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The International Development Association
acting as Administrator of the Interim Trust Fund**

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**REPORT AND RECOMMENDATION
OF THE
MANAGING DIRECTOR
TO THE
PRESIDENT OF THE
INTERNATIONAL DEVELOPMENT ASSOCIATION
ON A
PROPOSED INTERIM FUND CREDIT
IN AN AMOUNT OF SDR 7 MILLION
TO
BOSNIA AND HERZEGOVINA
FOR AN EMERGENCY INDUSTRIAL RE-START PROJECT
(INCLUDING A POLITICAL RISKS GUARANTEE FACILITY)**

NOVEMBER 19, 1996

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CURRENCY EQUIVALENTS

(as of October 22, 1996)

Unit of Currency : Bosnia and Herzegovina Dinar (BHD)

100 BHD = DM 1 = US\$ 0.65

FISCAL YEAR

January 1 - December 31

ABBREVIATIONS AND ACRONYMS

BH	Bosnia and Herzegovina
BHD	Bosnia and Herzegovina Dinar
DM	Deutsche Mark
EBRD	European Bank for Reconstruction and Development
ECA	Export Credit Agency
EU	European Union
GNP	Gross National Product
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IDA (ITF)	IDA Interim Trust Fund
IFC	International Finance Corporation
IGA	Investment Guarantee Agency
IMF	International Monetary Fund
MIGA	Multilateral Investment Guarantee Agency
PMAU	Procurement Monitoring and Audit Unit
PRGF	Political Risks Guarantee Facility
SGC	Standard Guarantee Contract

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BOSNIA AND HERZEGOVINAEMERGENCY INDUSTRIAL RE-START PROJECTCredit and Project Summary

- Borrower:** Bosnia and Herzegovina. (BH)
- Executing Agency:** Investment Guarantee Agency (IGA), an independent corporation established by the Government.
- Beneficiaries:** BH industrial and commercial enterprises.
- Amount:** SDR 7 million (US\$ 10 million equivalent).
- Terms:** 35 years repayment including 10 years of grace, repayable in DEM. The standard administrative and commitment fees will be charged.
- Financing Plan :**
- | | |
|---|---------------|
| <i>Guarantee Facility:</i> | |
| IDA (ITF) | \$ 10 million |
| Switzerland | \$ 5 million |
| <i>Financing gap</i> ¹ | \$ 35 million |
|
<i>Start-up and Marketing Cost:</i> | |
| The Netherlands | \$ 200,000 |
| United States | \$ 130,000 |
- Objectives:** The proposed operation is designed to help re-start industry and production by: (i) attracting foreign private finance for working capital and minor short-term investments to re-start viable parts of BH industrial and commercial enterprises; and (ii) providing foreign exchange for the purchase of critical imports for industry.

¹ While the Guarantee Facility is an open-ended program, the Government's target is to increase its total size to \$ 50 million, to meet expected high demand for coverage.

Description:

IGA would sell guarantees against political and war risks to foreign parties such as input suppliers, trading companies, and financial institutions that finance BH enterprises. Through an agent bank hired by IGA, an IDA (ITF) Credit and funds from other donors would backstop the guarantees. IGA's Marketing Department will work with international experts to match foreign and BH firms and to facilitate the execution of viable, self-standing transactions. IDA (ITF) funds not used for paying claims after expiration of the guarantee facility would be used to finance critical imports for industry.

Benefits:

The project would help (i) BH industrial and commercial enterprises re-establish links with private foreign firms and so restart their operations (ii) contribute to the emergence of private input supply and output marketing channels; (iii) restore employment and production in the short term thus setting the foundation for structural industrial reforms; (iv) promote a transparent business climate characterized by the rule of law; and (v) finance imports critical to economic activity.

Risks:

The main risks are, firstly, a breakdown of the political environment and even a resumption of hostilities, which could lead to many claims on the guarantees. This will be mitigated by IDA's right to suspend IGA's authorization to issue new guarantees backed by the project's resources in the events of (a) major policy reversals; (b) a resumption of hostilities; and (c) if a claim is paid by the project. Secondly, the project may not generate sufficient private financing for working capital and short term investments. This risk has been minimized by designing the project on the basis of well-established market principles and by the work of IGA's Marketing Department.

Disbursements:

Political Risks Guarantee Facility: IDA (ITF) funds would be disbursed to the Agent Bank against the issuance of guarantees. The Agent Bank would hold the funds in trust to backstop its Letters of Credit. The funds in trust could be used to backstop future guarantees. The interest received on the funds held in trust would be used initially to finance IGA's operating expenditures, and after that to increase the available guarantee facility. Co-financiers of the Guarantee Facility would make individual arrangements to disburse funds, including the possibility that some of them may issue promissory notes when

back-stopping a guarantee, and disbursing funds only if the guarantee is called. Financing of Critical Imports for Industry: Those funds not used for claims payment following expiration of the guarantee facility --three years after effectiveness-- would be used to finance critical imports for industry, according to a positive list to be agreed with IDA.

