



## **United Nations in Bosnia and Herzegovina**

# **Socio-economic Impact Assessment of the COVID-19 crisis in Bosnia and Herzegovina**

**17 September 2020**

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## Executive Summary

It is impossible to predict when a full economic recovery from COVID-19 will start in Bosnia and Herzegovina (BiH) and what shape it will take. BiH is now moving through a reactivation phase. Safety and health considerations, as well as peaks of resurgence of the pandemic, still slow down economic activity. Navigating through this uncharted territory requires careful balancing of immediate and mid to long-term policy considerations.

The UN Socio-economic Impact Assessment (SEIA) of the COVID-19 crisis in BiH (SEIA) is intended to inform and guide the policy design of the authorities in BiH in response to COVID-19 over the next 12 to 18 months, and also provide medium- and longer-term policy recommendations, as well as help mobilize resources for recovery. These recommendations can help institutions and other stakeholders build a recovery plan by putting forward aspects of inclusiveness and sustainability.

The SEIA in BiH is based on [the UN Secretary-General's Shared Responsibility, Global Solidarity Report](#) and the [global UN operational framework, which](#) includes five pillars: health first, macroeconomic response, economic response and recovery, protecting people, and social cohesion and community resilience. It is based on assessments and studies of COVID-19's impact by UN agencies, donors and International Financial Institutions (IFIs) and analyses and policy decisions of the authorities in BiH.

The SEIA provides **one UN integrated and country-specific socio-economic impact analysis**, articulating the effects of COVID-19 and providing recommendations. The broader guiding reference of the SEIA recommendations remain the 2030 Agenda for Sustainable Development and its central promise to “*leave no one behind*”. Core to this is the UN's role in assisting with building back better, greener and fairer, and helping to preserve gains across all Sustainable Development Goals (SDGs), with a focus on those who are most vulnerable. The near-term socio-economic impact of the pandemic in BiH has been profound. Every person has been impacted and no sector is immune, and it is intensifying the equity gaps across society, putting at risk decades of social and economic progress, especially for those who are most vulnerable. It will be essential to keep the SDGs at the very core of the plans and actions to respond and recover from the crisis.

The SEIA is prepared by the UN Development Programme (UNDP) as the technical co-lead of the BiH UN Country Team's Socio-Economic Task Team (SETT) under the leadership of the UN Resident Coordinator, with input from UN agencies leading or participating in the five pillars. The SEIA thus gathers the collective expertise of the UN in BiH.

In the short-term, fighting the public health dimension of the pandemic (pillar one of COVID-19 response), protecting jobs (pillar three), and social protection (pillar four) demand more from the authorities in BiH than initially envisaged in the spring of 2020. The immediate response has to fit within a mid-term sustainable macroeconomic framework (pillar two). Making it sustainable requires broad restructuring efforts in the mid- to long-term in the face of the pandemic's consequences.

Recommendations are grouped under three time-perspectives: (1) *immediate responses* – which relate to measures to be implemented now, with an expected immediate impact; (2) the *immediate to mid-term* measures - which need to be designed now and implemented as soon as possible, while their impact is expected to unleash growth potential starting from 2021; and (3) the *mid- to long-term* – refers to policies and measures which take more time to prepare and implement. These are not critical for the immediate crisis response, but they are critical for sustainable recovery after the health risks of the pandemic pass away. The third group of policies and measures is included in the document because neglecting it under current pressures would hinder economic development for years to come.

The following five tables provide a summary of findings and recommendations.

| <b>Pillar 1: COVID-19 Pandemic and Health</b>   |  |
|---|--|
| <b>Findings</b>   | <b>Recommendations</b>   |
| <p>F1.1 Implemented public health and social measures were appropriate, but their effectiveness was partly hindered by insufficient management, coordination, and risk communication skills.</p> <p>F1.2 Better understanding of summer rise in infections is needed in order to increase effectiveness of public health and social measures.</p> | <p><b>Immediate response</b></p> <p>R1.1 Analyse factors behind summer rise in infections, strengthen management, coordination, and crisis communication to affect peoples' behaviour.</p>   |
| <p>F1.3 Case management system is facing capacity constraints for efficient implementation of testing, tracing, and treatment.</p>  | <p><b>Immediate response</b></p> <p>R1.2 Enhance dual-track surveillance system and establish Rapid Response Teams for case investigation.</p> <p>R1.3 Support case management training and screening/triage services at first point-of-contact/primary health care level and in standardizing referrals/patient care pathways across the levels of care.</p> <p>R1.4 Implement and update hospital treatment protocols, optimize hospital capacities in the light of demand and improve/coordinate supply management. Implement communication plan.</p> |
| <p>F1.4 Balancing life and health protection without severe lockdown will particularly affect socio-economically vulnerable individuals, who face hardships in finding and keeping jobs and accessing high quality health care and other social services, even in normal times</p>  | <p><b>Immediate response</b></p> <p>R1.5 Prioritize essential health services which require continuous provision and address needs of vulnerable individuals among the population. Make vaccination plans if reliable vaccine becomes available.</p>   |

| <b>Pillar 2: Macroeconomic response and Multilateral Collaboration</b>   |   |
|--|---|
| <b>Findings</b>  | <b>Recommendations</b>  |
| <p>F2.1 Projected GDP loss by 5% (2020) expected to be followed by recovery in 2021.</p>   | <p><b>Immediate response</b></p> <p>R2.1 Prepare, update, and adopt mid-term economic recovery program for COVID-19 crisis based on a need for longer fiscal stimulus, supported by IFIs, the EU and other donors. Coordinate with recommendations under pillar three.</p>  |
| <p>F2.2 Currency board ensured stability of local currency and financial sector appears stable.</p>  | <p><b>Immediate response</b></p> <p>R2.2 Ensure independence of the currency board arrangement. Ensure independent prudential supervision while providing temporary debt relief measures for companies and individuals.</p>   |
| <p>F2.3 Adjusted budget plans allowed for temporary formal employment preservation measures (wage subsidies), but other social protection measures were left unchanged and public investment was reduced.</p>  | <p><b>Immediate to mid-term</b></p> <p>R2.3 Undertake SDG-informed reviews of public spending in priority areas to assess the efficiency, effectiveness, equity and adequacy of spending. Change composition of public expenditure and increase size and efficiency of public investment. Make reform of state-owned enterprises core part of a recovery program. Coordinate with recommendations under pillar three.</p>   |
| <p>F2.4 Danger of supply chain disruptions is moderate, however BiH industry was on a downward trend even before pandemic. Drop in the demand from EU and other export markets represents a key risk.</p>  | <p><b>Mid to long-term</b></p> <p>R2.4 Focus public investment on new sustainable infrastructure - green energy nexus which can promote industrial restructuring and digitalization. Coordinate with recommendations under pillar three.</p>  |
| <p>F2.5 Recession dynamics is such that negative demand shock is now stronger than the supply shock. Change of consumer spending patterns may be prolonged unless the authorities in BiH manage both expectations and aggregate demand directly.</p> | <p><b>Immediate to mid-term</b></p> <p>R2.5 Provide fiscal space for keeping social transfers and similar outlays elevated for a certain period of time. Once the immediate COVID-19 threat passes away, active labour market measures will have to take larger share of increased expenditure in order to facilitate restructuring. Use fiscal space to a maximum allowed by long-term sustainability assessment in cooperation with IFIs. Coordinate with recommendations under pillars three and four.</p> |

### Pillar 3: Economic Response and Recovery - Protecting Jobs, SMEs and Informal Sector Workers

| Findings   | Recommendations  |
|--|--|
| F3.1 Most heavily affected sectors measured by drops in employment are accommodation and food, trade, transportation and storage, and creative industries. Most vulnerable are micro and small companies, with gender specific vulnerabilities. Up to 40% of corporate investment may be postponed, based on survey responses. BiH export sector faces high risks as EU and CEFTA countries output contracts and demand drops. | <p><b>Immediate response</b></p> <p>R3.1 Implement short working time wage subsidies, effective until recovery takes place (most probably 2021).</p> <p><b>Immediate to mid-term</b></p> <p>R3.2 Based on the Joint Socio-Economic Reforms 2019-2022 (Reform Agenda 2), update, develop and implement without delays a comprehensive <i>development plan for jobs, industry and competitiveness</i> - a catalyst for sustainable post-COVID-19 recovery based on structural change and make reform of SOEs an essential element. Coordinate with recommendations under pillar two and ensure coordination of policies between two entities.</p> <p>R3.3 Adopt long-term industrial policy strategies and ensure countrywide coordination, covering critical areas of energy, industry 4.0 and digitalization in order to provide basis for implementation of financial instruments, especially for micro and SMEs.</p> <p>R3.4. Ensure that women-owned micro and small companies receive adequate technical and financial support in order to improve their resilience to future adverse economic shocks.</p> |
| F3.2 Guarantee schemes which were implemented are not adequate in terms of loss absorption. Equity incentive schemes are missing.  | <p><b>Immediate to mid-term</b></p> <p>R3.5 Enhance guarantee schemes in cooperation with IFIs and implement equity investment schemes with Western Balkans dimension for SMEs, ensuring gender responsiveness.</p>  |
| F3.3 The COVID-19 recession deepens labour market fragmentation reflected in very low activity and employment rates, especially among women. Youth unemployment is extremely high, providing incentives for emigration. Share of informal employment is very high (estimates range around 20% of total) and the COVID-19 recession may particularly hit unprotected workers in the informal sector.                            | <p><b>Immediate to mid-term</b></p> <p>R3.6 Perform in-depth analysis of the COVID-19 recession impact on the labour market including gender and age demographics. Implement labour market adjustment plan based on combination of labour cost subsidization, reform of unemployment benefits scheme and mid to long-term active labour market measures.</p> <p>R3.7 Special measures should address vulnerable workers. Include a plan for bringing the informal sector under formal umbrella by using labour subsidies, reform of unemployment benefits and lower tax burden as nudges. Coordinate with measures from pillar four.</p>   |
| F3.4 Private sector is facing administrative barriers due to unreformed public administration in BiH, which is substantially lagging behind peers in terms of digitalization.  | <p><b>Immediate to mid-term</b></p> <p>R3.8 Commit to mid-term jump on Doing Business, GCI and similar global rankings by reforming administrative processes based on simplification and digitalization.</p>   |

### Pillar 4: Protecting People and Basic Services - No One Left Behind

| Findings   | Recommendations  |
|--|--|
| F4.1 <b>Education.</b> Digital inequity broadened the existing educational gaps. This adds to the existing problems in the education and VET system, which are resulting in high youth unemployment due to professional skills mismatch and inefficient input-outcome ratios in education. Fundamental problems were reflected in the weak 2018 PISA results and in the ETF's Torino Process Review <sup>1</sup> , showing that BiH is substantially lagging behind its peers in the region. | <p><b>Immediate</b></p> <p>R4.1 Ensure common implementation standards and digital training resources (teaching materials, hardware, internet access) for general education schools and VET schools and their students and upgrade the skills of teachers and trainers for delivering E-learning under educational inequity prevention program.</p> <p>R4.2 Protect and increase education and VET budgets and ensure that funds are directed to most vulnerable children and youth.</p> <p><b>Immediate to mid-term</b></p> <p>R4.3 Modernize curriculum under improved educational reform coordination and eliminate inequity which arises from large discrepancies due to decentralized funding of education. Ensure continued participation of BiH in PISA program. Anticipate skills needs of the labour market and adapt VET programmes, to reduce skills mismatch.</p> <p>R4.4 Invest in accessible pre-school education. It has indirect effect on women labour force participation.</p> |

<sup>1</sup> European Training Foundation (2019)

|   |   |
|---|---|
| <p>F4.2 <b>Health (non-COVID)</b>. The health system is under strain due to financial shock, although BiH's health spending to GDP ratio ranks high above the peers. Secondary pandemic mortality is still not known. It is estimated that around 20% of population is not covered by the public health insurance scheme. There are indications of significant out of pocket expenses in vulnerable segments of the population. Health cost burden is partly caused by air pollution due to coal-based power plants and residential heating, technologically old road transportation systems.</p> | <p><b>Immediate</b><br/>R4.5 Research secondary pandemic mortality due to lock down, ensure continuity of health services (link R1.5) and implement primary prevention as priority programme.</p> <p><b>Immediate to mid-term</b><br/>R4.6 Perform in-depth research of out of pocket health expenses and use the results to adjust social assistance in order to reduce inequity in access to health protection. Broaden insurance coverage.</p> <p>R4.7 Implement health sector reform based on best international practice in order to ensure short-term and long-term financial sustainability while keeping universal open access system.</p> <p><b>Mid to long-term</b><br/>R4.8 Make sure social cost of air pollution is internalized in cost-benefit calculations of green investment programs (coordinate with pillar three).</p> |
| <p>F4.3 <b>Poverty incidence and social protection</b>. Depending on depth of recession, number of new persons under poverty line will be counted in tens of thousands, which requires immediate remedy. Targeting of social protection measures is not effective, because resources directed to groups such as women, children, youth and unemployed are less than to war veterans and pensions. Administrative costs of running the system is extremely high in relative terms.</p>   | <p><b>Immediate</b><br/>R4.9 Reform unemployment benefits system in order to make it more effective during fight against pandemic, including informal sector workers. Coordinate with measures from pillars two and three.</p> <p><b>Immediate to mid-term</b><br/>R4.10 Eliminate excess administrative burden in the social protection system, free up resources and reallocate to transfers.</p> <p>R4.11 Increase efficiency and effectiveness of means-tested targeting by integrating databases, improving controls and basing measures on evidence.</p>  |

## Pillar 5: Social Cohesion and Community Resilience

| Findings  | Recommendations   |
|---|---|
| <p>F5.1 BiH substantially lags behind peers in terms of fight against corruption which is corrosive for both social cohesion and economic growth. Trust in government is low.</p> | <p><b>Immediate to mid-term</b><br/>R5.1 Implement anti-corruption programs, improve public sector transparency. Promote and facilitate public administration reform based on digitalized services. Implement merit as criteria for public sector employment (fight nepotism). Coordinate with pillar 2 and 3.</p> <p>R5.2 Promote equal opportunities and citizens' participation, especially with respect to recovery programs. Enhance social dialogue and include views of all social partners.</p> |
| <p>F5.2 Poor communities are left on their own as there is no territorial fiscal equalization mechanism, even within entities.</p>  | <p><b>Mid to long-term</b><br/>R5.3 Consider legislative changes related to implementation of fiscal equalization mechanisms, where feasible.</p>   |

## Introduction

The purpose of the UN SEIA is to support immediate and mid- to long-term policy response to the COVID-19 crisis in BiH based on evidence and global best practice.

COVID-19 represents an unprecedented global challenge. It is important that each country reacts quickly and in line with best practice, with policies targeting the most vulnerable individuals. The *ultimate goal is to minimize the negative socio-economic impact of the pandemic and use this crisis as a catalyst for a forward-looking recovery agenda.*

The SEIA follows the global UN framework with its 5 pillars: health first, macroeconomic response, economic response and recovery, protecting people and social cohesion and community resilience. Each chapter contains review of analytics performed by UN agencies and other international partners and donors (IMF, World Bank, EBRD, OECD, USAID, and others) as well as by local stakeholders. A review of measures by the authorities in BiH is included in each chapter. Measures are discussed in view of international best practice to identify gaps and improvements that may facilitate BiH's fight against pandemic and its socio-economic consequences.

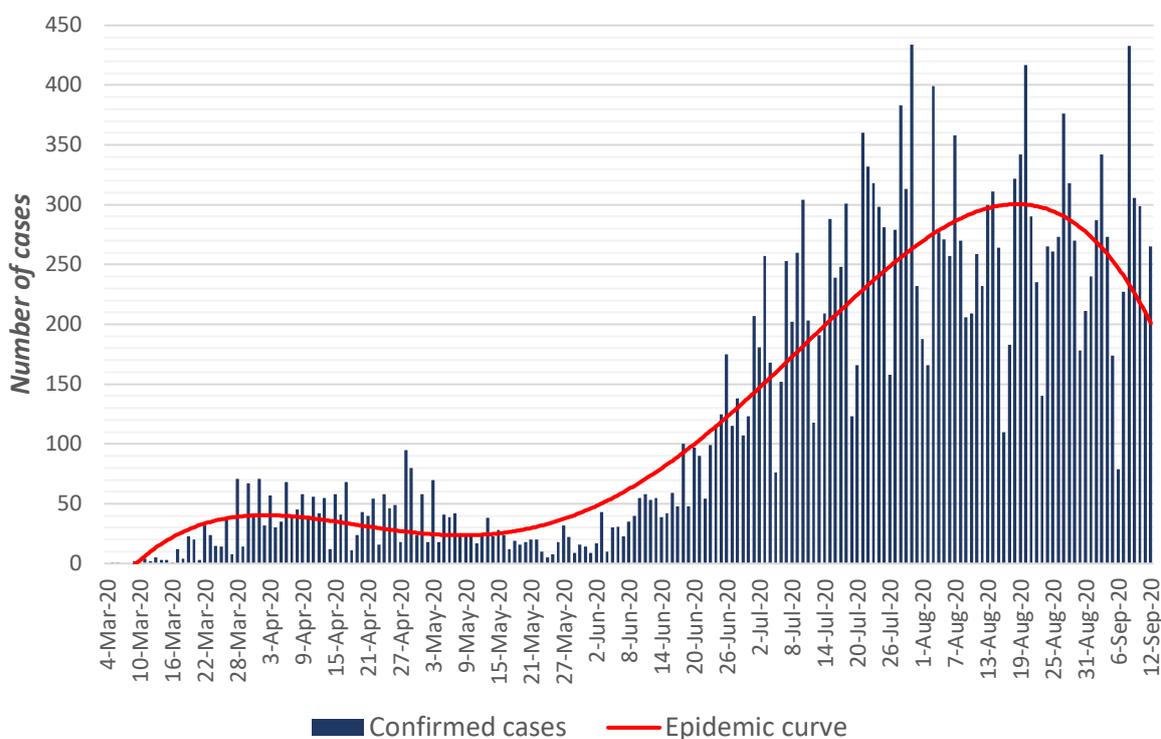
## COVID-19 Pandemic and Health

### Analytics: COVID-19 Impact and Vulnerabilities

With 23,465 confirmed cases as of September 13<sup>th</sup>, 2020, of which 6,689 were active, and with 694 deaths, BiH belongs to a group of countries in South East Europe where the summer of 2020 was marked by continuous spreading of COVID-19.

