and stability.

## IDA CONTRIBUTIONS

IDA has played a significant role in BH since 1996, investing roughly one billion dollars in a reconstruction program deemed highly successful by the Bank's Independent Evaluation Group. Together with resources from the EC, exceptional levels of per-capita support have

helped BH repair its infrastructure, develop economically and move towards deeper structural reforms.

One decade after the war, IDA and the EC remain the two biggest providers of financial support for the country.

### **International assistance helped overcome the challenges of peace-building in BH.**

#### **Consolidating a fragile new state.**

Bosnia and Herzegovina's complex political and administrative system, created by the Dayton peace accord, represented a special challenge for IDA and other international organizations and donors operating in the country. The state comprises two entities with different institutional setups—one republic (the 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 and political savvy.

IDA often acted as a catalyst and skilled facilitator bringing together different local parties behind joint projects and endeavors. For example, an IDA power sector project helped create a new state power transmission company, and several credits helped establish a single deposit insurance agency and a single business registry for companies in both entities.

In this way, IDA contributed not only to the implementation of specific projects, but more generally to social reconciliation within the country.

#### **Mission Sarajevo**

"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?"

#### **Mobilizing significant resources.**

IDA engaged early and extensively in the post-war reconstruction and development efforts. The first World Bank teams arrived in BH in 1995, even before the fighting fully stopped. IDA has since supported 53 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 a total of US\$1.1 billion to BH—more money on a per capita basis than in any other post-conflict country to date. The total value of these projects, including Bank-managed funds and counter-part funding, amounts to US\$2.74 billion.

This exceptional post-conflict allocation represents some 53 percent of the total value of the special US\$5.1 financial aid package pledged during the Dayton peace talks in late 1995 by the international community.

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. BH continues to

receive exceptional access to IDA resources as the country makes steady progress towards credit-worthiness.

### **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.

An ongoing, second Living Standard Measurement Study (LSMS) supported by IDA provides crucial data for a variety of activities in a country where local statistics agencies have not yet reached their full potential.

Some of the most recent World Bank reports included a labor market study and a public expenditures and institutional review.

### **Coordinating and catalyzing other donors' support.**

IDA was asked to co-chair, together with the EC, five international donor meetings which eventually mobilized US\$5.1 billion for BH. This financial package was central to the quick and successful reconstruction of BH basic infrastructure and services. International support, especially in the immediate post-war period, was provided within the context of needs assessments undertaken in all key sectors.

In addition to this over-arching donor coordination role, IDA often acted as a focal point

for donor coordination in specific sectors. One good example is the power sector: through three finalized and one continuing project, IDA financing of US\$130 million was able to mobilize 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 set on joining the EU, integration will certainly be one of the overarching themes of IDA's country assistance for years to come, along with job creation and the improvement of public services. Increasingly, IDA seeks to complement EC efforts to build the country's capacity in this accession process.

IDA and the EC already work in tandem in the following areas: cross border cooperation; stable macro-economic environment; stronger commercial courts; better BH statistics; small and medium enterprises and industrial policy development; agriculture and rural development; environment; energy; transport policy; public administration reform; and anti-corruption policy.

### **Supporting policy reforms.**

Since 2000, with most of the basic reconstruction work completed and infrastructure levels raised to almost pre-war levels, a greater emphasis has been placed on fundamental structural reforms critical to the emergence of a market economy.

IDA assistance has focused on fostering private sector-led growth and employment,

strengthening institutions and governance, reforming the public sector, and encouraging social sustainability.

Although a significant outstanding agenda remains, and policy discussions have not always proved easy, IDA support kick-started several important reforms. This includes 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 a public land registration system.

#### Getting Credit

The success of the banking sector reform and the microfinance sector in BH is reflected in the *Doing Business 2007* report: Bosnia and Herzegovina ranked 7th worldwide in terms of access to finance.

In addition to providing six policy loans, IDA supported reforms through a number of important reports and policy and advisory notes prepared over the past decade. As a direct or indirect result of these efforts, BH managed to maintain macro-economic stability.

While the difficult political environment and regional insecurity still prevent the implementation of key policy reforms, the fact that some basic reforms have been initiated so soon after the conflict is a success in itself.