Rate of Return: Not Applicable. The project will be deemed to have been a success if it results in a large volume of transactions and little or no claims payments.

Poverty Target: Not Applicable.

This report is based upon the findings of preparation and appraisal missions which visited Bosnia and Herzegovina between April and July 1996, comprising Mmes./Messrs. Peter Glenshaw (industrial specialist and mission leader), Onno Rühl (guarantee specialist), Tariq Hassan (counsel), Xavier Devictor (operations officer), Gordon Thompson, Carol Oman Urban, Lloyd Edgecombe, and Anatol Gobjila (consultants). Mark Walker and Tariq Hassan provided legal support. Maythinee Sriboonruang provided secretarial and administrative support. Documents were reviewed by Andrew Ewing and Alfred Watkins. Jean-Michel Severino and Christine Wallich are, respectively, the Director of the Central Europe Department, and Acting Director for Bosnia and Herzegovina. Hans Apitz is the Division Chief of the Energy, Environment, Transport and Telecommunications Operations division, responsible for Bosnia and Herzegovina in the Europe and Central Asia Region.

**REPORT AND RECOMMENDATION OF THE MANAGING DIRECTOR
TO THE PRESIDENT OF THE INTERNATIONAL DEVELOPMENT ASSOCIATION
(THE ASSOCIATION ACTING AS ADMINISTRATOR OF THE INTERIM TRUST FUND)
ON A PROPOSED CREDIT
TO BOSNIA AND HERZEGOVINA
FOR AN EMERGENCY INDUSTRIAL RE-START PROJECT
(INCLUDING A POLITICAL RISK GUARANTEE FACILITY)**

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1. I submit for your approval the following report and recommendation on a proposed credit to Bosnia and Herzegovina (BH) for SDR 7 million to support an emergency industrial re-start project (including a set-aside for a political risk guarantee facility). The credit would be on standard IDA terms with a maturity of 35 years, including a grace period of 10 years.

Background

2. BH was a well developed industrial economy before the recent war, ranking among the leaders of the former socialist economies of Eastern Europe and well known as a reliable supplier of export goods and services. There were about 1000 industrial organizations which contributed about half of the GNP and employed nearly 450,000 people - about half the number of people in formal employment. The industrial structure consisted of a dozen or so big export-oriented conglomerates while the 1,000 or so smaller firms were directed mainly to the local market. Considerable industrial activity, natural resources, capital stock, and technical and commercial human skills existed before the conflict. Some of it is salvageable with relatively minor investments, mostly in working capital. Industrial reconstruction will provide considerable employment and is one of the core elements of future development in BH, as there is little agriculture.

3. The key to successfully re-starting those parts of the industry sector in BH that remains viable but which now operates at 5 - 10% of its rated capacity, is to define and then implement simple, low cost projects that can be brought to profitable operation quickly in open competition in the world market. Detailed discussions with some 30 large and medium-sized industrial enterprises in all parts of BH showed that there is no shortage of such projects, although enterprise managers often want to restart the whole enterprise at once. A sample of quick-starting, low cost projects is given in **Box One**. Typically the deals would be able to be closed in 6 - 12 months, would be completed in another 6 - 12 months and would cost no more than a few million DM.

4. Financing for the projects would come from foreign industrial partner firms and/or foreign banks and would be mostly for working capital to purchase inputs, cover processing costs and fund the shipment of the output and whatever credit would be given to buyers. Some small investments in equipment repair or renewal would also be covered. Discussion with likely foreign partners and banks showed that there is strong interest in doing this type of business in BH, i.e. starting with small deals that can be easily and quickly closed and implemented. Once working relations become established and confidence grows, the way would be open for larger deals with longer terms.

5. The foreign firms which are ready to take on the commercial risks of such projects generally know the capability and reliability of the BH firms from pre-war experience. Foreign banks are ready to participate both on the basis of past experience with the BH firms, and by such mechanisms as taking mortgages on fungible materials and equipment. What these foreign firms and banks are unwilling to accept now is the risk that political events, including renewed outbreaks of hostilities, could jeopardize the projects. Political risks common to many economies in transition and exacerbated by the recent hostilities in BH are mainly to do with retroactive changes in rules and regulations that change the "rules of the game" and disrupt the business environment.

6. The lack of working capital finance resulted from the devastation of the war which eroded the capital bases of both the BH banking system and of the industrial enterprises. BH banks are not able now to supply enough credit to support sound, commercially viable working capital transactions. Foreign banks will not confirm letters of credit opened by local banks on behalf of their BH clients. Consequently, even potentially viable BH industrial and commercial enterprises with good export prospects are having difficulty obtaining working capital.

7. Export credit agencies (ECAs) currently do not cover transactions in BH, making even short-term, ECA-guaranteed commercial banking flows highly unlikely in the immediate future. At present, there are no BH banks that would qualify as acceptable counterparts for ECA transactions. Even if one or two acceptable local banks do eventually emerge, they are unlikely to have the capital base and credit appraisal skills to satisfy the working capital requirements of BH enterprises for some time.