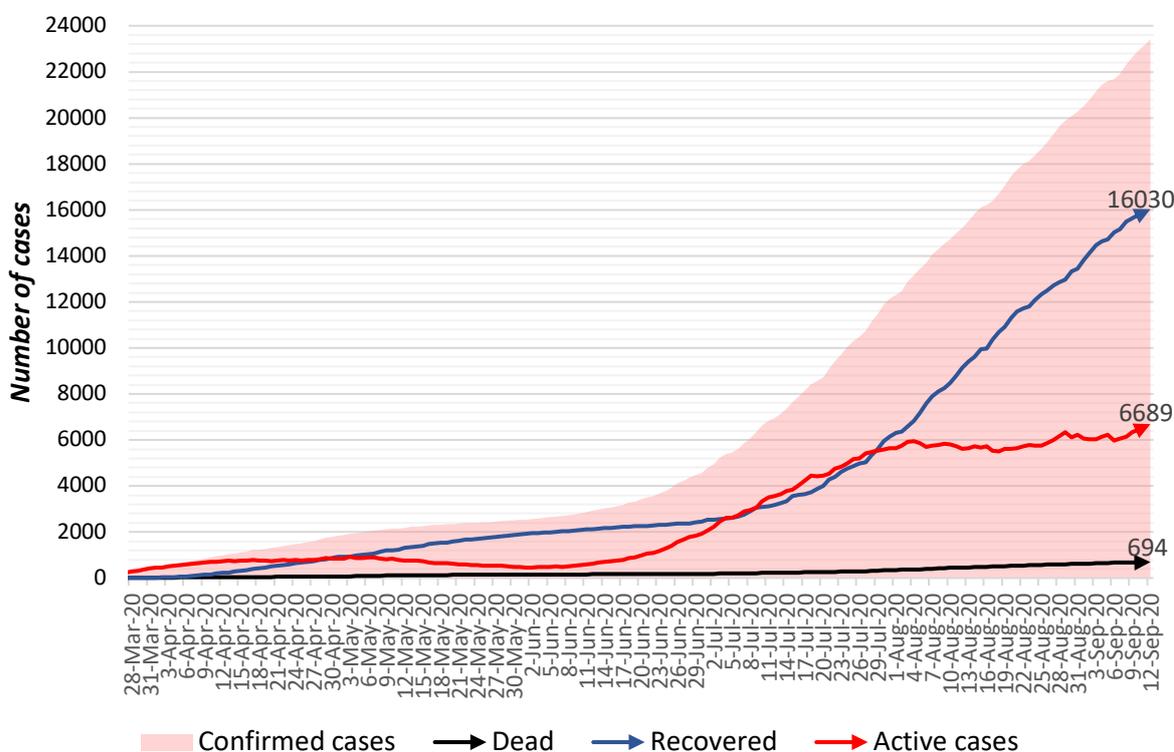
**Figure 1. Distribution of COVID-19 positive and trendline in BiH, September 13<sup>th</sup>, 2020**

(Sources: IPH FBiH, IPH RS, FMH, MoCA)



**Figure 2. Overview of the ongoing COVID-19 epidemic situation in Bosnia and Herzegovina, September 13<sup>th</sup>, 2020**

( Sources: IPH FBiH, IPH RS, FMoH, MoCA)



During April and May 2020, authorities accumulated know-how about the nature of the virus, coupled with better tracing and treatment and milder consequences of infections, which allowed normalization of all walks of life in late May. However, in summer of 2020, BiH experienced a rise in daily number of confirmed cases (Fig. 2). This trend is similar to other Western Balkans countries. The situation was very similar in the Federation of Bosnia and Herzegovina (FBiH) and the Republika Srpska (RS). According to the FBiH Ministry of Health, confirmed cases during the summer of 2020 were concentrated in the working age population 20-64 years old. The 20-44-year-old age group, where fatalities are very rare, was particularly hit. New infections are largely concentrated in big cities. Less than 15% of total confirmed cases were found in elderly age groups of 65+, where fatalities are more frequent.<sup>2</sup>

The summer outbreak of infections prevented further relaxation of stringent anti-COVID-19 measures in BiH. Measures remained stronger than in peer countries.<sup>3</sup> However, containing the infection and avoiding the repetition of lockdown is of great importance to avoid further psychological, social and economic challenges.

### Government Response and Effectiveness

In mid-March 2020, the authorities in BiH responded to the COVID-19 pandemic by severe lockdown which included reorganisation and/or closure of part of the health system. There is no in-depth analysis of consequences of delays and interruptions of non-COVID related health services. Early anti-COVID-

<sup>2</sup> Statistical data based on: worldometers.info. FBiH Ministry of Health, *Information on COVID-19 epidemiological situation*, July 2020

<sup>3</sup> Oxford Coronavirus Government Response Tracker

19 measures included cancelling of public gatherings, closing of educational and cultural institutions, closure of public and domestic transportation of passengers, restrictions on gatherings and introduction of stay at home programs for enterprises and institutions, including promotion of work from home. An overnight curfew was introduced in both entities for a certain period in the spring. Guidelines for temporary absences from work were issued, orders for avoiding concentration of workers by organising work in new shifts and regulating temporary absence from work were introduced.<sup>4</sup>

Both entities, as well as the cantons in the FBiH, adopted new budget plans for 2020, reflecting larger budgetary allocations for the fight against COVID-19 and purchase of medical equipment. A special fund for coverage of healthcare costs was established in the RS. BiH received support from a number of multilateral and bilateral donors in terms of medical equipment and funding. Tax exemption for purchases of medical equipment was introduced. A rapid (negotiated) procurement procedure in case of emergency, including improved procedure for e-procurement, was activated when the state of emergency was proclaimed in March. The State of emergency was abolished on May 21<sup>st</sup> in the RS and May 28<sup>th</sup> in the FBiH.

It is still difficult to identify factors which have led to the summer 2020's upsurge in the number of infections (Fig. 2). Resurgence of the pandemic led authorities (FBiH) to re-declare the state of pandemic on the 17<sup>th</sup> of July and continue with measures such as distancing, wearing masks, special regime of border control and prohibition of large-scale public gatherings. The continuation of infections dynamic may complicate the epidemiological situation when the regular influenza season starts in autumn and winter.

### Key Conclusions and Identified gaps

Thorough analysis of the increase in the number of daily cases from mid-June to September period will inform next steps in fighting the pandemic. Authorities claim lack of discipline among the general population, notably among younger cohorts, to be the main reason for the summer outbreak of infections. However, it can be, at least partly, attributed to the lack of risk communication required for affecting people's daily routines. The World Health Organisation's Gap Analysis and Recommendations<sup>5</sup> pointed at a lack of general strategic plan and coordination among health/crisis management authorities, inadequate crisis management skills, imperfect coordination between public and private health care, challenges related to case management, as well as general lack of staff (epidemiologists, infectious disease specialists, microbiologists) and adequate expertise, including having common databases and issuing clear, coordinated guidelines to critical services such as primary health care and border controls.

Dealing with the continuation of pandemic challenges requires significant increase in health system capacities in terms of 3T – testing, tracing, and treatment. Faster implementation of state-of-the-art know-how, organisation and health technologies in BiH would enhance opportunities for providing timely health interventions against other diseases. It is of critical importance to contain infection and fatality rates, while allowing the economy to remain open. Balancing life and health protection without severe lockdown will particularly benefit socio-economically vulnerable groups, such as children, women, young workers and workers in the informal sector of the economy. These groups suffer the most due to economic losses in case of severe lockdown.

### Recommendations

- Perform analysis of factors which led to the summer rise in number of infections.

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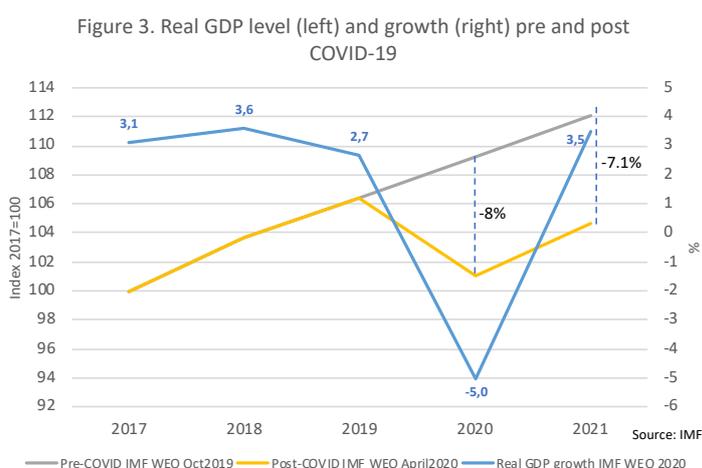
<sup>4</sup> Deloitte. (2020): COVID-19 – Overview of measures for the stabilization of economy in BiH

<sup>5</sup> WHO (2020): *BiH Gap Analysis and Recommendations*, 24th July

- Based on results, strengthen management and improve coordination for crisis management among health/crisis management authorities, both within health sector and multi-sectoral, including border police. Substantially increase crisis communication coordination and skills in order to affect responsible behaviour of general population. Encourage equal representation of women and men in crisis teams.
- Collect sex and age-disaggregated data to more adequately respond to different needs of women and men.
- Support entity and cantonal Institutes of Public Health in FBiH in enhancing their dual-track surveillance system and establishing Rapid Response Teams for case investigation.
- Support the health authorities in BiH and country-wide laboratory networks in coordinating approaches and expanding and quality-assuring capacities for COVID-19-related case identification and testing.
- Secure full implementation of infection prevention and control measures in all healthcare facilities, especially with respect to screening/triage services at first point-of-contact/primary health care level and in standardizing referrals/patient care pathways across the levels of care in local settings.
- Support health institutions to further enhance their knowledge and skills in COVID-19 case management.
- Develop, apply, and regularly update institutional protocols and procedures for treatment and care of hospitalized COVID-19 patients.
- Prepare resource plans for shifting medical experts and materials among health institutions to optimize capacities vis-à-vis demand for health care. Improve supply chain management.
- Generate specific lists of prioritized essential health services which require continuous provision and address particular needs of vulnerable. Communicate continuous provision of services through community information platforms.
- Develop and update where existing specific plans for COVID-19 vaccine, including ensuring adequate fiscal space.

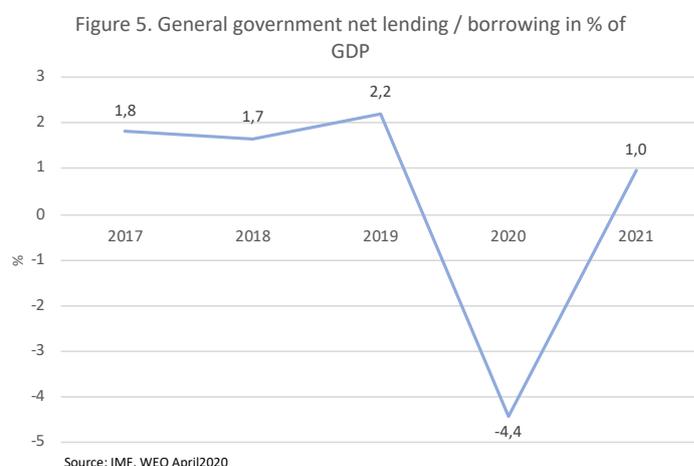
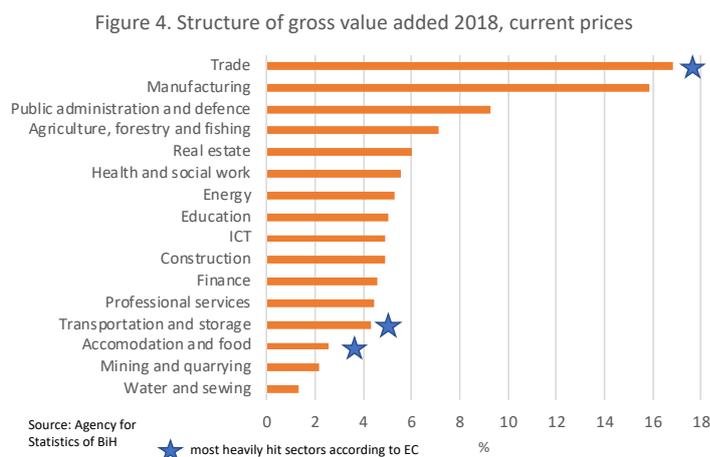
## Macroeconomic Response and Multilateral Collaboration

### Analytics: COVID-19 Impact and Vulnerabilities



BiH economy was growing slightly above 3% per annum 2016-2018, but the rate of growth slowed down to 2.7% in 2019. The COVID-related shock disrupted BiH's economic growth. The IMF expects real GDP contraction of 5% in 2020, which implies GDP loss of 8% compared to the pre-COVID-19 growth trend (Fig. 3). After expected recovery at a rate of 3.5% in 2021, the GDP is expected

to remain around 7% below the pre-crisis trend.<sup>6</sup>



BiH authorities communicated expected GDP contractions between 3% and 5% in 2020, depending on the scenario and entity. However, these forecasts may be overly optimistic as the negative demand shock during summer months has been stronger than expected. This fact points to a very low probability of V-shape recovery. Navigating through this uncharted territory requires careful balancing of immediate vs. mid-term and long-term policy considerations.

The expected negative shock in BiH is smaller compared to the EU average of -8.3% and neighbouring Croatia's -10.8%.<sup>7</sup> One reason is the relatively low level of development. Pre-crisis GDP per capita at PPP stands at 32% of EU-27 average. Another important factor is economic structure (Fig. 4). Share of hard-hit sectors such as transportation and storage and accommodation and food in BiH economy is relatively low, although significance of trade and manufacturing still makes BiH economy exposed to the COVID-19 shock. Comparison to peer group of countries is shown in the next chapter.

Public sector output represents particularly large share of BiH economy. While in structural terms it represents a weakness, *it provides some cushion in times of crisis*. Public debt to GDP ratio around 38% is moderate, and fiscal deficit is manageable after a period of fiscal surpluses (Fig. 5). Fiscal capacity is conducive for effective fiscal expansion, if expansion is well targeted and timed. Long-term fiscal sustainability will be preserved by carefully crafted combination of immediate responses in the area of social protection and mid- to long-term structural measures which would increase potential output growth and fiscal capacity once the immediate pandemic threat fades away.

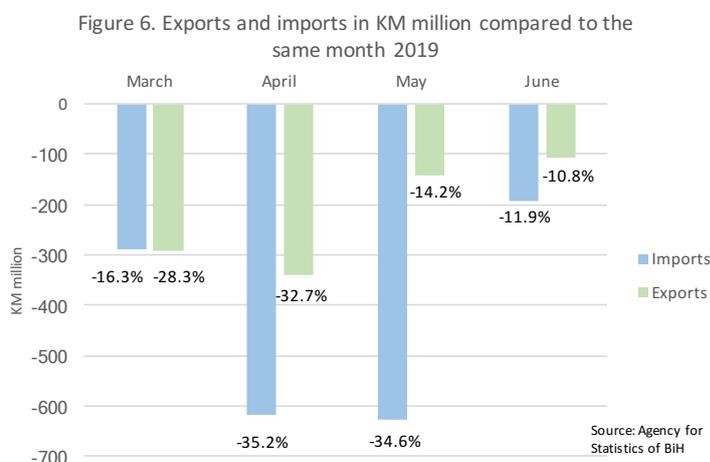
The IMF forecasted increase in general government expenditure from 40.8 to 45.2% of GDP between 2019 and 2020, with public revenues to GDP ratio falling from 43.1% to 40.8%.<sup>8</sup> Increase in public expenditures is mainly related to wage subsidies in the formal sector (see details in the next chapter).

<sup>6</sup> IMF (2020): *BiH Request for Purchase Under Rapid Financing Instrument*, April 2020. The EBRD expects 4.5% contraction in 2020 and strong recovery of 6% in 2021. This implies smaller loss of GDP compared to IMF's forecast (EBRD (2020): *Regional Economic Prospects - COVID-19: From Shock to Recovery*, May 2020 Update). The World Bank forecasted a range of possible contraction between -3.2% (in baseline) and -4.2% (in downside scenario) for 2020, with moderate recovery of 3.2% in 2021. (*The Economic and Social Impact of COVID-19.: Country Notes*. Western Balkans Regular Economic Report no. 17 Washington, D.C: World Bank Group)

<sup>7</sup> European Commission (2020): *Summer Economic Forecast*

<sup>8</sup> IMF (2020): *BiH Request for Purchase Under Rapid Financing Instrument*, April 2020

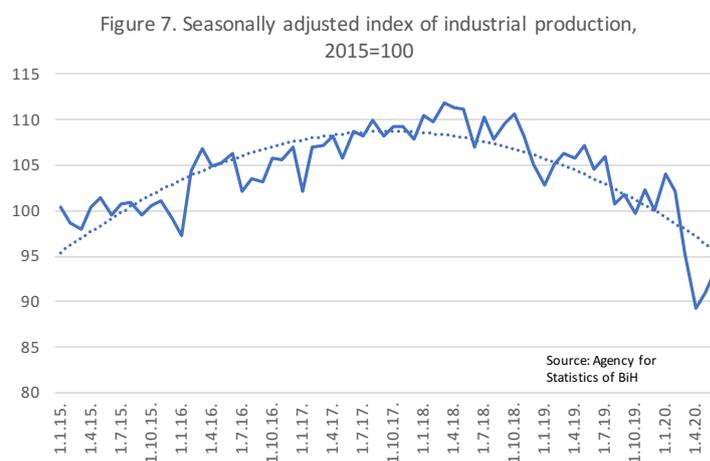
Social transfers are set to increase from 14.9% of GDP in 2019 to 18.4% in 2020. Nominal amount is expected to grow 17% between 2019 and 2020, followed by a decline of 10% in 2021.<sup>9</sup> Therefore, official projections rest upon optimistic forecast that economic and social situation will improve substantially in 2021. Authorities need to develop remedies for a less optimistic scenario.



