At a Glance

- Bosnia and Herzegovina (BiH) needs to continue to implement the strong reform agenda, adopted in 2015, that is helping it move toward European Union (EU) integration.

- The country’s economic model needs to be rebalanced by shifting the engine of growth and job creation to the private sector while reducing the public sector footprint.

- With other development partners, the World Bank Group (WBG) is providing financial and advisory support to ensure implementation of the reform agenda.

- The Bank program focuses on making the public sector more effective and efficient, boosting private sector growth, and building resilience to natural shocks.

Country Context

The political system in BiH is complex, reflecting the provisions of the country’s constitution developed to end ethnic conflict, as well as subsequent changes to the system introduced under the guidance of the international community through the Office of the High Representative.

In July 2015, the Council of Ministers of BiH, Government of Republika Srpska (RS), and Government of the Federation of Bosnia and Herzegovina (FBIH) adopted a joint program of structural reforms known as the reform agenda. This reform agenda presents a rare window of opportunity for structural reforms in BiH, underpinned by a broad national consensus on the country’s critical challenges and priorities and the sustained support of key development partners.

BiH’s key economic challenge is the imbalance of its economic model: public policies and incentives are skewed toward the public rather than the private sector, consumption rather than investment, and imports rather than exports.

The country needs to shift to a business environment conducive to private investment that supports both vibrant small and medium-sized enterprises and the growth of larger companies, facilitates export performance and productivity improvements, and generates much-needed private sector employment.

At the same time as addressing these imbalances in the economic model, the country must also ensure the sustainability and inclusiveness of future growth.
The World Bank and Bosnia and Herzegovina

The WBG Country Partnership Framework for 2016–20 provides analysis, advice, and financing to accelerate the implementation of reforms designed to promote economic growth. To design this new strategy, a systematic diagnostic analysis was carried out to clarify the challenges that BiH faces on the road to growth and prosperity and to identify possible solutions. The fundamental conclusion is that BiH can attain sustainable growth that will benefit broad groups of society only if it takes decisive steps to make the public sector leaner and more efficient and to unleash the growth and job creating potential of the private sector. Through the strategic framework, the WBG supports reforms in three areas:

- increasing public sector efficiency and effectiveness;
- creating conditions for accelerated private sector growth; and
- building resilience to natural shocks.

Key Engagement

Improving Road Connectivity and Safety in BiH. A €58 million International Bank for Reconstruction and Development (IBRD) loan for the Federation Road Sector Modernization Project was approved in August 2016, cofinanced by the European Investment Bank and the World Bank. This project is the first Bank operation in the transport sector in BiH since 2007, reflecting a renewed focus on connectivity and the need to strengthen key economic infrastructure as the country advances toward EU accession.

The project aims to improve road connectivity and safety for users along selected roads and to strengthen capacity for sustainable management of the main road network in FBiH. Fully 178 kilometers of main roads will be rehabilitated, including three tunnels and nine bridges. Additionally, the construction of the new route M17.3 (Neum-Stolac road) should stimulate growth in the southern parts of BiH through improved accessibility to the Adriatic coast, boosting tourism development and creating jobs.

In addition to infrastructure works, the project will support the Public Enterprise Roads FBiH in its efforts to improve the financial sustainability of these and future investments and to streamline climate resilience and road safety considerations into road design and construction, ensuring a better understanding of the network’s potential vulnerabilities to extreme weather and climate change.

The project is the first phase of the BiH Transport Sector Modernization Program and will be implemented in FBiH. The Program, organized as a series of projects, will flexibly support the long-term development of transport in BiH, allowing for subsequent phases to be developed in other parts of the country as technical and financial opportunities arise.

A high-quality, safe, and efficient road network would allow the country’s exporters greater access to markets.
Recent Economic Developments

Growth reached 3.1% in 2016, 0.1 percentage points lower than envisaged by official estimates (BiH Global Fiscal Framework 2017–2019). Consumption remains the main driver of growth. On the production side, agriculture and manufacturing contributed about 80%, together offsetting a contraction in services.

