Country Context

The political system in BiH is complex, reflecting the provisions of the country’s constitution established 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.

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.
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 will support 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.
Recent Economic Developments

Economic growth is estimated to have reached 2.8% in 2016, driven primarily by consumption but also investments. The labor income contribution for poverty reduction was limited in the absence of improvements in employment and with wages largely stagnant. As the reform agenda advances, economic growth is projected to accelerate to 4% in the medium term.

Unemployment remains high, with modest improvements in the labor market. The unemployment rate fell from 27.7% in 2015 to 25.4% in 2016, masking a reduction in employment in absolute terms, in spite of the positive economic growth. Unemployment among the youth has decreased but remains high at 54.3%. Given the strong connection of the income of the bottom 40% to labor income, poverty is expected to have remained unaltered.

Consumer price deflation (consumer price index [CPI]) provided a small boost to real incomes. The CPI dropped by 0.3% year-on-year (y-o-y) in November, the 23rd consecutive month of decline. The biggest driver of the fall was imported goods, reflecting low prices, such as food (down 0.6% y-o-y), clothing and footwear (down 8.4%), and outpatient services (down 4.7%). In contrast, notable price rises were seen for alcohol and tobacco, with smaller increases for education, housing, and utilities.

Although strong fiscal consolidation was seen in 2015, fiscal accounts are likely to have deteriorated in 2016. The fiscal balance of BiH was in a positive surplus of 0.7% of GDP in 2015. With the 2016 revenues-to-GDP ratio projected to have remained stable, an increase in social spending and a recovery in capital spending are estimated to have moved the fiscal balance to a deficit of 0.6% of GDP in 2016.

Economic Outlook

Supported primarily by domestic demand, economic growth is projected to strengthen from 2.8% in 2016 to 4% by 2019. The strengthened growth performance will be underpinned by (i) a pickup in investment resulting from expected improvements in the business environment and new energy, transport, and tourism projects; and (ii) higher consumption due to the steady flow of remittances, persistent deflation, and low oil prices.

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, may support improved employment outcomes in 2017.

The current account deficit (CAD) is forecast to improve in the short run due to favorable external conditions (low oil prices and improved external demand for exports). In the medium run, with slow progress on ongoing structural reforms, the CAD is expected to deteriorate from 5% of GDP in 2016 to 6.7% by 2019. As the Government proceeds with its ambitious fiscal adjustment, the consolidated overall fiscal balance is projected to move to a surplus of 1.6% of GDP in 2019. A balanced budget is projected in 2019, on the assumption of progress on the ongoing structural reform agenda.

Political uncertainties that could hold back the reform agenda are seen as the highest risk for the medium-term outlook. Still, continued progress on the reform agenda is evident as the country received a detailed Questionnaire from the European Commission in December 2016 on which its readiness to be granted EU candidate status will be evaluated—the first step in the accession process.
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 International Development Association (IDA) credit from the WBG’s Crisis Response Window. This credit was approved on the very last day BiH was eligible to receive IDA financing. 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 510,000 people in flood affected areas. It is estimated that 51% of beneficiaries are women.
- The project has recovered about 180 infrastructure facilities to pre-flood condition and is expected to exceed the end target of 200 infrastructure facilities.
- Most of the civil works under the project will be completed in 2017, one year ahead of the project closing date (December 31, 2018).