General government compensation of employees is expected to be reduced by 1% only. According to the IMF, fiscal expansion is expected to turn fiscal surplus of 2.2% in 2019 to a deficit of 4.4% of GDP in 2020, with quick recovery back to surplus of 1% of GDP in 2021 (Fig. 5). Projected fiscal scenario critically depends on expected economic recovery in 2021. If this expectation comes true, significant financing gap of BAM 811 million will occur only in 2020, which will be covered by IMF, World Bank

and EU programs.<sup>10</sup> Authorities need a backup plan for a less optimistic recovery scenario.

BiH's main trading partners are Germany, Italy, Slovenia, Croatia, Serbia, China and Turkey. The EU is the target of 73% of BiH exports and BiH is vulnerable to output contraction in EU and CEFTA markets. Initial export demand shock was transmitted to lower imports due to high import dependency of exports in sectors of mineral fuels and oils, chemicals, plastics, and machinery. BiH records large merchandize trade deficit of 22 to 23% of GDP which is expected to decrease in 2020 due to the crisis: structurally higher imports will diminish more than exports (Fig. 6), but this effect may be transitory. Then the fundamental weakness of inward orientation / lack of export orientation (with total exports to GDP ratio of 40%, BiH lags behind the average for small and open economies in Europe) will come



to the fore.

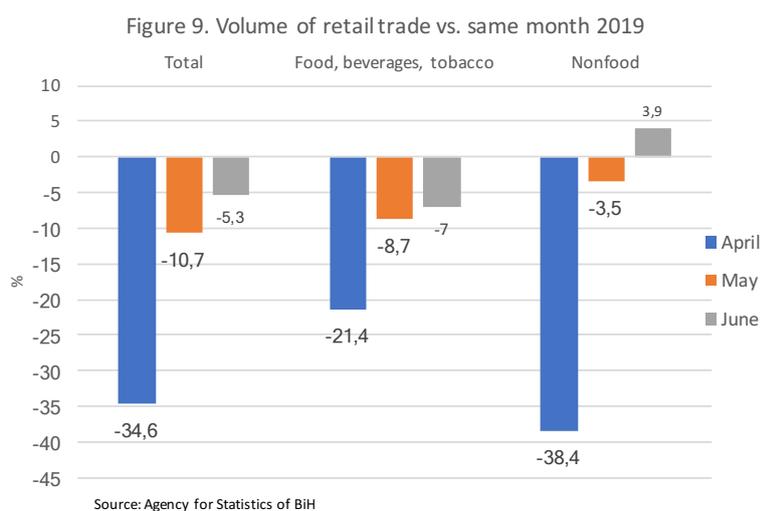
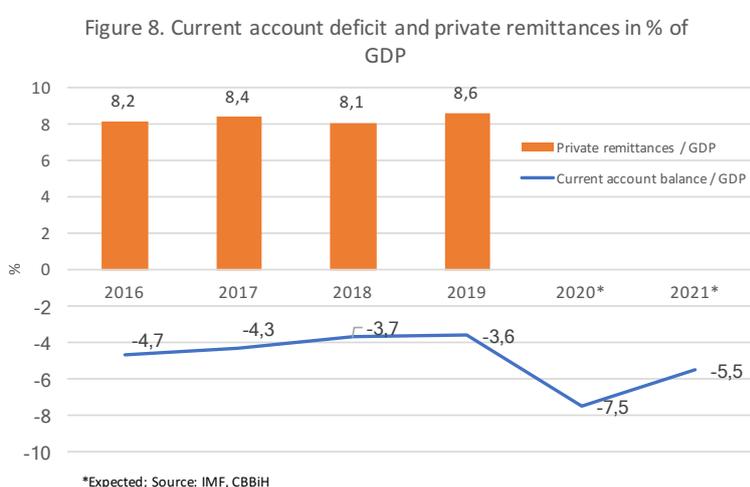
To date, the exports-manufacturing nexus appears to be moderately vulnerable to global supply chain disruptions, as reflected in a manageable drop of manufacturing activity by 15% year-on-year in May, 10.6% in June and 9.2% in July (Fig. 7). However medium- and longer-term impact of an EU recession on demand for BiH exports is a key risk that remains. On the other hand, global disruption and the expected move toward nearshoring of supply

chains, which will be supported by the Next Generation EU program, may provide an opportunity for BiH industry, if BiH credibly speeds up European integration and increases industrial productivity and competitiveness. While this fact has no implication for fighting the immediate consequences of pandemic, it may be critical for long-term recovery based on a new institutional and structural matrix of an integrated small open economy in Europe.

<sup>9</sup> Ibid  
<sup>10</sup> Ibid

To reach this goal, BiH industry needs to diversify, modernize, digitalize, become more innovation intensive and energy efficient, integrate with related services and find better fit within the EU supply chains. Fig. 7 shows that *industrial recession occurred before the pandemic*, largely related to spillovers from German industrial recession in 2018-19, which was induced by German auto-industry. Therefore, the COVID-19 crisis needs to be understood as an opportunity to deal with deeper, structural issues. According to the ILO, a large part of the workforce is trapped in low productivity jobs in agriculture, construction, tourism and retail, which on average command wages that are 10 % lower than the national average. This is a signal that the structural transformation of the country has been slow. Despite an increase in the value added by sectors such as information technology and finance and insurance, the contribution of these sectors to job creation remains low.

Large merchandise trade deficit is partly financed from surplus in trade of services, official transfers, and mainly from remittances. Private remittances associated with large diaspora and a large number of workers abroad represent around 8.5% of GDP in recent years (Fig. 8). Current account deficit is expected to worsen due to substantial reduction in remittances in 2020, which the IMF expects at two thirds of 2019 level. After reaching -7.5% of GDP, current account deficit is expected at -5.5% of GDP in 2021, still below 2019 level.<sup>11</sup>



Remittances also explain large discrepancy between GDP and disposable income. Discrepancy is reflected in a relatively high share of household final consumption in GDP (75%), partly funded by private remittances. It is very hard to predict how much remittances will diminish in 2020 due to labour market shocks in Europe and restrictions on travelling as part of remittances depend on arrivals when people bring cash. Inflow of remittances in Q1 2020 was 3.8% lower compared to Q1 2019. Preliminary data from the IOM survey of diaspora highlights that 18% of surveyed diaspora expects to reduce the amount of remittances sent while 67% will send the same amount.<sup>12</sup>

Retail trade data in April and May (-34.6% and -10.7% y-o-y respectively, Fig. 9) indicated substantial household consumption shock. The contraction was primarily a result of restrictions in movement of people and closure of a significant number of retail businesses. June

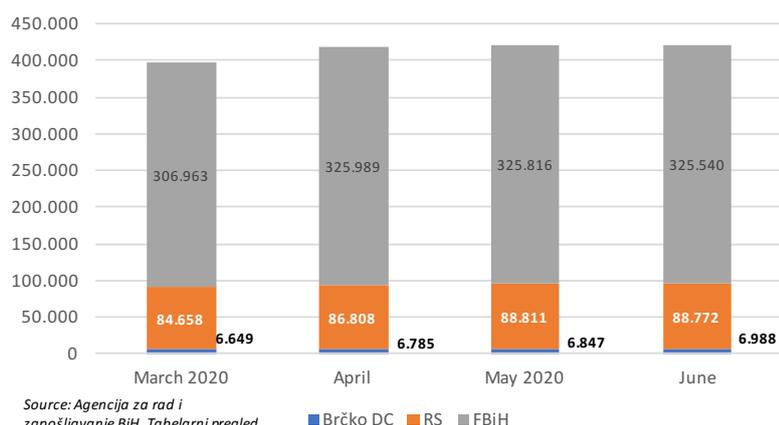
<sup>11</sup> IMF (2020)

<sup>12</sup> Rapid assessment of COVID-19 impact on BiH diaspora remittances, investments and movements, IOM, July 2020

2020 retail data brought some relief, as year on year change in volume of retail trade begun to catch up with 2019 levels. Catch-up was very visible related to non-food consumption (Fig. 9). However, negative consumption shock was felt strongly in purchases of food, beverages, and tobacco, which are normally more resilient as consumption baskets do not change against basic needs during times of crisis. This is an indication that COVID-19 economic consequences may be amplifying social problems of poverty already. According to media reports citing data from the BiH Indirect Tax Authority (ITA), VAT collection in January-July 2020 was 9.6% below the same period of 2019, which confirmed severe demand contraction.

Price developments also show that BiH, after initial supply shock, entered the phase of demand shocks. CPI deflation of 2.1% year on year in May 2020 is comparable to Cyprus and Greece, far stronger than in Serbia and Croatia. Demand shock is not associated with credit markets. Loans to households begun to contract in April and May 2020, with housing lending still on an upward path. Contraction of other loans to households by 1% from end March to end May 2020 is too small to serve as a plausible explanation for the strength of contraction of retail trade. Also, banking supervision agencies coordinated temporary moratoria and banks implemented loan rescheduling and refinancing for persons affected by COVID-19. Therefore, reasons for spending contraction in April and May 2020 lay with the severity of the lockdown and uncertainty rather than the direct effect of a labour market shock.

Figure 10. Number of registered unemployed persons between March and June 2020



Wages continued to grow in the RS during the initial phase of the crisis, as average nominal wage was 5.3% higher y-o-y in June 2020. In the FBiH, last available data for May point at slight decrease (-0.3%), which may be related to stronger labour market pressure. (Fig. 10). Around 23,000 new unemployed people registered with the public employment service between March and June, the large majority (80%) in the FBiH. Thus, registered unemployment in BiH increased from around 398,000 in March to

around 421,000 in June (+5.8%). It is too early to assess the impact of COVID-19 on jobs as the loss of working hours and associated loss of income may be more dramatic than loss of workplaces. While the immediate employment retention measures have taken place and to some extent retained and recovered job levels, notwithstanding their immediate effects, it remains to be seen what the long-term impacts on unemployment will be towards the end of the year as the full economic costs of COVID-19 and output contraction in export markets unfold. According to the ILO's *Rapid Assessment of the Employment Impacts and Policy Responses*, BiH could lose approximately 121,000 full-time equivalent jobs (assuming a 40-hour working week).<sup>13</sup> Employment as of June 2020 was 804,028 persons, that is, 2.7% (22,311) lower compared to June 2019.

<sup>13</sup> This is based on the ILO "nowcasting" model, which tracks declines in working hours resulting from lay-offs and other temporary reductions in working time.

## Government Response and Effectiveness

### Fiscal policies and response

Both entities adopted revised budget plans which increased their overall budget spending in 2020 and included additional transfers to local governments. Cantonal limits for raising new debts increased from 10% to 15% of revenues, and most Cantons rebalanced and/or increased their budgets creating fiscal space for crisis response and recovery measures. Budgetary arrangements were restructured rapidly, which helped fiscal response and provided some room for necessary increase of wage subsidies which were introduced as a prime employment preservation measure. However, there is a price associated with budget restructurings. First, outlays for public investment were cut. Net acquisitions of non-financial assets will decline compared to 2019 by 29% in nominal terms.<sup>14</sup> This budgetary item is expected to drop from 4% of GDP in 2019 to 3.4% in the FBiH, and from 4.6% to 2.2% of GDP in the RS.<sup>15</sup> Second, some social programs were cut. In the FBiH, there were cuts in budgets for labour and social policy, education and science, culture and sports and environment and tourism, and in the RS, cuts were related to science, technology and higher education (UN Women, 2020).

Budgetary Stabilisation Fund of the FBiH was founded with BAM 200-250 million overall capacity. BAM 150 million is allocated for road construction on top of the existing plan of BAM 800 million, but actual public investment outlays are expected to contract in 2020 anyway. The rest of the Stabilization Fund capacity is allocated to labour market interventions which are discussed in detail in the next chapter.<sup>16</sup>

Advance payments for corporate income tax were abolished in both entities. There were no changes to payments of VAT at state level, but there were extensions of deadlines for tax applications, including tax deferrals for profit tax until June the 30<sup>th</sup> in the RS, with the option for subsequent payments in instalments until the end of 2020.<sup>17</sup> As part of commitments under the Joint Socio-Economic Reforms (Reform Agenda 2), the FBiH committed to continue with tax reform by unification of social contributions at 32.5%, and increase in personal tax allowance for calculation of income tax to BAM 800, which is expected to substantially reduce tax wedge which is higher in the FBiH than in the RS. It will be a welcome contribution to fiscal harmonization in BiH.<sup>18</sup> The RS Government committed to reduction of para-fiscal charges.<sup>19</sup>

### International arrangements

BiH concluded € 330 million Rapid Financing Instrument with the IMF in April.<sup>20</sup> Conclusion of the arrangement was rapid. However, internal political disputes about allocation of funds delayed immediate impact of the arrangement. It is expected that negotiations about a new stand-by arrangement with the IMF will commence in September-October 2020.<sup>21</sup> This arrangement would enhance fiscal space and facilitate adoption and implementation of structural reforms.

The EU allocated € 80.5 million in grants, and the loan of € 250 million for macro-financial assistance is negotiated as a part of the EU financial support for Western Balkans worth € 3.3 billion. The EIB also facilitated counter-cyclical effect of public investment with € 11.8 million grant for highway

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<sup>14</sup> IMF (2020): *BiH Request for Purchase Under Rapid Financing Instrument*, April 2020

<sup>15</sup> Ibid

<sup>16</sup> Program ekonomske stabilizacije i oporavka Federacije Bosne i Hercegovine 2020. - 2021. godina

<sup>17</sup> [koronavirususrpskoj.com](https://www.koronavirususrpskoj.com)

<sup>18</sup> Presently, employees pay 17% contribution for pension insurance, 12.5% for health insurance and 1.5% for unemployment insurance, in total 31% of gross wage while comparable contribution rates in the RS are 32.8%. But, in the RS no employers' contributions are paid, while such contributions in the FBiH are in total 10.5% on gross wage, of which 6% for pensions, 4% for health and 0.5% for unemployment. Harmonisation of tax system is a common goal declared in the document titled *Zajedničke socio-ekonomske reforme za period 2019.-2022. godina*

<sup>19</sup> Program ekonomske stabilizacije i oporavka BiH 2020-2022. godina

<sup>20</sup> IMF (2020): *BiH Request for Purchase Under Rapid Financing Instrument*, April 2020

<sup>21</sup> Jewell, Andrew (2020): [Razočarani smo odnosom vlasti prema našem novcu](#). Nezavisne.

construction and lines of credit for financial intermediaries. In May 2020, BiH concluded € 33 million worth long-term World Bank loan for fighting COVID-19.

#### Financial and other macroeconomic measures

Bank regulators in both entities banned pay-outs of bonuses and dividends in banks and adjusted prudential regulation to facilitate loan restructuring for all sectors without proposing the new law. Measures included at least one of the following, without applicable fees or changes in interest rates: (1) repayment moratoria up to six months without calculation of penalty interest, (2) grace periods up to six months, (3) extending repayment periods of loans, and (4) refinancing obligations.

Price and/or margin limits were imposed for essential products (food and medical equipment) in the immediate pandemic outset and these were subsequently phased out.

#### Recovery plans versus immediate crisis response

Some levels of government adopted recovery plans beyond immediate COVID-19 impact measures. The FBiH Government adopted the Programme of Economic Stabilisation of FBiH 2020-2021 with the following key objectives: preservation of jobs, fiscal stability, supporting exports, reform of state-owned enterprises, strengthening the health and social protection, improving business environment and increasing competitiveness. The Council of Ministers of BiH established an advisory group that has been working on the draft Programme of Economic Stabilization 2020-2021.

### Key Conclusions and Identified Gaps

The short-term fiscal response focused on measures for preventing immediate job losses due to containment measures (job retention schemes) is discussed further below. This approach left informal workers and other categories, such as atypical workers, out of reach. Depending on the entity and the specific design of the measures, specific categories of enterprises were also excluded, while some large firms offering on average higher wages and operating in low-contact sectors may have benefited from support.<sup>22</sup>

Budgetary reallocations were accompanied with financing arrangements with IFIs. Public investment, an instrument with mid-term counter-cyclical potential, remained underused. It was sacrificed compared to pre-crisis budgetary plans and 2019 levels (-1pp of GDP and a much sharper contraction in nominal terms). This has to be reversed as soon as possible, based on better evidence which is required to define this set of stimulus measures in order to maximize investment multipliers and other goals, such as more immediate gender balanced job creation and improvement of governance in state-owned enterprises (SOEs).

Mid-term counter-cyclical investment response should rely on investment in sustainable infrastructure, digitalization and green energy transition as key elements of long-term structural change (see further in the next chapter). Otherwise, BiH is risking too weak or too late fiscal response despite fiscal capacity which is still there, representing the only macroeconomic stabilization instrument. The range of monetary policy options is limited, given the currency board. The currency board has served well during the crisis. It provided monetary stability, anchored expectations, and facilitated trust in the system. The currency board must be preserved to continue to play its positive role in the future.

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<sup>22</sup> For a more detailed elaboration on the intensity, differentiation, and distributional impacts of the job retention schemes in BiH, please refer to: ILO (2020): *Covid-19 and the World of Work. Rapid Assessment of the Employment Impacts and Policy Responses*. Chapter 5.2.

The World Bank estimated the size of initial direct fiscal response (without guarantees) in BiH at 2.3% of GDP. This is similar to Albania (2.4%) and Kosovo\* (2.8%), countries that have smaller fiscal capacity compared to BiH. At the same time, the initially planned discretionary fiscal response in BiH was stronger than in Montenegro (1% of GDP) and North Macedonia (2%) and significantly weaker than in Serbia (6.7% of GDP) and most EU member states.<sup>23</sup> Comprehensive figures about fiscal execution and add-on fiscal packages are yet to come. Even if the final analysis will show relatively strong fiscal expansion, it appears that low initial public debt level allows for stronger fiscal stimulus. However, decentralized decision making, lack of fiscal policy coordination between entities and a time needed to coordinate funding with IFIs, put a break on stronger counter-cyclical reaction. Policy coordination needs to improve in BiH to enable more effective country-wide response.