#### Enhancing the role of the private sector.

IDA has played an important role in improving BH's business environment. Current development policy loans have introduced a one-stop shop for investors, and are expected to significantly reduce the time and cost of

registering a business in BH, as well as the cost of business licensing and permits. A new land registration project will also help to provide greater certainty and security of title. Analytical work, such as the World Bank Group's *Doing Business* report, has also supported policy discussions in these areas.

#### Community development and 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 microfinancing 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.

#### Empowering Women

Under the Bank's microfinance 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.

Through small grants, IDA also supports local non-governmental organizations in their efforts to strengthen civil society and protect the most vulnerable groups.

**In a country utterly devastated by war, IDA's ability to work across sectors and on many different 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 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 Bosnia and Herzegovina'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 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 the Bank financed US\$21.5 million, or 7.81 percent.

**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 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 have sought to stimulate job creation, a key challenge in post-war BH. In addition, **200,000 jobs** have been created or supported under two local initiatives projects, which provided some 350,000 microfinance loans.

A social sector adjustment credit helped increase labor market flexibility (particularly low because of BH's pre-war communist history), 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, now considered one of the best in the region. Banks have seen their total assets increase by almost 100 percent over the past four years and enjoy renewed confidence.

**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

## CHALLENGES AHEAD

Now that many post-war reconstruction challenges have been met, it is critical for Bosnia and Herzegovina to further reconciliation and move from reconstruction to development and poverty reduction. Both post-conflict and ex-communist, the country faces the challenge of implementing difficult structural reforms

to compete with neighboring economies and further improve the living conditions of its citizens.

**Supporting the country's transition to a competitive market economy will be vital, as the international community continues to downsize its political and financial assistance.**

### Post-war Poverty

- In 2004, almost 18 percent of the population lived under the poverty line.
- Unemployment affects officially around 40 percent of the working age population. Although registered rates certainly overstate the problem, recent studies show that unemployment is still in the range of 18–22 percent.

**BH faces a new set of transition challenges.**

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.

Faster reforms—especially improving competitiveness and fostering private sector-led growth—are needed for BH to compete with other transition economies. 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.

Improved business climate should help attract foreign direct investment and harden budget constraints on enterprises to facilitate their

transformation into profit-driven, competitive firms.

Rationalizing and streamlining government spending will be needed to help cope with the pressures of building state institutions, creating a social safety net, and increasing much-needed capital outlays by the government. The authorities also need to reduce the external deficit further by sustaining fiscal discipline, curbing credit growth, and accelerating structural reforms.

Keeping corruption in check by sticking to an anti-corruption action plan is also essential to the success of economic reforms.

### **Becoming a dynamic, self-sustaining economy.**

Although Bosnia and Herzegovina still requires further investments in many sectors, from urban infrastructure to health, education and transport, the main challenge for BH will be to make the transition from a largely aid-dependent country to a dynamic and self-sustaining economy.

To meet this challenge, it will be necessary to reform the public sector and establish conditions conducive to private investment while strengthening the social protection system, thereby improving employment opportunities, including for women and youth, and the livelihoods of the working poor.

These reforms include: easier registration of businesses; an improved inspection system; effective implementation of bankruptcy laws; further privatization of strategic state-owned enterprises; as well as further labor market reforms, including the introduction of active

labor market programs. The EU accession process will also mandate shoring up state-level institutions, procedures and financial management.

Due to the complexity of these reforms and relatively low level of local technical capacity, such reforms still call for strong international financial, technical and political support. While BH has already received exceptional IDA assistance, it has not yet achieved credit-worthiness and cannot borrow from the International Bank for Reconstruction and Development (IBRD), the World's Bank lending arm for wealthier countries.

BH still relies on strong IDA support to achieve its objectives. Graduation from IDA, however, is becoming more likely as BH's credit-worthiness improves, as well as its appetite for larger infrastructure projects which can only be financed by IBRD. For example, the pan-European Vc corridor, a motorway which is expected to link Bosnia and Herzegovina to neighboring European countries, could benefit from resources from IBRD.

### **Lessons from IDA's participation in BH's reconstruction.**

Just over 10 years after the end of the war, Bosnia and Herzegovina's successful recovery offers useful insights.

- 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.

February 2007.

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