Although beginning to decline, unemployment, especially among the youth, remains high, despite significant improvements in the labor market. The unemployment rate fell from 25.4% in 2016 to 20.5% in the first half of 2017, driven by a fall in the activity rate and a slight rise in the employment rate. Unemployment among the youth has also decreased from 54.3 to 45.8 percent in 2017. These positive outcomes should have translated into a slight poverty reduction in 2017.

2017 marked the end of deflation. The consumer price index declined by an annual average of 0.8% in 2016, as low global energy prices placed downward pressure on overall prices. However, a long winter and a rebound in global energy markets led to increasing prices for fuel and imported food after December 2016, raising consumer prices by 1.1% year-on-year in June 2017. Given the limited growth in nominal salaries, higher consumer prices led to a reduction in real incomes.

Strong fiscal consolidation in 2015 resulted in a fiscal surplus of 0.6% of GDP. Still, fiscal accounts are likely to have deteriorated in 2016 and 2017 to a deficit of 0.6% of GDP due to a stable revenue-to-GDP ratio, combined with an increase in social spending and some recovery in capital spending. Recent Debt Sustainability Analysis confirms BiH is a moderately indebted country with public debt to GDP ratio slightly above 40 percent of GDP.

Economic Outlook

Political uncertainties that could hold back the reform agenda are the highest risk for the medium-term outlook.

Supported primarily by rising domestic demand, economic growth is projected to strengthen from 3.1% in 2016 to 3.5% by 2019. This is considerably lower than the estimated 6% growth needed for BiH to catch up to EU income levels by 2037 and close the gap with other transition economies that are already EU members.

As poverty is strongly associated with unemployment and inactivity in BiH, for economic growth to translate into poverty reduction, improvements in labor market participation and employment will remain key. The implementation of new labor laws in both FBiH and RS, as well as the introduction of support schemes for first-time job seekers, is expected to support improved employment outcomes in 2018. However, as unemployment remains high and real wages are expected to remain largely flat due to the substantial persistent slack in the labor market, poverty is projected to decline at a slow pace over the next couple of years.

The current account deficit is forecast to widen in the short to medium term due to the stronger demand for imports and consumer preference for imported goods.

Overall, in the medium term both fiscal and external deficits will persist until 2019 when a balanced budget is expected to be helped by progress with ongoing structural reform agenda and an ambitious fiscal adjustment. Fiscal consolidation will not be effective if structural rigidities on the expenditure side are not addressed, especially the large public wage bill and sizeable and poorly targeted social assistance.
**Project Spotlight**

**Better than Before - Rebuilding in Bosnia and Herzegovina**

In May 2014, unprecedented rainfall in BiH affected more than 1 million people (25% of the population), and the resulting heavy flooding caused estimated damages and losses equivalent to nearly 15% of the country’s GDP.

In a country where one-fifth of the workforce is employed in agriculture, river floods inundated newly plowed fields and ravaged 81 municipalities, severely disrupting the economy and imperiling livelihoods. The World Bank participated in a systematic recovery needs assessment, led by the BiH authorities and supported also by the EU and the United Nations. The assessment provided a basis for developing effective rehabilitation measures for infrastructure and services in the affected areas.

In response to the crisis, the Bank promptly met the Government’s request to provide financial support for emergency goods and the rehabilitation of high-priority infrastructure by approving a US$100 million from the WBG’s Crisis Response Window. The project was declared effective within a record two and a half months after approval.

Preparation of the project saw an unprecedented effort by the multi-sector WBG team to rapidly design and deliver a high-quality project in response to the emergency. The project was declared effective within a record two and a half months after approval.

**Key project results to date:**

- Overall, by delivering emergency recovery goods and supporting the rehabilitation of regional and local infrastructure, the project has benefited over 580,000 people in flood affected areas. It is estimated that 51% of beneficiaries are women.

- The project has already recovered about 248 infrastructure facilities to pre-flood condition, thus exceeding the end target of 200.