BiH authorities should immediately develop, update, adopt and timely implement a credible mid-term recovery plan with greater emphasis on public investment, based on mid-term arrangements with the IMF and other IFIs. Such arrangements would enable reform of the health system and public sector in general and pave the way for further reductions in taxation of labour in the mid-term. Strategic documents such as the BiH Economic Reform Programme (ERP 2020-2022) and the Joint Socio-Economic Reforms 2019-2022 should be revived in the COVID-19 context, as these documents addressed main long-term challenges: aging, emigration, EU accession, health system reform and reform of public administration and state-owned enterprises.

Private enterprise sector is small (15% of working age population works in the formal private sector).<sup>24</sup> It is weakly capitalized and exposed to strong economic and pandemic shocks. Large public sector buffer effectively serves as a shield for about a third of total employees,<sup>25</sup> but consumes scarce fiscal resources that might be used for alleviation of shocks which affect larger part of society outside the public sector. Threats of significantly lower incomes or jobs losses are real in the private and informal sector, and anxiety is widespread among population segments which are more directly exposed to economic shocks. This asymmetry between public (protected) and private (exposed) sectors contributed to demand contraction during 2020.

Restructuring of the public sector, freeing up fiscal resources for broad-based employment, and social measures that affect the whole of society coupled with active labour market measures discussed in the next section, are needed to address this structural problem.

## Recommendations

- Adhere to currency board and ensure financial sector stability through prudential supervision.
- Free up fiscal resources to extend employment protection schemes and establish more systemic income support measures for those who are vulnerable, disadvantaged and unemployed.
- Keep social transfers elevated for a certain period of time, and once the immediate threat of COVID-19 passes away, active and efficiently targeted labour market measures should take a larger share of increased expenditure in order to facilitate restructuring of the BiH economy.
- Prepare, update, adopt and timely implement a mid-term economic recovery program at the level of the Council of Ministers of BiH, the FBiH Government and the RS Government. Program should account for the COVID-19 crisis and provide basis for longer fiscal stimulus, supported by IFIs, EU and donors.

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<sup>23</sup> *The Economic and Social Impact of COVID-19: Western Balkans Outlook, Spring 2020., Table 1.* Western Balkans Regular Economic Report no. 17 Washington, D.C: World Bank Group

\* Reference to Kosovo shall be understood to be in the context of the Security Council resolution 1244 (1999).

<sup>24</sup> Joint Socio-Economic Reforms 2019-2022

<sup>25</sup> Ibid

- Improve budgetary allocations so that fiscal policy provides direct support to economic recovery in the mid-term via increased public investment in sustainable infrastructure, green energy and similar projects.
- Make restructuring of the public sector, including SOEs, core component of the program.
- Use external financing envelope, to the degree consistent with safeguarding fiscal capacity and sustainability of public debt, and for the rest of measures, change composition of public expenditure and increase size and efficiency of public spending.
- Strengthen public finance management and procurement to maximize accountability, transparency and efficiency. Support undertaking gender responsive, SDG-informed reviews of public spending in priority areas to assess the efficiency, effectiveness, equity and adequacy of spending.

## Economic Response and Recovery: Protecting Jobs, SMEs and Informal Sector Workers

### Analytics: COVID-19 Impact and Vulnerabilities

The COVID-19 shock has highlighted BiH's structural weaknesses in terms of job creation, competitiveness of enterprises, and slow transition from unofficial to official sectors. The economic challenges engendered by the health crisis threaten to deepen the divide between formal and informal economy, public and private sector, and large and more resilient versus micro/small and more vulnerable companies. Doing Business global ranking (BiH is the 90<sup>th</sup> in the World)<sup>26</sup> and WEF's Global Competitiveness Index ranking (BiH is the 92<sup>nd</sup>)<sup>27</sup> point to weak enterprise ecosystem, in terms of support services for start-ups, obtaining permits, navigating the tax system, enforcing contracts, and innovation. The COVID-19 crisis *can be a catalytic opportunity for a forward-looking recovery agenda and labour market reform.*

According to the on-line survey conducted in April by the FBiH Employers' Association, about one-third of the 761 surveyed enterprises had reduced the workforce (17% by 30% or more) during the lockdown phase. About half had a plan for layoffs of 21% or more of the workforce during the second quarter.<sup>28</sup> In the RS, out of 543 surveyed enterprises, 6% had reduced the workforce and 17% had a plan to do so in the near future. 29% respondents were expecting contraction of employment by 21% or more.<sup>29</sup> While these surveys are not fully representative in terms of their scope and size, they nevertheless provide important insights into enterprise assessments and expectations in the early stage of COVID-19 crisis.

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<sup>26</sup> [www.doingbusiness.org](http://www.doingbusiness.org)

<sup>27</sup> World Economic Forum, Global Competitiveness Report 2019

<sup>28</sup> Udruženje poslodavaca FBiH (2020): The Economic Impact Assessment of COVID-19 in the Federation of BiH

<sup>29</sup> Unija udruženja Udruženje poslodavaca Republike Srpske (2020): Uticaj COVID-19 na poslovanje u Republici Srpskoj

Figure 11. UNDP Economic Pulse survey

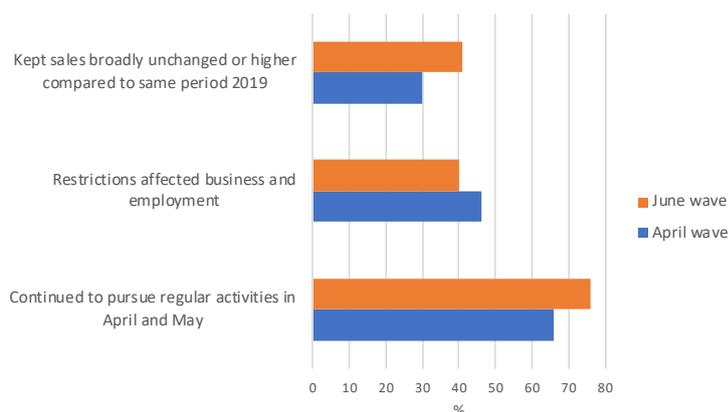
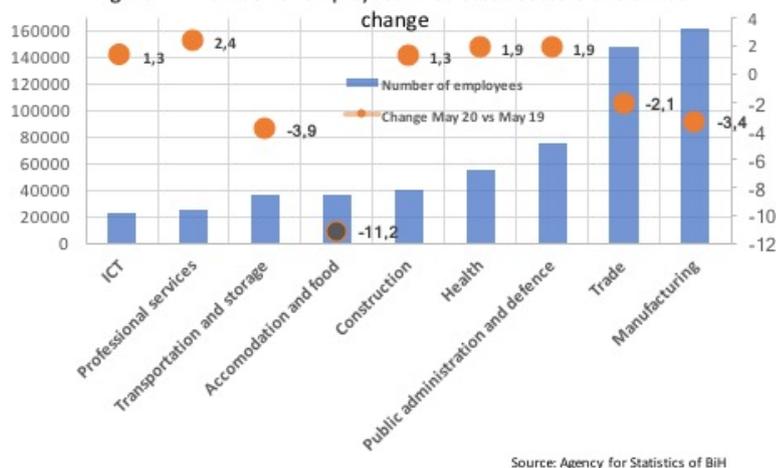
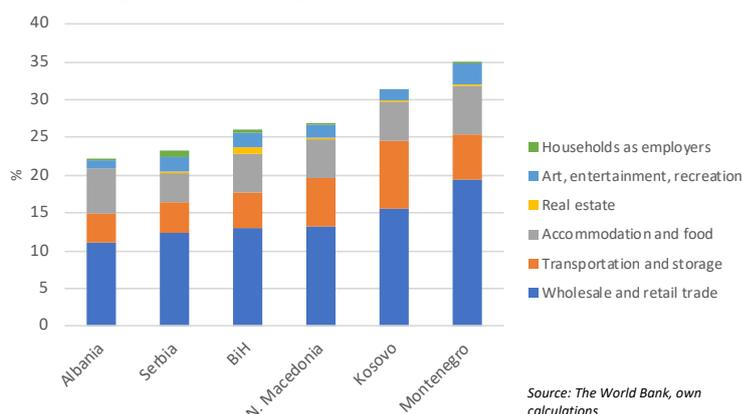


Figure 12. Number of employees in selected sectors and annual change



Source: Agency for Statistics of BiH

Figure 13. Share of highly impacted sectors in employment



Source: The World Bank, own calculations

Despite methodological challenges of on-line surveys, it is possible to hypothesise that in early surveys, employers put restrictions on work and movement of people on the top of the list of problems, as urgent remedies called for were: (a) resolving liquidity problems; and (b) a need for moratorium on bank loans. Both remedies were reflecting extreme short-term orientation. In a later wave, the decline in demand, which is a phenomenon of a mid-term nature, was the most prominent challenge for three of four respondents in both entities. In the RS, 71% of business were affected by business partners not operating normally due to the pandemic (46% in the FBiH). A non-negligible share of respondents (around 1/5) dealt with supply-side challenges, related to unavailability of inputs or raw materials being more expensive than usual.<sup>30</sup> Demand recovery became an urgent need for regaining growth.

UNDP's Economic Pulse survey (Fig. 11) also showed differences between April and June surveys.<sup>31</sup> The number of firms that reported regular continuation of business activities went up from 66% to 76%. The share of companies which reported that restrictions negatively affected business and employment went down from 46% to 40%.

The most heavily affected sectors in BiH are services, accommodation and food, trade, transportation, and storage. Manufacturing is also affected (Fig. 12). Creative industries are often forgotten, although they

<sup>30</sup> See ILO (2020): COVID-19 and the World of Work, 14 July 2020. Chapter 3.1.

<sup>31</sup> UNDP accelerator lab (2020): The Economic Pulse of BiH – comparative analysis and key findings, April and June. The web survey included 1,023 usable responses in April wave and 379 in June with underrepresentation of micro and small enterprises in the sample. The survey results are available at <https://puls.zamisli2030.ba/>.

employ more than 2,500 workers in BiH who tried to respond to COVID-19 by digitalization of cultural content.<sup>32</sup> Recent data showed that tourism decline is stark: the number of tourist arrivals for January-June 2020 period is 77.2% below the first half of 2019. July results were marginally better (-68.2%)<sup>33</sup>.

Sectoral differences are reflected in differences regarding size of firms and geographical locations. Smaller companies with a lack of their own funds are more vulnerable and less prepared. In many cases such companies are owned by and employ women. Having in mind that 92% of women-owned businesses in BiH are in the services sector, the COVID-19 crisis has been constraining women's ability to support themselves and their families.<sup>34</sup> Companies owned by women, on average, have declared significantly higher turnover drops from February to March 2020. Preliminary research data available show that 68.4% of women-owned entities in the FBiH completely stopped their activities, whilst that number in the RS is even higher at 76.3%.<sup>35</sup> Further, 76.4% of women business owners fear that they will be forced to close their business as a result of the pandemic given that women-owned businesses are more reliant on self-financing and thus have fewer resources that provide fall-back options during extended periods of significantly reduced or no revenue. The challenges brought about by COVID-19 came on top of structural issues and inequalities that women in BiH face, particularly when it comes to economic participation and opportunity<sup>36</sup>. Moreover, the COVID-19 crisis has resulted in an additional burden on women who traditionally take care after their families.<sup>37</sup>

The COVID-19 shock has a geographical component. It is concentrated in urban areas where trade, transportation, hotels, restaurants, other services and creative industries represent bulk of economic activities, such as in Banja Luka and Laktaši, Sarajevo (Stari Grad), District Brčko, Gradiška, Tuzla and Mostar.<sup>38</sup>

The ILO's *Assessment of the COVID-19 and the World of Work in BiH* identified 14 sectors that are highly vulnerable and severely impacted by the crisis, as presented in the Table below. According to the ILO's *Assessment of the Covid-19 and the World of Work in BiH*, there are 245,000 jobs at risk in these sectors.

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<sup>32</sup> UNESCO Venice Regional Office (2020): Socio-economic Impact Assessment of COVID-19 to Cultural and Creative Sectors in BiH

<sup>33</sup> Agency for Statistics of BiH, Tourism Statistics, No. 5

<sup>34</sup> UNDP BiH (2020): *Economic Impact Assessment of COVID-19 in BiH*

<sup>35</sup> Foundation 787 (2020)

<sup>36</sup> According to the latest World Economic Forum's Global Gender Gap Index Report, that observes economic participation, educational attainment, political empowerment and health and survival, BiH declined for 7 positions and is 69th out of 153 countries, lagging behind particularly in economic participation and opportunity. Also, on the Country's Gender Inequality Index (GII), which reflects gender-based inequalities in three dimensions – reproductive health, empowerment, and economic activity – BiH is ranking 38 out of 162 countries in the 2018 index (World Economic Forum, 2019).

<sup>37</sup> UN Women (2020): *Mapping the impact of COVID-19 on the socio-economic situation of women at local level*

<sup>38</sup> UNDP accelerator lab (2020): *The Economic Pulse of BiH – comparative analysis and key findings*, April and June.

**Table 1: Sectors with significant labour vulnerabilities and highly or medium-highly impacted by the crisis**

| FBiH  | RS   |
|---|--|
| Wholesale trade, except of motor vehicles and motorcycles               |  |
| Wholesale and retail trade and repair of motor vehicles and motorcycles |  |
| Retail trade, except of motor vehicles and motorcycles                  |  |
| Land transport and transport via pipelines                              |  |
| Crop and animal production, hunting and related service activities      |  |
| Forestry and logging  | Food and beverage service activities                 |
| Repair and installation of machinery and equipment                      | Accommodation  |
| Manufacture of wearing apparel  |  |
| Manufacture of rubber and plastic products                              |  |
| Manufacture of food products  | Manufacture of wood and of products of wood and cork |
| Manufacture of wood and of products of wood and cork                    | Manufacture of other non-metallic mineral products   |
| Manufacture of other non-metallic mineral products                      | Manufacture of food products                         |

Source: (ILO, 2020). *Covid-19 and the World of Work. BiH: Rapid Assessment of the Employment Impacts and Policy Response.*

May 2020 data on employment also confirmed a structural divide among sectors. Employment growth compared to May 2019 was recorded in construction, ICT, professional services, public administration, and health. Decline was recorded in accommodation and food, manufacturing, trade, transportation, and storage (Fig. 12). According to the World Bank's Western Balkans Regular Economic Report, BiH is structurally less exposed to the COVID-19 shock compared to regional average due to sectoral distribution of employment (Fig. 13).<sup>39</sup>

In addition, there are at least four pre-existing structural vulnerabilities in labour and capital markets in BiH, which have been exposed and amplified by COVID-19 crisis. The first three are discussed in this chapter and the fourth in the next one: (1) low employment-to-population rates, with high incidence of inactivity and informality among certain population categories, (2) lack of both public and private investment, (3) shallow capital markets, and (4) skills gap i.e. quantitative and qualitative skills mismatches between educational and training outcomes and demand for labour (present and expected).

**Low employment and activity rates.** Demographic challenges such as aging of the population and emigration have had significant effect on the BiH labour market. Additionally, the country has low rates

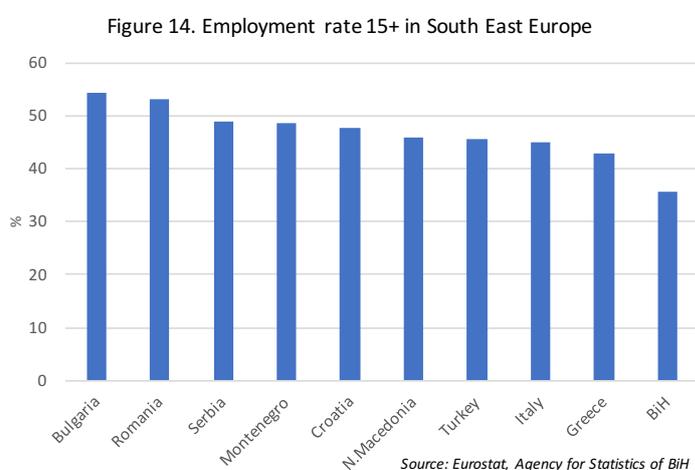
<sup>39</sup> *The Economic and Social Impact of COVID-19. Western Balkans Regular Economic Report no. 17* Washington, D.C: World Bank Group (Annex 1). In the calculation in Fig. 13 sectoral distribution from Annex is adjusted for estimated breakdown of other services in order to exclude impact on professional and administrative services which appeared to be resilient and inclusion of transportation and storage in highly impacted sectors. The World Bank also found that reported layoffs in Western Balkans were less than expected after the initial supply shock was transformed into a more permanent demand shock *The Economic and Social Impact of COVID-19.: Private Sector. Western Balkans Regular Economic Report no. 17* Washington, D.C: World Bank Group. See also *Analiza utjecaja pandemije COVID-19 na privredni sektor u Federaciji Bosne i Hercegovine za period mart-maj 2020. godine.* Federalno ministarstvo razvoja, poduzetništva i obrta, juli 2020.

of activity and official employment (Table 2), as well as a high share of informal employment. The ILO estimated informal employment at 30.5% in 2019 (29.8% for women), of which 90.6% is in the informal sectors (80.5% if agriculture is excluded).<sup>40</sup>

**Table 2. Selected labour market indicators**

| in % of 15+  | Activity rate | Employment rate | Unemployment rate | Share of inactive with low education | Share of employment in services |
|--------------|---------------|-----------------|-------------------|--------------------------------------|---------------------------------|
| <b>Men</b>   | 51,7          | 44,6            | 13,6              | 39,2                                 | 42,7                            |
| <b>TOTAL</b> | 42,1          | 35,5            | 15,7              | 51,4                                 | 50,3                            |
| <b>Women</b> | 32,9          | 26,7            | 18,8              | 59,8                                 | 62,6                            |

Source: Labour Force Survey, 2019



The employment rate is low even by South and Southeast European standards (Fig. 14). It is probably underestimated due to circular migration to EU in recent years. Also, female participation in the labour market and employment is low. Concentration of female labour force in high-contact occupations in the service sector and the incidence of low-educational attainment among inactive women make them highly vulnerable during the COVID-19 crisis. Family responsibilities place an additional burden on women and

may lead to suboptimal employment outcomes for prime-age workers. During the lockdown, women took on the largest part of the additional care responsibilities induced by the temporary closure of schools. According to ILO estimates, the share of vulnerable employment is very high once the gender dimension is taken into account.<sup>41</sup>

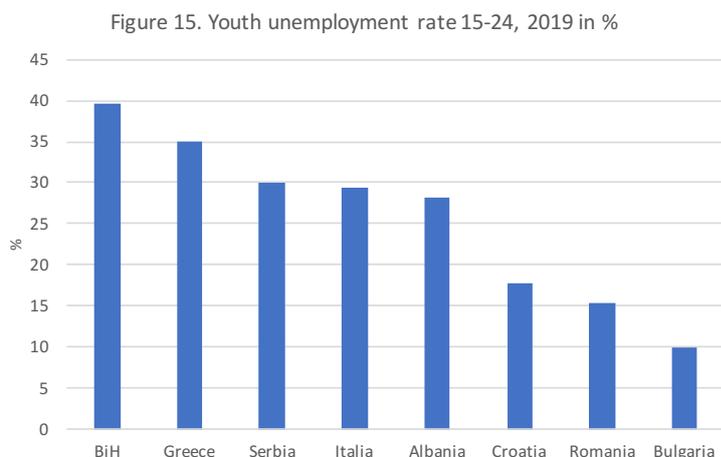
Fig. 15 shows that BiH has the highest rate of youth unemployment among countries in South East Europe. Estimates of social cost of youth emigration, based on cost of education, hover around 20,000 euro per person.<sup>42</sup>

<sup>40</sup> ILO (2019)

<sup>41</sup> ILO (2020b): *Covid-19 and the World of Work. BiH: Rapid Assessment of the Employment Impacts and Policy Response*

<sup>42</sup> WFD and IRI (2020): *Cost of Youth Emigration from BiH*. Western Balkans Democracy Initiative

**Investment** rate, slightly below 20% of GDP is low for BiH's level of development. BiH is not leveraging its location, and to some extent low labour costs (this is relative since relatively high tax wedge on labour) to attract investment. Weak institutions, burdensome regulation and corruption all contribute to lower FDI and investment.



Source: World Development Indicators

Weak institutions, burdensome regulation and corruption all contribute to lower FDI and investment.

In BiH, there is a large and inefficient sector of SOEs. There are around 550 SOEs in BiH which absorb more than 11% of administrative employment and create one third of tax debt. This system produces fiscal risks, inefficiencies and contributes to unfriendly business environment and inward orientation of the economy.<sup>43</sup>

**Underdeveloped private capital markets** are both a cause and a consequence of BiH's structural weaknesses.<sup>44</sup> Developmental constraints exist both on the supply and the demand side. It is likely that latent lack of risk capital will deepen negative impact in the coming period as many companies, especially micro and small, will not be able to bridge cash flow problems at the basis of debt instruments only. Companies lack equity funding for fresh starts and restructurings. Bridging the equity finance gap is a necessary condition for survival through the COVID-19 crisis and recovery period as well as for modernization of BiH economy.

The weak institutional environment, with low levels of digitalization of public services, augments these problems. The index of e-participation in public services of 0.43 reveals a wide gap vs. peer countries (e.g. North Macedonia 0.70, Croatia 0.77 and Serbia 0.81).<sup>45</sup> Digitalization of public services is a means for achieving public transparency, efficiency and equal access to public institutions for all. Transparent and efficient public administration contributes to greater trust, cohesion and potential to transform BiH to a modern, open and inclusive economy. Additionally, there are two important side effects. First, e-governance facilitates development of the local IT sector, as can be seen for example in the Baltics. The potential is there: as of 2018, the ICT sector in BiH contributed 4.2% of gross value added (and growing) and currently employs more than 22,000 workers i.e. close to 3% of total formal employment (and growing). Second, investment in IT/digitalization allows more people to telework and obtain government services online. Increased share of people who can work on-line is increasing resilience to COVID-19 type of adverse shock.

Digitalization and development of the IT sector has the potential to facilitate structural change in sectors of industry and energy. BiH needs energy transition towards sustainable green energy for three reasons. First, as a prospective candidate for EU accession, BiH has to plan energy transition to achieve goals of climate-neutral Europe by 2050. Second, transition to sustainable energy, based on renewables and efficient use of energy, requires substantial investment in buildings, smart grid, decentralized production capacities based on solar, wind and biomass, which BiH has. Such investments are IT intensive and less dependent on subsidies. These have the potential to affect local industrial development by boosting innovations and creating local value chains in high value-added

<sup>43</sup> *Zajedničke socio-ekonomske reforme za period 2019.-2022. godina*

<sup>44</sup> BiH's assessment of venture capital availability of 2.3 within Global Competitiveness Index is substantially below peers (e.g. 3.2 in Serbia and 2.6 in Croatia).

<sup>45</sup> World Economic Forum, Global Competitiveness Index 2019

industries and construction. Third, energy transition is needed due to low quality of air which threatens people's health. This problem is particularly present in Sarajevo, Zenica and Tuzla cantons.

Air quality is an immediate issue related to pandemic. Recent findings point to correlation between air quality and severe consequences of COVID-19. Low air quality fertilizes lung, acute respiratory and obstructive pulmonary diseases.<sup>46</sup> So, COVID-19 should be understood as a watershed event which should bring social costs of air pollution to policymakers' attention.<sup>47</sup> Channelling investment to resolution of air pollution problem may facilitate the post-COVID recovery, reduce health problems in the long-term and provide indirect support to sustainable finances of the public health system and industry transformation based on modern information technologies.

## Government response and effectiveness

### Labour Market

The FBiH covered compulsory social security contributions (up to BAM 244.85 monthly) per employee until one month after the state of emergency for employees in companies that recorded a fall in revenues of 20% or more, compared to the same month in 2019.<sup>48</sup> The RS covered full salary contributions for March and minimal salary contributions from April 2020. Taxes and contributions were also covered for workers in enterprises most affected by COVID-19. The RS established the Solidarity / Compensation Fund of € 29 million to cover minimum wages and related contributions for about 70,000 most affected workers in April and May 2020. After May, the measure was extended for coverage of taxes and contributions only.<sup>49</sup> In June, additional BAM 15 million from the RS Solidarity / Compensation Fund was allocated to local communities. Similar allocations between different levels of government were applied in the FBiH.

The aforementioned measures represented immediate responses by the authorities in BiH. As far as mid-term measures are concerned, the loan from the World Bank for extension of active labour market (employment) programs is currently under negotiation. It represents an extension of cooperation with the World Bank and donors which started for 2017-2020 period.

Labour market measures, mainly in the form of subsidies to the cost of labour, appear to have been to a certain degree effective in preventing initial increase in unemployment by covering minimum wages and/or contributions in enterprises most affected by the lockdown. However, measures were linear and provide no guarantee that BiH will avoid protracted labour market consequences as the recession matures.<sup>50</sup> Three sets of measures are missing for prevention of the worst-case scenario. First, broader social safety net for those outside formal employment. Second, extended measures for preservation of jobs in the formal sector, subject to continuation of recession in the autumn and winter 2020/2021. Third, the set of mid-term labour market measures directly aiming at more vulnerable workers with less experience such as younger workers, women, and workers in the informal sector. Such measures are required to prevent widening of structural gaps in the already segmented labour market in BiH and to increase inclusiveness and speed of recovery. The destiny of vulnerable workers should not be left

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<sup>46</sup> *The Economic and Social Impact of COVID-19: Air Pollution Challenges*. Western Balkans Regular Economic Report no. 17 Washington, D.C: World Bank Group

<sup>47</sup> *Ibid*. Social costs of air pollution in BiH are, by far, the highest in Southeast Europe (see the section on health in the following chapter).

<sup>48</sup> Zakon o ublažavanju negativnih ekonomskih posljedica FBiH

<sup>49</sup> [koronavirususrpskoj.com](http://koronavirususrpskoj.com)

<sup>50</sup> This is based on the ILO "nowcasting" model, which tracks declines in working hours resulting from lay-offs and other temporary reductions in working time.

to social protection measures only, which have limited scope in coverage and are subject to inefficient targeting, as discussed below.

### Taxes and Finance

The RS postponed payments of corporate income tax until June 30<sup>th</sup> 2020. A 3-month repayment moratorium on the RS Investment-Development Bank's (RSIDB) loans was introduced. RSIDB's credit line (via banks) based on Guarantee Fund of € 25 million funded by the EBRD was introduced for small loans for micro and SMEs. Partial risk coverage up to 70% was introduced with expected multiplier effect up to € 122 million. The RS introduced a program of € 1.1 million for small loans in agriculture and 20,000 vouchers worth € 50 for domestic tourism.<sup>51</sup>

The FBiH Development Bank established a Guarantee Fund with a target amount of € 255 million (expected effect with multiplier is € 610 million), based on € 50 million stand-by credit line from IFI's as a first loss cover to facilitate lending.<sup>52</sup> The FBiH also abolished calculation of penalty interest as long as moratoria is applied.

As a general direction, credit guarantee schemes which have been developed in both the FBiH and the RS represent optimum policy response for providing liquidity to the corporate sector and maintaining flow of corporate investment at times of strong negative shocks, when risk calculations are cumbersome and normal flow of credit to the economy may stop. However, the consequences of the COVID-19 shock will last. In response, capacities for risk coverage by guarantee funds should be enhanced via extended long-term programs with IFIs.

A number of other more detailed measures were introduced, such as preferential treatment of 30% (discount on bid price) for domestic companies in public procurement and decrease of lease amounts for business premises managed by the FBiH by 50%.

### Key Conclusions and Identified Gaps

Immediate government responses alleviated the initial labour market shock at the outset of COVID-19 recession. However, responses were targeting formal sector employment in the short run. Missing response elements, such as broader social protection including informal sector workers, women supporting their families, prolonged short-term measures like subsidies for shorter working time and active labour market measures, may prove to be socially costly in the most likely scenario of continuation of the recession and late recovery in 2021.

On top of it, BiH is missing a comprehensive employment policy, in line with ILO recommendations and international labour standards, as well as mid-term development plan - a catalyst for sustainable recovery based on structural change, which may ease upturn starting in 2021. Such a plan should be built upon the existing strategic documents,<sup>53</sup> specifically the Joint Socio-Economic Reforms 2019-2022, adjusted for reality of post-COVID-19 recovery which may require prolonged mid-term fiscal stimulus supported by IFIs.

Existing strategic documents do mention critical areas for development of jobs and enterprises, such as: depoliticization and better management of SOEs, reform of public administration, reduction of taxes and para-fiscal burdens, active labour market policies, industrial restructuring, green energy, digitalization and innovation. Thus, the development of comprehensive employment policies would

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<sup>51</sup> kokronavirususrpskoj.com

<sup>52</sup> Program ekonomske stabilizacije i oporavka Federacije Bosne i Hercegovine 2020.-2021. godina

<sup>53</sup> Economic Reform Program for 2019-2021 (ERP BiH 2019-2021), Zajedničke socio-ekonomske reforme za period 2019.-2022. godina (Reform Agenda 2); Program ekonomske stabilizacije i oporavka FBiH 2020.-2021. godina

support the achievement of employment targets and bring BiH more in line with EU orientations and ILO recommendations.

Lack of results so far cannot be attributed to the COVID-19 outbreak. COVID-19 might have diverted policymakers' attention and resources from structural issues, but structural change is slow due to lack of detailed plans, clear common targets, milestones, resource and activity plans and public sector management coordination in highly fragmented governance structures in BiH.

A comprehensive mid-term development plan - a catalyst for sustainable recovery based on structural change - should lean on immediate responses based on the following set of principles:

- Broader immediate response based on social transfers should be followed by active labour market measures that include both short-term and long-term perspective: short-term support for most heavily hit enterprises/sectors (coupled with reduction of para-fiscal charges)<sup>54</sup> combined with mid to long-term assistance programs for re-skilling, up-skilling and finding jobs. Such programs will help domestic demand recovery. It is of utmost importance to coordinate demand side with supply side measures targeting private investment (e.g. development of both debt and equity finance products).
- Guarantee programs should be substantially extended beyond existing 0.5%-1% of GDP capacity for loss absorption, which is by a multiple below similar programs in EU countries. Guarantee programs should facilitate lending to enterprises which invest in green energy, digitalization and modernization of BiH industry based on innovation, technical change and export orientation. Programs should be supplemented by support for equity and quasi-equity investment, emphasising micro enterprises and SMEs.

Aforementioned principles need to fit within mid to long-term development perspective which has to include: (1) *institutional reforms* (improvement of regulation and institutional quality, digitalization of public administration, transparency and fight against corruption), (2) *industrial policy* (enhancing the exports-manufacturing nexus competitiveness and promoting digitalization-green energy nexus), (3) *reforming the education system in line with expected demand for skills*, and (4) *improved, more efficient social protection*.

## Recommendations

### Employment:

- Develop a comprehensive employment policy, in line with EU orientations and ILO standards.
- Complete thorough labour market analysis pre- and during COVID-19 shock, including gender and age demographics. Use the results for the design of comprehensive labour market adjustment plan.
- Use the findings of the impact assessments of active labour market measures for the period 2017-2019 to negotiate the new loan with the World Bank.
- Design specific measures for vulnerable workers (youth, women and informal workers) and devise a *long-term plan for tackling informality in line with international labour standards and particularly ILO Recommendation 204 concerning the Transition from the Informal to the Formal Economy*.

### Competitiveness:

- Based on existing strategic documents, build and timely implement a comprehensive *mid-term development plan for jobs, industry, and competitiveness* - a catalyst for sustainable post-

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<sup>54</sup> See section on proposed measures for transport sector, Infokom no. 78, July 2020

COVID-19 recovery based on structural change. Build a precise plan for reduction of para-fiscal charges a necessary element of the mid-term development plan.

- Assess and anticipate the skills needs of key industries and assess the needs for workforce training, re-skilling and up-skilling.
- Adopt fundamental long-term industrial policy documents covering critical areas of energy, industry 4.0 and digitalization to provide basis for implementation of financial instruments.
- Make reform of state-owned enterprises (depoliticization, professionalization and privatization) an essential element of the industrial package.
- Substantially enhance guarantee schemes in cooperation with EU and IFIs; streamline loss exposures in line with industrial policy and put special emphasis on micro enterprises and SMEs.
- Design (and/or use better) equity and quasi-equity investment schemes, covering the whole range, from crowdfunding for start-ups and micro, venture capital for start-ups and small, to private equity schemes for mid-sized enterprises.<sup>55</sup>
- Coordinate the aforementioned measures with macroeconomic response, institutional (regulatory) reform and reforms in social sectors discussed below.
- Ensure coordination of goals, targets and timing within the fragmented framework of governance in BiH to secure country-wide response.

## Protecting People and Basic Services: No One Left Behind

### Analytics: COVID-19 Impact and Vulnerabilities

COVID-19 is not only a health challenge. Complex combinations of supply and demand shocks, with fiscal capacity under strain, threatened delivery of basic social services: education, non-COVID related health care, social security and fighting poverty. During budgetary reallocations in Spring 2020, budgetary cuts were made to programs such as science, education, VET, entrepreneurship and similar, which have gender and generational impacts.<sup>56</sup> Also, it is far from clear how the education system coped with the consequences of closures of schools and universities in BiH,<sup>57</sup> given that general education schools, VET providers and universities are essential for development of human capital and social inclusion. Without proper intervention and policies, even the existing level of human development in BiH, which lags behind the peers, may come under threat (Fig. 16). Fig. 17<sup>58</sup> shows that human development gap vis-à-vis peers is particularly large for women.

The fact that a short-term response targeting broader population segments is missing (recall that wage subsidies target only formally employed to stay at work) may prove to be more problematic if the expectation of a prolonged recession comes true. The World Bank is predicting that poverty in BiH is to rise from estimated 11.8% in 2019 to 12.9% to 14.6% in 2020. Mounting pressures on poverty will depend on duration of the COVID-19 recession. Expected range of the number of persons likely falling into poverty is between 35,000 and 85,000, with 50-60% of estimated number currently not covered

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<sup>55</sup> As BiH market is too small for national private equity schemes, international coordination of projects (specialized funds usually supported by EIF) at Western Balkans level needs to deepen in order to increase supply of equity for growing companies.

<sup>56</sup> UN Women (2020): Occasional Budget Briefs No. 1 and 3, April and May

<sup>57</sup> *The Economic and Social Impact of COVID-19: Education*. Western Balkans Regular Economic Report no. 17 Washington, D.C: World Bank Group

<sup>58</sup> UNDP (2020): *Social Inclusion in BiH: 2020 National Human Development report (in draft)*. Human development index reflects gross national income per capita, rate of unemployment and general level of education

by social protection programs.<sup>59</sup> This estimate comes on top of estimate that around 20% of population is not covered by the health insurance.<sup>60</sup> BiH needs a comprehensive social program covering three critical social sub-systems covered in this chapter: education, health (non-COVID) and social protection. The remainder of the chapter explains sequencing of such a program, starting from more inclusive unemployment benefit scheme for cushioning the immediate impact, to labour market measures, educational and VET reform, which will have impact in the mid to long-term.

Figure 16. Regional trends in Human Development Index 2000-2018

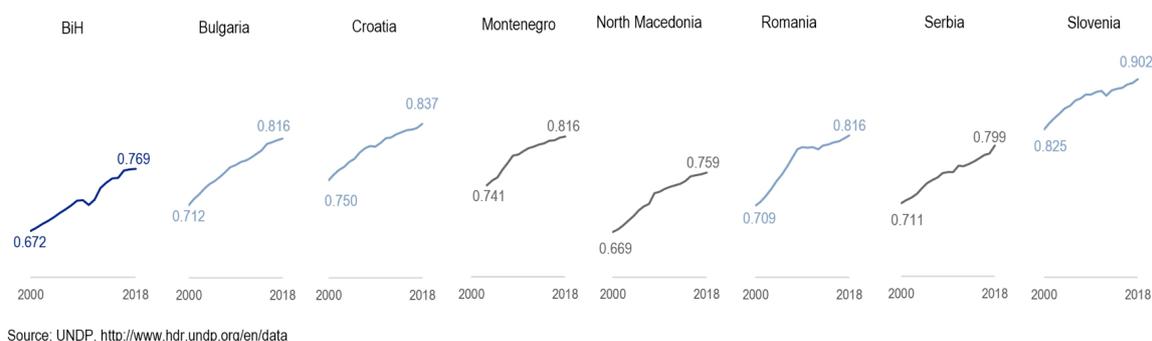
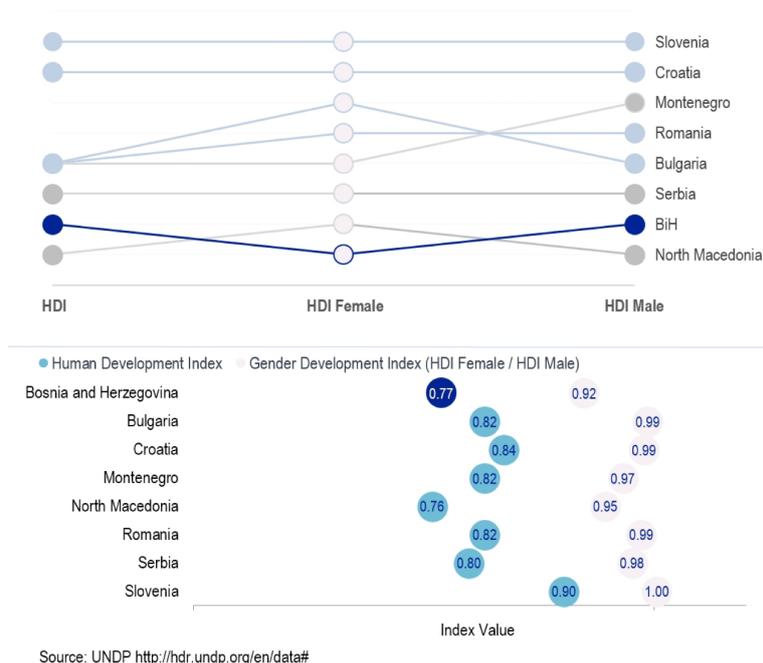


Figure 17. Gender development Index



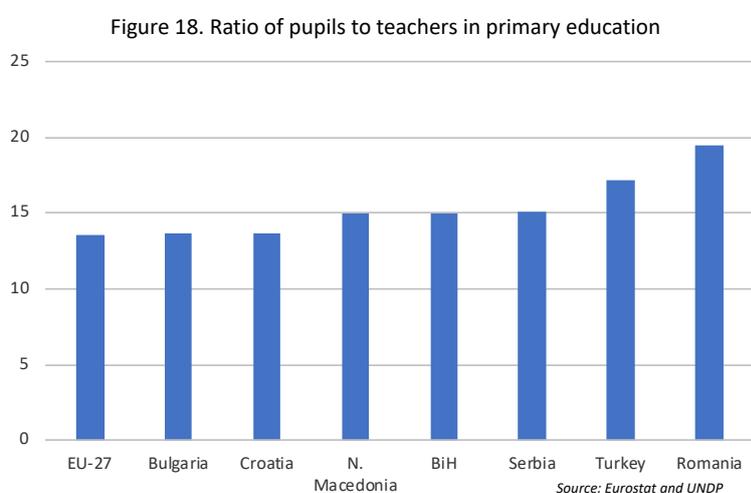
<sup>59</sup> *The Economic and Social Impact of COVID-19: Poverty and Household Welfare*. Western Balkans Regular Economic Report no. 17 Washington, D.C: World Bank Group

<sup>60</sup> UNDP (2020): *Social Inclusion in BiH: 2020 National Human Development report (in draft)*

## Education

The World Bank estimated that future productivity of today's children in BiH is at 62% of what it could be, if access to education and match between curricula and future labour market needs were improved earlier.<sup>61</sup> Failure to do so is related to structural weaknesses in the education system. COVID-19 risks amplify structural problems primarily due to unequal access to digital resources. Unequal access has immediate - pandemic related - as well as long term consequences, related to critical role played by the digital skills in today's labour markets.

Accumulation of educational gaps and inequalities starts at pre-schooling stage: only 25% of children were included in the pre-schooling programs in 2019-2020 schoolyear.<sup>62</sup> Earlier studies showed that in 30 of 143 BiH's municipalities surveyed in 2016 there was no such program.<sup>63</sup> This problem affects labour participation of women of working age as they stay longer at home to raise children and support men at work.



Gaps are accumulated further in primary education. Class sizes (19 pupils) and pupil/teacher ratios (14-15 depending on the schooling year) are in line with peers and international standards (Fig. 18). Primary enrolment is high (97% in FBiH and 99% in RS), except for Roma (80%). However, spending per pupil differs substantially between FBiH and RS. Gap is 24% in favour of the FBiH.<sup>64</sup> Nevertheless, spending per pupil in primary education is in line with peers. The FBiH, with € 1,404 per pupil per annum, spends more than Romania (€ 766) and Turkey (€ 1,271), close to Bulgaria (€ 1,604). The RS, with spending of € 1,130 per pupil, is close to Turkey and spends more than Romania.<sup>65</sup> Total public spending on education (4.3% of GDP) ranks well among peers (Fig. 19).

<sup>61</sup> UNDP (2020): *Social Inclusion in BiH: 2020 National Human Development report (in draft)*

<sup>62</sup> UNICEF (2020): Country Programme Document for BiH, UNICEF 2020

<sup>63</sup> UNICEF Multiple Indicator Cluster Survey (2011 – 2012) and USAID (2016): Monitoring and evaluation support activity (measure-BiH): brief assessment of basic education in BiH

<sup>64</sup> 2750 in FBiH vs. 2213 BAM in RS in primary education and 2608 vs 2122 in secondary education; UNDP (2020): *Social Inclusion in BiH: 2020 National Human Development report, p. 39 (in draft)*

<sup>65</sup> Eurostat, 2017 data

Figure 19. Public spending on education in % of GDP\*

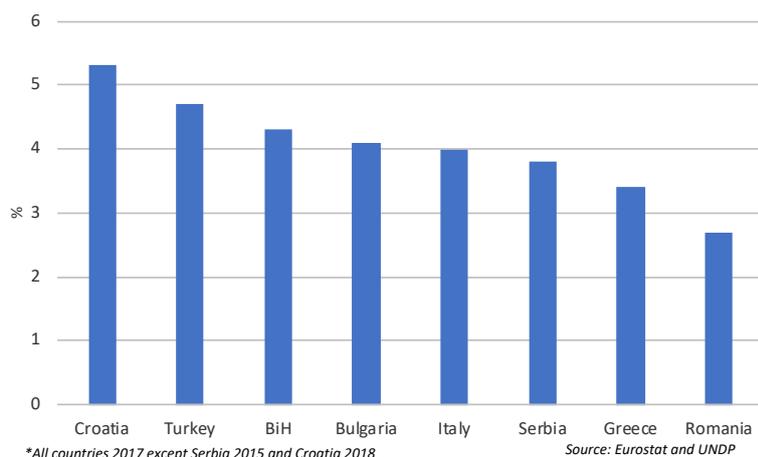


Figure 20. PISA 2018 scores

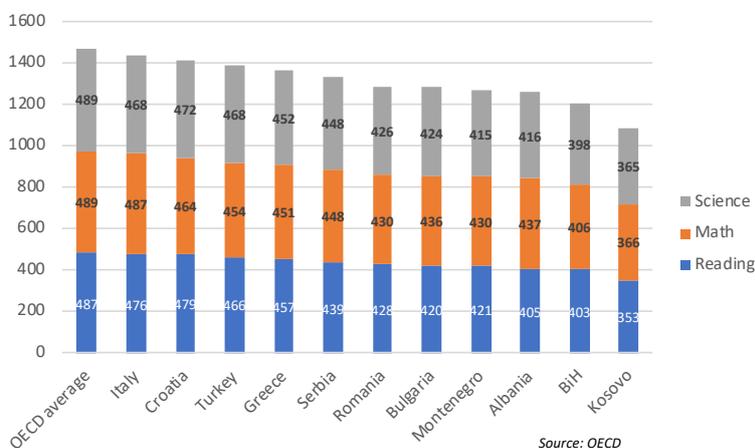
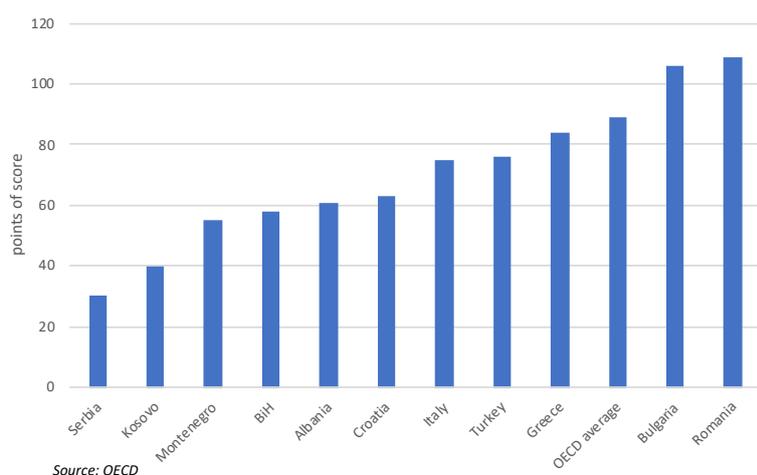


Figure 21. PISA socio-economic gap in reading



Even once the linear decrease in the number of children enrolled in primary schools due to aging of the population is taken into account, BiH has made relative improvement in reducing school dropouts between 2013 (678) and 2017 (272), with minority dropouts among girls. However, the 2018 PISA results for 15-year olds lag behind the peers.<sup>66</sup> Only pupils in Kosovo\* had worse results, and this outcome is uniform across three educational dimensions of reading, math and science (Fig. 20). Regional peers with lower or similar expenditure on education score better (e.g. Romania, Turkey, Serbia).

BiH has relatively equitable educational outcomes when compared to other countries as indicated in Fig. 21 which shows differences in PISA scores between socio-economically advantaged vs. disadvantaged students. Nevertheless, the main problem remains: input-outcome ratio is not proportionate in comparison to other similar countries. This fact should draw policy makers' attention to reforming curricula, content, and methods of teaching.

Weak outcomes in the educational system and a lack of skills in particular, calls for labour market measures and an adequate adaptation of VET curricula. There is also a lack of work-based learning opportunities in companies, which is one of the major reasons for skills

<sup>66</sup> OECD (2019): Results from PISA 2019, Country Notes

mismatches and high youth unemployment.<sup>67</sup> Wedge between educational system and labour market is deep.<sup>68</sup>

In general, decentralization, substantial fiscal variations, lack of coordination and common teaching standards represent main reasons for weak outcomes. Similar results are found in the areas of higher education, lifelong learning and science.

The COVID-19 crisis will likely have negative short-term effects on education acting through two channels: (a) substantial budgetary cuts<sup>69</sup> and (b) lack of access to quality inclusive education during the complete and partial school closures.

The World Bank also estimated impact of COVID-19 on education to be largely negative:<sup>70</sup> *human capital growth will likely decline or come to a standstill and current gaps in learning equity will widen. Learning loss will be considerable, disproportionately affecting the disadvantaged.* These grim predictions rest upon the assumption that shifts to remote modalities of education can work for higher education where capacities, organisation and student autonomy are stronger. However, it cannot substitute for classroom work at pre-primary, primary and secondary levels due to access problem and unequal students' backgrounds. According to 2018 PISA results for BiH, there is a significant gap between top and bottom quintile of students in terms of share of students with access to internet and computer that can be used for schoolwork. Data suggest that advantaged students will have no problem with remote teaching, as 100% have access to internet and 97% have computer for schoolwork. However, respective shares in the bottom quintile are 87% and 73%.<sup>71</sup> Substantial portion of students are exposed to risk of lagging behind if school work will be continued online, which at the time point of the SEIA document (mid-September) is the case for a substantial share of students. This may increase risk of student dropouts. BiH authorities also estimated risk of access for 4,800 children in both primary and secondary education due to lack of IT access. According to UNICEF's U-report in BiH, 35% of young people faced difficulties with access due to lack of devices and internet, but also due to necessity to share devices with other household members and lack of appropriate space for learning. Such problems are critical for children in vulnerable groups such as poor, Roma and youth with disabilities who require intensive teaching support. The mentioned report noted that pre-school education was fully interrupted in most schools, while in some of them e-learning was not organised for children in lower primary grades.<sup>72</sup> Finally, a survey by ILO, UNESCO and the World Bank Group showed that most TVET schools were unprepared for delivering quality e-learning in terms of digital infrastructure (learning materials, hardware, internet access) and teacher preparedness. Inflexible legal provisions were named as an important obstacle. Practical classes and work-based learning in companies had to be suspended.<sup>73</sup>

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<sup>67</sup> European Training Foundation (2019)

<sup>68</sup> UNDP (2020): *Social Inclusion in BiH: 2020 National Human Development report (in draft)*

<sup>69</sup> UN Women (2020): Occasional Budget Briefs No. 1 and 3, April and May

<sup>70</sup> *The Economic and Social Impact of COVID-19.: Education.* Western Balkans Regular Economic Report no. 17 Washington, D.C: World Bank Group

<sup>71</sup> OECD (2019): Results from PISA 2019, Country Notes

<sup>72</sup> Rapid Needs Assessment - Education, UNICEF BiH, March 2020

<sup>73</sup> ILO, UNESCO and The World Bank (2020): *Joint Survey on Technical and Vocational Education and Training (TVET) and Skills Development during the time of COVID-19*

## Health (non-COVID)

Figure 22. Healthy life expectancy in 2019 in selected countries of SEE

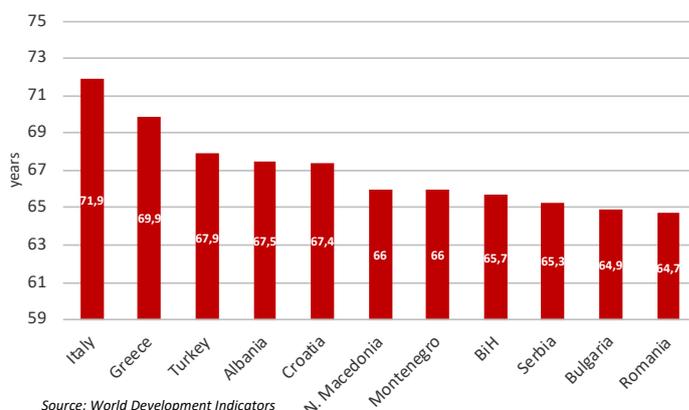
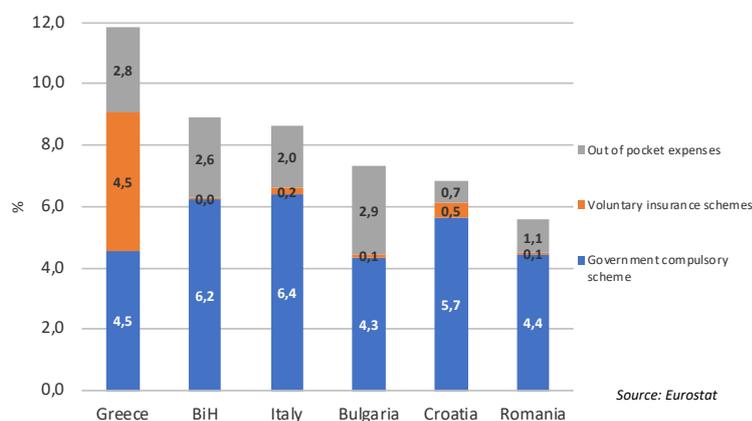


Figure 23. Health expenditures by financing scheme in % of GDP 2018 in selected countries of SEE



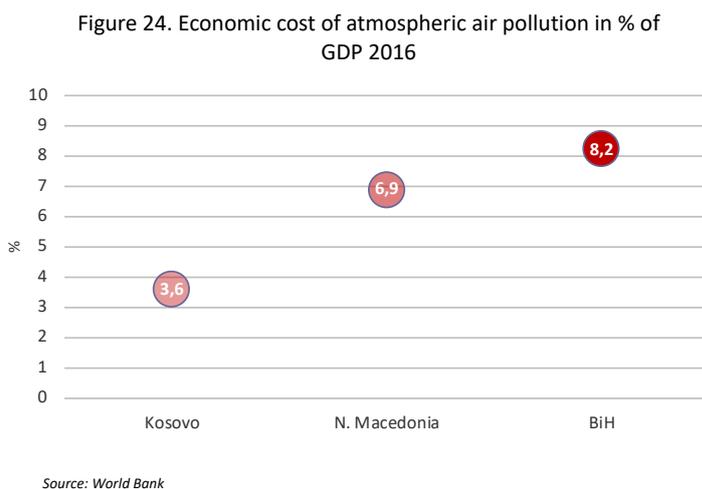
Life expectancy in BiH is around 77.2 years, in line with peers in South East Europe. In terms of healthy life expectancy, BiH is lagging behind (65.7 years). At a first glance, this outcome, which is similar to Bulgaria, Romania, Serbia, Montenegro and North Macedonia is exactly as expected (Fig. 22). However, total health spending (including out of pocket private expenses) was 8.9% of GDP in 2018 and 9.2% of GDP in 2019. This is far above peers and higher than in more developed countries in South East Europe which have substantially better health outcomes (Fig. 24). Ratio of health funding will increase further in 2020 due to increase in COVID-19 related health spending and contraction of GDP. BiH is an outlier also in terms of private household out of pocket spending for health services. Disproportionality between inputs and outcomes is similar to the situation in education, revealing general inefficiency in the public sector.

The first factor explaining such a situation is similar across all policy areas: fragmentation creates inefficiency. BiH has 13 compulsory health insurance funds with consequent lack of management standards and a failure in use of economy of scale. For example, drug purchases result in high share of spending for medication (27% of total health expenditures). Share of purchases of medications is even higher when only out of pocket health expenditures are considered.<sup>74</sup>

The second factor is related to aging of population. Older people consume most of health system resources: 33% of insurance holders in the FBiH and 35.5% in the RS are pensioners.<sup>75</sup>

<sup>74</sup> UNDP (2020): *Social Inclusion in BiH: 2020 National Human Development report (in draft)*

<sup>75</sup> Ibid



The third reason may be related to air pollution which is an acute problem in BiH. The World Bank estimated direct social cost of air pollution on health in BiH at alarming 8.2% of GDP in 2016. This is by far the highest social cost of air pollution in SEE (Fig. 24)<sup>76</sup>. Turning the problem to a chance, BiH has a great opportunity to increase investment, standard of living, health of population, quality of life and environment by setting proper policy priorities, targets and allocations for energy

efficiency and decentralized production of energy from renewables (green investment). Savings in the health system due to lower air pollution may be substantial. This positive externality should be considered in cost-benefit calculations for future green energy investments.

Substantial improvements are also possible by strengthening prevention in primary health service, including investment in telemedicine. Telemedicine proved its usefulness during the COVID-19 crisis in other countries.

Secondary pandemic mortality due to closure of parts of the health system is an open issue. It is still widely discussed globally, and research results are not clear. Time which elapsed since the beginning of pandemic is too short to assess impacts precisely. It takes time to observe non-COVID-19 risks, such as late detection of cancer and coronary diseases which are frequent causes of death in BiH. Preliminary results show that secondary morbidity and mortality may be significant, with lots of unexplained variations across states and regions.<sup>77</sup> No analysis of non-COVID-19 mortality in BiH is available as yet.

Decentralized financing and management of the health system in BiH is producing chronic debt problem and fiscal instability of the health sector. It represented a challenge even before the pandemic outbreak due to structural problem of aging population which fuels growth of demand for health services. The main challenge is the lack of funding due to small number of employees in the formal sector. It is a challenge to mitigate financial sustainability problem in a situation like this, with formally universal health care and already high health contributions based on workers' wages (employees pay social contribution of 12.5% in the FBiH and 12% in the RS and additional 4% is paid by employers in FBiH).<sup>78</sup>

The COVID-19 shock affected the health system financing in two ways on top of immediate purchases for personal protective equipment and other resources necessary for COVID-19 case management: (a) recession layoffs reduced the base for calculation of health contributions; (b) hospital revenues diminished, as partial closure of the system reduced supply/demand of non-COVID-19 health services.<sup>79</sup> Authorities have to act urgently in order to find solutions for both short-run and long-run health financing challenges as impact of health crisis on health finance threatens the health standard

<sup>76</sup> World Bank (2019) Country Reports BiH, Kosovo\*, North Macedonia

<sup>77</sup> Wolf, S. H., et. al. (2020): Excess Deaths From COVID-19 and Other Causes, March-April 2020. JAMA Network Research Letters

<sup>78</sup> UNDP (2020): *Social Inclusion in BiH: 2020 National Human Development report (in draft)*

<sup>79</sup> *The Economic and Social Impact of COVID-19.: Education*. Western Balkans Regular Economic Report no. 17 Washington, D.C: World Bank Group

in BiH beyond systemic problems which were creeping before the outbreak of pandemic. Most importantly, high out of pocket expenses, indication of unequal access to health care and evidence of catastrophic spending (primarily on drugs) by vulnerable individuals call for supplementing the health sector reform with social protection measures in order to reduce inequalities and poverty related to health problems.<sup>80</sup>

### Poverty Incidence and Social protection

The latest available BiH official poverty data are for 2015 when poverty was estimated at 16%.<sup>81</sup> The World Bank is predicting that the poverty in BiH is expected to rise from estimated 11.8 % in 2019 to 12.9 to 14.6 % in 2020. Mounting pressures on poverty will depend on duration of the COVID-19 recession. Expected range of the number of persons likely falling into poverty is between 35,000 and 85,000, with 50-60% currently not covered by social protection programs, depending on the duration of recession.<sup>82</sup> This estimate comes on top of approximation that around 20% of population is not covered by the health insurance.<sup>83</sup> World Bank estimates were developed under the assumption of no additional targeted government response beyond the measures already taken to protect jobs in the formal sector.

According to recent calculations by the World Bank, 16.8% of the population receives some form of social transfer besides pension. Following are the main elements of social protection in BiH besides pensions: social assistance, unemployment and disability benefits. About 30% of households in BiH declare pension to be the main source of family income (smaller proportion declared that wages play that role, which is broadly in line with the number of pensioners - close to 800,000 - approaching the number of formally employed, somewhat higher than 800,000).

BiH has the highest proportion of expenditure on veterans, survivors and disability benefits in the Western Balkans region. This weighs over resources for spending on family and child benefits.

The cost of administration of the social protection system in relative terms is by far the highest in the region.<sup>84</sup> Therefore, it does not come as a surprise that pensions are inadequate: average pension to average wage ratio is 44% in the FBiH and 42% in the RS. Similar holds true for unemployment benefits. Duration of benefits depends on previous duration of work, which creates weak protection for young workers who experience indirect incentives to seek jobs abroad.

Coverage of the poorest quintile with social transfers remains low compared to countries with similar per capita income levels. In addition, only 1.9% of the total population and 6.2% of the poorest benefit from means-tested permanent and/or one-off social assistance. The actual expenditure on families with children, persons with non-war related disability and other vulnerable categories is between 1 and 1.2% of GDP, the lowest in the region.

Coverage is low compared to other countries in Europe and Central Asia region. The current system is uneven and inadequate to keep vulnerable out of poverty. The fundamental problem lies in the fact that non-contributory cash benefits for social protection in BiH are mainly based on 'status rights', particularly in the case of veterans' benefits. This results in poor targeting. In addition to inadequate targeting, social benefits remain out of reach for many families in need due to restrictive eligibility

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<sup>80</sup> UNDP (2020): *Social Inclusion in BiH: 2020 National Human Development report (in draft)*

<sup>81</sup> Based on earnings below 60% of median income

<sup>82</sup> *The Economic and Social Impact of COVID-19: Poverty and Household Welfare*. Western Balkans Regular Economic Report no. 17 Washington, D.C: World Bank Group

<sup>83</sup> UNDP (2020): *Social Inclusion in BiH: 2020 National Human Development report (in draft)*

<sup>84</sup> UNDP (2020): *Social Inclusion in BiH: 2020 National Human Development report (in draft)*

criteria, complex and sometimes costly administrative procedures, stigma and discrimination, limited geographic provision, or simply because families are not aware of the cash benefits, services or their entitlements.<sup>85</sup>

The performance of social service providers at the local level is affected by significant challenges in terms of human, financial and technical capacities. Social services, particularly for marginalized and vulnerable are scarce and where existing, these are often overburdened with limited time and resources, affecting the quality and overall accessibility. These weaknesses of the system were coupled with additional challenges borne by the COVID-19 crisis – increased demand for benefits and services.

It needs to be noted that even though there were no cuts in social assistance cash benefits as part of budget re-balancing due to COVID-19, budget cuts were recorded in the social protection sector at all levels (e.g. at the level of Federal Ministry of Labour and Social Policy, as well as the Cantonal and Local levels). The budget cuts were mainly related to either decrease or removal of initially planned budgets for development projects, grants for NGO sector for provision of social services or funds that were allocated for employment of new social service workforce (e.g. Sarajevo Cantonal Centre for Social Work).

On a more positive note, there are two sorts of “natural” poverty cushions in BiH: (a) less than 3% of households pay rents for their apartments, mostly living in own or parents’ premises, and (b) private remittances from abroad are around 8.5% of GDP. The COVID-19 crisis will likely reduce the second source, which may aggravate social problems beyond domestic labour market shock.

Authorities did not use strong social protection instruments to respond to consequences of the COVID-19 crisis at its outset. For example, qualifications for unemployment benefits scheme are still the same as in normal times. Criteria involves at least 8 months of work in prior 18 months (in the FBiH) or 12 months (in the RS) and the benefit duration is proportional to months of work. This means that the benefit program has the characteristic of an insurance scheme, excluding the short-term employed and informal sector workers. Also, several years of prior work guarantee only a few months of benefits (e.g. 5 years - 3 months in the RS).<sup>86</sup> This is inappropriate when adverse economic shocks are strong. This is the reason why the number of beneficiaries in BiH is very low compared to the number of registered unemployed (recall Fig. 10). In addition, these categories are not entitled to any immediate social assistance benefits either. An urgent response is needed. Globally, UNDP has prepared proposals for temporary basic income (TBI) measures, that are meant to provide time-bound support to the most vulnerable.<sup>87</sup>

## Government Response and Effectiveness

There is a common theme related to government response and effectiveness in the areas of education, health and social protection which are discussed in the remainder of the chapter. Political fragmentation of governance, finance and operational management, create economic inefficiencies and lack of effective outcomes including unequal standards across the country. BiH authorities should strive to achieve better coordination within existing political setup in order to improve outcomes and free up resources to be diverted from administrative cost to transfers of public goods to citizens. In this way, regions and municipalities which are exposed to the highest risk of lagging behind in terms of production of social services may reduce the developmental gap.

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<sup>85</sup> E.g. Roma families, families living in remote areas, etc.

<sup>86</sup> Zavod za zapošljavanje Republike Srpske

<sup>87</sup> TBI is unconditional emergency cash transfer for poor or near poor households that do not currently have access to social assistance or social insurance (UNDP, 2020).

## Education

The school year of 2019/2020 was finished on a remote basis, supported by TV programs. Children without access were provided with adequate learning materials. Ad hoc efforts of educational authorities were also undertaken to assist disadvantaged to overcome the digital gap. Notwithstanding such efforts, clear instructions and developed teaching programs were missing. On a more positive note, ad-hoc good news occurred in the local media, such as bottom-up initiatives of teachers and introductions of digital school diaries where these were missing. Notwithstanding positive examples, pupils, schools, teachers and parents had to cope with the situation largely based on decentralized initiatives. Governments also provided justified absence from work for one of the parents of children up to 10 years of age. This mitigated some of the immediate challenges, but this measure did not resolve the key learning problems in primary and secondary education.

It is not possible to precisely assess the effectiveness of government measures. Indirect evidence points to risks of inequitable access to the education system and digital tools. UNICEF (2020) highlights that this problem is universal - it has occurred in all countries. While digitalization of channels and content are welcome as they have led to faster learning of digital skills by both teachers and pupils, there is still a real risk that these advancements were not able to compensate for losses related to inequitable access which would not have occurred during regular classroom work. Problems may escalate further during the school year of 2020/21 if the pace of pandemic continues and schools remain closed or partly open. On top of this, the COVID-19 crisis may delay efforts on the front of structural reform of the education and VET system, which is badly needed in order to narrow the skills gap.<sup>88</sup>

## Health (non-COVID)

Both entities committed to work with the World Bank on the health sector reform, including better financial monitoring, inclusion of all public health institutions in central treasury and centralized procurement in order to cut costs of drug purchases.<sup>89</sup> The law on financial consolidation and restructuring of public health institutions in F BiH envisages BAM 300 million World Bank loan for funding health sector reform in 2021 and 2022.<sup>90</sup> Such programs are expected to increase effectiveness of health protection. However, more is needed in terms of balancing COVID-19 and non-COVID-19 morbidity and mortality risks, including development of prevention and telemedicine in order to catch up with present crisis. In-depth analysis of secondary (non-COVID-19) health risks induced by the response to pandemic is still missing. Also, financial sustainability needs to be restored in the mid-term to prevent financial disruptions in the critical period of fighting pandemic, especially if BiH wants to get closer to full universal insurance coverage. At present, there are estimates of about 20% of population not covered by the public health insurance and high incidence of (potentially catastrophic) out of pocket private health expenses for seriously ill. These problems are not tackled by authorities yet.

## Poverty Incidence and Social Protection

Social support system in BiH did not react to the COVID-19 crisis so far. Authorities relied on absorbing shockwaves by (a) retaining employment and wages in large and protected public sector which encompasses about a third of total employment, and (b) subsidies for cost of labour in the formal private sector which was hit by the consequences of severe lockdown. Subsidies were extensive during lockdown, but after opening the economy assistance is being phased away. Discussion in the third

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<sup>88</sup> The Joint Socio-economic Economic Reforms 2019-2022 (Reform Agenda 2) envisaged reforms in the fields of career development in the context of lifelong learning, implementation of qualification standards, development of new curricula and improvement of expert knowledge and capacities at all levels of education system with ultimate aim to harmonise skills and outcomes with future labour market needs.

<sup>89</sup> Zajedničke socio-ekonomske reforme za period 2019.-2022.

<sup>90</sup> Program ekonomske stabilizacije i oporavka Federacije Bosne i Hercegovine 2020.-2021.

chapter of the report pointed out that *there is a need for prolongation of some measures because the recession will likely not be resolved through a V-shaped recovery*. Summer outbreak of pandemic posed a threat of further interruptions of normal activities in autumn and winter. Continued wage subsidies should be of limited duration, while more fiscal resources should be devoted to active labour market measures which may become effective when recovery becomes more firmly rooted during 2021. Also, there are structural weaknesses in unemployment benefits system and there are pockets of potential exposures to increased poverty related to: (a) people facing catastrophic out of pocket health expenses, (b) reductions in received private remittances from abroad, and (c) workers in the informal sector. In addition, the social assistance benefits are not well targeted and have low or no impact on poverty reduction. More effective and targeted measures are needed to prevent falling of vulnerable to poverty.

## Key Conclusions and Identified Gaps

**Education.** The advancements in terms of digitalization of teaching channels and content cannot fully mitigate the problems related to interruption of regular classroom and practical VET attendance. The gap in terms of access to education is looming. The problem should be tackled immediately, as it has both immediate and long-term consequences: in the short-run, it creates unequal access to public education and VET services; in the long run, it deprives poorer segments of youth from basic digital skills, critical for access to labour markets during their lifetime. In addition, there are profound impacts that school closures have on students. It threatens to increase education disparities, provoke significant learning losses, increase the risk of children dropping out of school, especially those from vulnerable families, such as Roma, and undermine the learning process for generations to come. Also, physical presence at school provides sense of safety, peer support and a framework for personal development.

COVID-19-related problems came on top of structural problems in the BiH educational and VET system as reflected in 2018 PISA results. Lag versus peer countries which was uncovered by PISA may further increase as a consequence of COVID-19 crisis. This threat is especially present in BiH due to the fragmented organisation of education with the lack of coordination between education authorities. Teaching quality and curricula are in a heavy need for harmonisation and modernisation and, in the case of VET curricula, adaptation to the skills needs and business practices in the labour market, to bring educational and VET outcomes in line with expected demand for knowledge and skills.

Comparison of input-outcome ratios with peers shows need for reform. It is important to analyse, the proportions of potential educational inequity created by disruptions of classroom education and VET. Short run measures, such as providing resources for disadvantaged students and improving digital content and teaching skills are needed immediately, as long as there is risk of partial or full closure of schools during continuation of the pandemic. Innovative general education and VET schools, teachers and trainers who were best adapted to the lockdown situation should be recognized, awarded and used as role models. On a more of a mid to long-term basis, challenges posed and revealed by COVID-19 should be used *as a catalyst for forward-looking reform*. The reform should encompass substantial improvements in content, managerial coordination, quality and methods of teaching in order to modernize the educational and the VET system.

**Health.** Credible short-term and long-term health system response plans are required in order to tackle health risks not related to COVID-19. It is necessary to develop deeper understanding of secondary pandemic mortality due to closure of parts of regular health services and implement strategy for minimization of such risks. Strengthening gatekeeping role of primary care in terms of prevention programs and telemedicine may be helpful in this respect. Also, plans for priority continuity services are needed (see the first chapter on health related to COVID-19). Currently there are no comprehensive plans for financial sustainability of the health system. Such plans should include broadening health insurance coverage to the whole population. As it is not realistic to substantially

reduce out of pocket health expenses which create unequal access to the system, health measures should be coordinated closely with social measures for vulnerable people facing significant health expenses. There are indications that unusually high health care costs and frequency of pulmonary, respiratory and other diseases are associated with air pollution in big cities, where main cause is found in the technologically backward car transportation and heating systems, on top of the use of coal power plants. Allocation of funds for health programs should take this fact into account. It should affect prioritizing of green energy projects in order to protect people's health and reduce substantial fiscal and social cost.

**Social protection.** Criteria and targeting of social measures have not changed during the COVID-19 crisis. Social policy mix should adapt across crisis response phases, as consequences of COVID-19 will be felt for some time.<sup>91</sup>

Firstly, BiH has to reform unemployment benefits in order to make them more inclusive for the purpose of immediate response to consequences of expected prolonged recession throughout autumn and winter of 2020/2021. Broader access to non-contributory unemployment benefits for workers with shorter prior work experience is applied in many countries during the pandemic<sup>92</sup> and it may help workers with less work experience in the formal sector, prevent emigration and attract informal sector workers who lost their jobs to become visible for the system. Recent attempts by the FBiH Public Employment Institute in this direction are steps in the right direction. Remaining legal challenges should be addressed and attempts to harmonize the system across the country deserve support by authorities.<sup>93</sup>

This measure may be costly in fiscal terms, but it has the additional potential benefit (subject to design and implementation based on best practice) as non-contributory unemployment benefits program may be integrated - coordinated with active employment measures which may take over when recovery becomes more firmly rooted. In the medium term, potential for introduction of locally adjusted form of temporary basic income may be thoroughly researched within the broader effort of social protection reform and analysis of fiscal sustainability. It should be noted that usual arguments against use of unemployment benefits system for social protection purposes (due to reduction of incentives for job search) make less sense during pandemic-related economic shock, as there is general lack of job offers. For that reason, the proposal is part of a sequenced set of measures: as recovery takes place, inclusive non-contributory unemployment benefits scheme should be phased away, and active labour market measures, which are to be designed and tested in the meantime, should take over in order to facilitate restructuring of the economy. This policy effort should be a part of a holistic approach to labour market development as educational outcomes are also critical for long term labour market participation. The complexity of this effort is especially pronounced in the BiH context, where set of aforementioned measures should be designed and implemented with a goal to attract informal sector workers under umbrella of the formal sector.

Secondly, timely plan for reform of the administrative burden in the social protection system (by applying digital solutions) should be implemented in order to reduce administrative expenses which make BiH social protection system an outlier in the Western Balkans region. Improvement in administrative efficiency is a must, regardless of measures taken. Integrating databases, screening,

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<sup>91</sup> *The Economic and Social Impact of COVID-19: Social Protection Responses*. Western Balkans Regular Economic Report no. 17 Washington, D.C: World Bank Group.

<sup>92</sup> Ibid.

<sup>93</sup> There is a decision by the FBiH Supreme Court which states that an unemployed person has the right to unemployment benefits irrespective of unpaid contributions. The problem is that this decision by the FBiH Supreme Court is not respected by all cantonal employment offices. In cases where cantonal office refuses to grant benefits, the unemployed should raise the case to the FBiH Office as the second level organ, which will decide in accordance to the ruling of the FBiH Supreme Court, i.e. it will decide that the unemployed person has the right to unemployment benefits irrespective of unpaid contributions.

analysis and monitoring of different pillars of the social protection should be the by-product of the effort in order to streamline the system.

Thirdly, timely analysis to gain better understanding of significant out of pocket health expenses needs to be undertaken in order to design social assistance program specifically for this purpose, paid from the social assistance budget, not from the public health budget. Health sector budget will be burdened due to immediate COVID-19 needs and with the goal to broaden the coverage to reach universal health coverage.

Fourthly, better targeting of the non-contributory social assistance benefits is required. The reasons for directing the benefits to the poor is to channel limited resources to those most in need. This concept is particularly important at the present time, when the most vulnerable are even more exposed to the damaging impact of the COVID-19 crisis.

## Recommendations

### Education:

- Invest in digital connectivity for every child and increase quality of e-learning. Ensure common implementation standards and digital resources and implement inequity prevention program using the best solutions developed during the spring 2020 semester and best practice developed in other countries.
- Increase quality of learning in general, emphasising needs of most vulnerable children, including children with disabilities and Roma, who usually need more classroom support.
- Align long-term plan for educational reform with COVID-19 reality and ensure resilience of education in future emergencies.
- Lower access barriers to vocational training and lifelong learning opportunities, modernize and adapt VET curricula and lifelong learning provision to the needs of the labour market, in particular in industries that are key for economic recovery from the pandemic.
- Invest in pre-school education keeping in mind its indirect effect on gender equality as it helps participation of young women in the labour market.
- Protect and increase education sector financing and ensure that adequate funds are directed to most vulnerable children.

### Non-Covid-19-related Health:

- Prioritize programmes in the primary health care including options for development of telemedicine.
- Research secondary pandemic mortality due to lockdown and ensure continuity of health services.
- Perform in-depth research of out of pocket health expenses and use the results to adjust social assistance in order to reduce inequity in access to health protection related to vulnerable individuals facing catastrophic out of pocket expenses.
- Implement health sector reform based on best international practice in order to ensure short-term and long-term financial sustainability while keeping universal open access system. Reduce the currently estimated (about) 20% of citizens not covered by health insurance by linking it to other social protection programs.
- Coordinate and inform industrial policy measures with assessment of external social benefits of reduction of air pollution. Internalise expected health benefits in investment plans.

### Social protection:

- Eliminate excess administrative burden in the social protection system by improving Management Information System and development of digitalized social services
- Improve shock-responsiveness of the social assistance system (cash contingency, institutional preparedness, etc)

- Reform social assistance targeting system so that the benefits are based on needs and not on the status of beneficiaries. Define the monetary social security minimum. Use programmatic interventions and benefits including cash and in-kind transfers targeting vulnerable households such as single parent households, families with many children, people with disabilities and chronic illness, internally displaced and returnees.
- Reform unemployment benefits system in a way which will make it more inclusive (non-contributory) to include people who make their living in informal economy, those on temporary contracts, seasonal work and in precarious jobs and phase these benefits out when recovery becomes firmly rooted, with active labour market measures developed in the meantime.
- Prevent cuts in public spending in areas such as education, health and social protection.
- Make sure that the above groups of measures are fitted well within the mid-term macroeconomic scenario which ensures fiscal sustainability and preserves preconditions for economic growth.

## Social Cohesion and Community Resilience

### Analytics: COVID-19 Impact and Vulnerabilities

The social and economic consequences of the COVID-19 pandemic in BiH are likely to have an impact on social cohesion and result in the deepening of inequalities, a rise in tensions and possibly even grievances among and between various social groups. As documented in previous chapters, COVID-19 will exacerbate existing economic inequalities and vulnerabilities. Also, there is a risk that the response will not result in an equal distribution across communities (only one example: the differences in risks of unemployment related to public sector and private sector and informal sector). Previous chapters have highlighted that people in vulnerable situations are at a disproportionate risk to COVID-19-related hardship.

Inequality of income distribution in BiH (GINI coefficient of 33) stands at an average rate for Western Balkans countries and somewhat higher than the EU average of 31. BiH's HDI for 2018 is 0.769. However, when the value is discounted for inequality, the HDI falls to 0.658, a loss of 14.4% due to inequality in the distribution of the HDI dimension indices. Inequality has a geographical component. It can be partly explained by historic reasons, but part of it is related to weak regional policies and the lack of territorial fiscal equalization mechanisms. Poorer local communities are left on their own. In turn, this deepens territorial development gaps and the urban-rural divide.

This divide is also reflected in social systems such as education and access to other opportunities. Developmental gaps also explain some of the motives for emigration which is the most pressing social problem. People perceive that emigration of young families locks their communities in the vicious circle of underdevelopment.<sup>94</sup> While COVID-19 may stall emigration in the near term, BiH's structural problems will undoubtedly bring this to the fore again.

People in local communities have critical views on local employment services, road transportation, elderly care facilities and, above all, social assistance. Widespread perception of weak social support system affirms findings presented in the previous chapter. Education and health services fare better in the eyes of people, but territorial inequalities cause huge variations across municipalities.<sup>95</sup>

The limited capacities of local governments to adequately prepare for, and respond to, disasters are now being additionally stretched in response to the COVID-19 crisis. The UNDP assessment of local governments and MZs<sup>96</sup> highlight that in addition to measures taken at higher levels, mitigating strategies for the local economy have been adopted by a number of local governments through re-allocation of their budgets. The assessment also highlighted that civil society organisations (CSOs) in local communities were mainly engaged in preventing the spread of the COVID-19 virus on their own initiative and with their own funds.

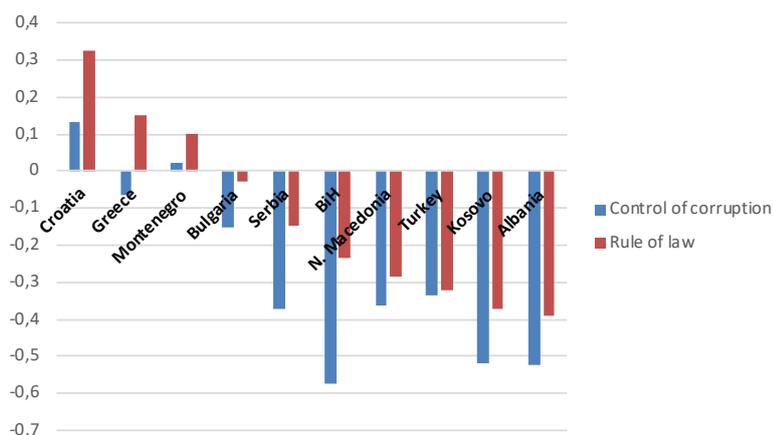
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<sup>94</sup> UNDP (2020): *Social Inclusion in BiH: 2020 National Human Development report (in draft)*

<sup>95</sup> Ibid

<sup>96</sup> UNDP (2020) *RARE assessment, COVID-19 Assessment within partner LGs, MZs and CSOs*

Figure 25. Rule of law and control of corruption in selected EU member states and Southeast Europe

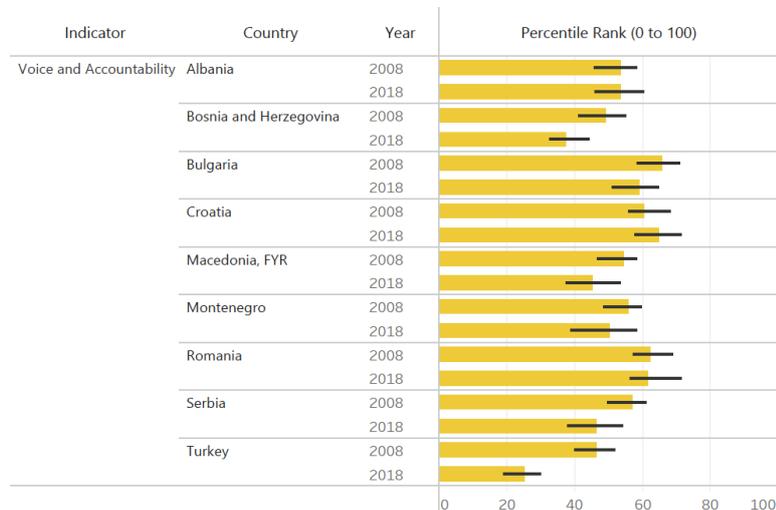


BiH continues to face serious challenges related to corruption and clientelism. Fig. 25 shows that BiH is a median country within the broader region with respect to the rule of law. However, it lags far behind in terms of control of corruption. The latter is particularly corrosive in terms of social cohesion and trust.

This finding is evident in the Regional Cooperation Council (RCC) public opinion survey carried out between December 2019 and January 2020 where 78% of

respondents completely distrust or tend not to trust the government in BiH. A lack of trust is present across a range of public institutions, where BiH has the lowest trust rating among Western Balkans countries in four of the five surveyed institutions (courts, parliament, government, ombudsmen, audit institutions). Of particular concern is the level of citizen confidence in the legal system. Some 80% (up from 67% in 2018) of respondents in BiH see the legal system as ineffective. 88% of the population in BiH view government’s handling of anti-corruption as unsatisfactory. In sum, BiH suffers from a lack of confidence in the ability of both governmental and non-governmental actors to hold the executive government to account.<sup>97</sup>

Figure 26. Voice and Accountability Indicator

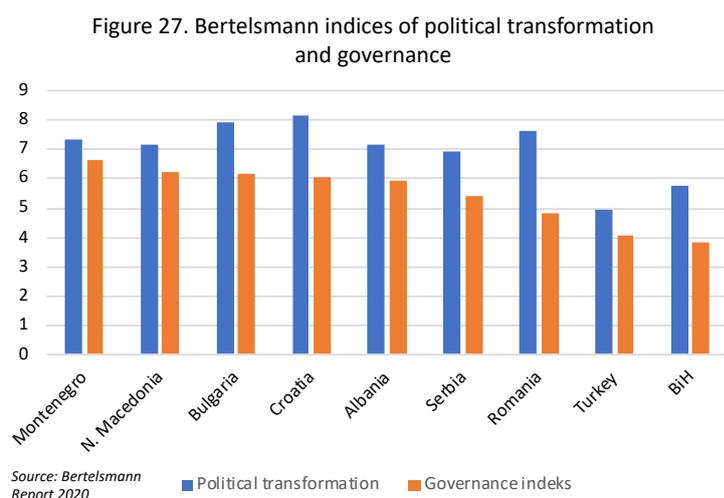


During the peak of the COVID-19 pandemic, several cases of allegedly irregular public procurements of medical equipment and PPE involving high level officials triggered investigations by the prosecution<sup>98</sup>. These cases have only bolstered citizens’ mistrust of certain government institutions. If the BiH court system effectively addresses these cases, this may help restore some level of trust and thus directly impact the social cohesion equation in a positive manner.

The World Bank’s indicator of Voice and Accountability (Fig. 26) captures perceptions about ability of citizens to participate in selecting their government, and freedom of association, expression, and media. BiH is lagging in the region, but a worrisome finding is that BiH fell far behind in the period between 2008 and 2018 (similar trends unfolded in North Macedonia, Bulgaria, Serbia, and Turkey).

<sup>97</sup> RCC, BALKAN BAROMETER 2020: Public Opinion Survey.

<sup>98</sup> Sources: press and Prosecution Offices (Tužilaštvo BiH).



These assessments are confirmed by the indices of the Bertelsmann Foundation. Its Governance index,<sup>99</sup> which also captures capacities for consensus building as well as the role of fear and patronage in policy making, ranks BiH at the bottom of the South-eastern Europe region. According to the Bertelsmann Foundation,<sup>100</sup> political elites in BiH use interethnic polarization for their own political and material interests. Ethnic divisions dominate politics but also seem to permeate broader social space: UNDP 2019 survey found that

the share of cross-ethnic friendships has been on a decline between 2009 and 2019.<sup>101</sup> This is also partly due to a generational problem as older people – who experienced inter-ethnic and internationality friendships in the former Yugoslavia – are replaced by younger generations who grew up after conflict and who had less opportunities to experience cross-ethnic friendships.

During the pandemic, the role and power of media and its impacts on societal cohesions and resilience are coming to the fore. On a positive note, social media is being used to increase civic awareness, mobilization and to enable increased access to information, empowering citizens to be more prominently engaged in critical issues. On a negative note, however, like in other countries, BiH is vulnerable to dis/misinformation campaigns and exposed to various conspiracy theories related to the pandemic crisis. One could argue that mis/disinformation itself took the form of a pandemic as it spreads through communities and society, often via unregulated social and online media sources. Media literacy is a critical challenge as some 27% of respondents stated that they do not know how to check or verify the accuracy of information being presented to them.<sup>102</sup>

The authorities in BiH have attempted to address the issue of mis/disinformation by adopting decisions during COVID-19 on sanctioning those responsible for spreading such content; while civil society organisations (CSOs) have highlighted the importance of striking a balance between containing misleading news and respecting the freedom of expression (e.g. specifically, during the state of emergency, in March, the RS Government adopted a decree prohibiting presentation or transmission of false news or allegations that could trigger widespread panic or disturb public order or peace; this decision was reversed in April, 2020 ).

In addition, during the COVID-19 pandemic period, stigmatization, discrimination and hate speech remain key drivers that can easily undermine social cohesion and community resilience. Stigmatization and discrimination of minorities, migrants, refugees, asylum-seekers, persons under subsidiary protection and at risk of statelessness – which was already present in host communities in BiH – may be easily manipulated or intensified during the COVID-19 crisis and further strain inter- and intra-community dynamics. The aforementioned groups will face even greater administrative, financial, legal and language barriers; and accessing basic services will become more challenging.

<sup>99</sup> Bertelsmann Foundation, 2020

<sup>100</sup> Ibid

<sup>101</sup> Ibid

<sup>102</sup> Findings of the survey *Adequate information on the situation regarding COVID-19 in BiH* conducted by the Communication Regulatory Agency (RAK) in cooperation with UNICEF BiH in April 2020

## Government Response and Effectiveness

There have been few COVID-19-related responses by the authorities in BiH which specifically address challenges that impact social cohesion and community resilience. In terms of government actions related to the pandemic which have not been discussed earlier, the BiH Agency for Prevention of Corruption and Coordination of the Fight against Corruption adopted an Action Plan for the Prevention of Corruption of BiH Institutions during the COVID-19 Pandemic.<sup>103</sup> While this is a welcomed step, the key issue remains the implementation of laws to ensure transparency and accountability and to restore trust.

## Key Conclusions and Identified Gaps

Institutional fragmentation has remained a long-standing, core problem affecting nearly all sectors of community life in BiH. The authorities in BiH need to find ways to better and more effectively coordinate within the country's decentralized system in order to achieve common priorities and goals of all the country's residents and increase efficiency and effectiveness for the benefit of the people. This is the common theme throughout this document – starting from the need to focus on public investment, social protection, active labour market policies, educational and health reform; to name just a few.

In this context, measures for strengthening social cohesion and community resilience intersect with other sectors in this document. For example, educational equity requires free transportation of pupils to schools and access to digital resources and technologies. Addressing large informal sector of the economy requires active labour market policies and support for women (and women should be supported by accessible pre-school programmes for children). Fighting corruption requires open budgets, transparency and the reform of the public administration system.

The authorities in BiH can use this *crisis as a catalyst for a forward-looking recovery agenda*. It can and should be implemented by those elected to public office, and in partnership with citizens they are supposed to represent. The COVID-19 recovery period represents a unique opportunity for BiH to build better society and for public authorities to restore trust of BiH's citizens and residents. This is an opportunity for greater social empowerment and for building up the resilience of communities across the country. BiH will do best in its COVID-19 response with greater involvement of, and ownership by citizens over the recovery process, especially when including youth, women and vulnerable groups.

## Recommendations

### Government transparency and Public Administration Reform (PAR):

- Authorities in BiH need to improve transparency and implement anti-corruption programs.
- Authorities in BiH need to accelerate digitalization and e-governance, with focus on key e-services for citizens and e-services for businesses (development of *Government-to-Citizens – G2C services and G2B*).
- Authorities in BiH need to implement merit as criteria for employment in open and professional public administration.
- Consider territorial fiscal equalization mechanisms in order to make local development more equitable.

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<sup>103</sup> PARCO (2020)

**Social dialogue and equity:**

- Authorities in BiH need to ensure collection of disaggregated statistics as a norm across the public sector and strengthen data-driven policy formulation and continuous monitoring of policy effects.
- Authorities in BiH should implement recovery programs via the broad participation of citizens, residents, and underrepresented groups. Establish or utilize existing social dialogue platforms that allow for communication between elected leaders and their communities and neighbouring communities to strengthen social cohesion and the overall resilience of communities in BiH.
- Authorities in BiH should ensure that economic and fiscal consequences of the pandemic do not affect fiscal capacities to provide support to marginalized groups including through appropriate, transparent and well targeted funding to civil society organizations.

**Transparent elections and media space:**

- Elected officials as well as CSOs, media and BiH's citizens and residents should proactively work to prevent hate speech, stigmatization, discrimination and the rhetoric of division and fear, enhance media literacy to ensure an effective COVID-19 response and recovery.

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