8. **A possible solution.** The discussions with business and government leaders, both local and foreign, indicated that an effective program to cover political and war risks would significantly increase the flow of private finance to BH enterprises. Political and war risk cover would eliminate a class of risks which input suppliers, trading companies and commercial banks cannot manage or control and which inhibit them from doing business in BH.

9. Some of the leaders go so far as to say that without effective political and war risk cover, there is scant hope that the foreign private sector will participate in the reconstruction of the country. Only the private sector can mobilize the volume of funding needed for the reconstruction effort. In the right circumstances, the private sector is effective and efficient and its involvement is essential to build up the necessary momentum that will make the reconstruction efforts sustainable.

10. It will take great ingenuity and skillful efforts to use the availability of such cover to push industrial activity in BH, but industry managers there show great ability to handle difficult situations such as keeping plants operating despite the wartime conditions. This ability, bolstered by some targeted technical assistance, should enable the management of the enterprises to define what can be easily restarted and what must be left for a later date, if not dismissed completely.

BOX ONE

Examples of Potential Industrial Guarantee Deals in BH

A major conglomerate in Sarajevo has about 25 deals that would be suitable for guarantees, and has selected one as a pilot project. It concerns the manufacture of measuring devices and would require an initial investment of some DM 500,000 by a foreign producer of the devices. The foreign firm is eager to start so that deal could be closed within a few months. It would pay back the investment in 12 months or less.

A mass producer of medium class furniture near Tuzla has already increased its capacity utilization from 5 - 35% by successfully obtaining reconstruction contracts. It has major European firms ready to collaborate by supplying working capital and selected equipment to upgrade production to export quality and by taking the output for their markets. A deal of about \$10 million would be preferred, but a smaller, pilot operation of a few million DM could be worked out within 3 - 6 months.

A large metallurgical enterprise near Mostar would restart in a modest way by producing a by-product, namely anodes for aluminum smelting. To finance the import of inputs it would use bank credit secured commercially by mortgages on the fungible inputs and products, and politically guaranteed by the facility. Equipment repairs and replacement would push the total requirement to about \$5 million. Preliminary project studies indicate repayment well within three years. Deal closure should take less than 6 months.

Shoe and footwear plants in Tuzla and Banja Luka have already re-established production in a modest but not highly profitable way through toll processing raw materials supplied by former foreign partners in Italy and Germany. They could increase both output and profitability if they could purchase their own inputs using - for instance - bank credit guaranteed by the facility, and by seeking their own markets. Deals of a few million DM might take 6 months or so to be completed.

A large, multi-faceted electronics firm in Banja Luka was rapidly converting from military production before the war mainly through seeking joint ventures with top quality foreign firms. These plans are ready to be revived. A modest, low cost, quick return project can be selected as a pilot for using the guarantee facility, and put into operation in a few months with a suitable foreign partner.

The big salt and coke based chemical firms of Tuzla and Lukavac have many large and small projects which would fit the criteria of the guarantee operation. Preliminary studies have been done and partners identified so that it should not take much effort or time to structure some deals. A giant German chemical firm has indicated interest in one operation that would produce maleic anhydride. This could be coordinated with production of phthalic anhydride in the Republika Srpska to provide a near-by source of basic inputs to the German company's plastics plant near the Slovenian/Austrian border.

A large producer of military goods near Mostar is converting to civilian manufacture and is exploring many projects with foreign interests. It would like help in designing a small project which can be rapidly implemented under the guarantee scheme - something that can be started in a few months and cost about DM 2 million.

World Bank Strategy and Programs in Bosnia and Herzegovina

11. On April 1, 1996, Bosnia and Herzegovina fulfilled the conditions of succession to the Socialist Federal Republic of Yugoslavia's membership in the Bank, IDA and IFC. Membership is retroactive to February 25, 1993. Since early 1995, the Bank Group has been deeply involved in developing a donor-funded reconstruction program for BH. A joint mission of the Bank, IMF, EU and EBRD in late 1995 resulted in the proposed Priority Reconstruction Program which was first presented to a donors' meeting, co-sponsored by the Bank and the EU in Brussels, a week after the signing of the Paris/Dayton Peace Agreement. This meeting led to donor commitments of about US \$600 million for immediate reconstruction activities. A second donors' conference, again co-chaired by the Bank and the EU, was held in mid-April 1996, and resulted in additional donor pledges on the order of US \$1.2 billion for financing priority reconstruction activities during 1996.

12. The Bank has been following a broad-based assistance strategy, which seeks to leverage its limited resources with significant resource transfer from donors. Before arrears resolution, the Bank supported a series of immediate assistance programs through a special Trust Fund for Reconstruction of Bosnia and Herzegovina which is providing US \$125 million on concessional terms equivalent to those offered by IDA, as well as an additional US \$25 million in grant funds. Seven emergency operations, committing the entire US \$150 million, were approved under the Trust Fund. The resolution of arrears, made possible by the Consolidation Loan package, allowed regular IDA lending to begin in June 1996. The Bank is continuing to focus on supporting the reconstruction program in the infrastructure and social sectors, with special emphasis on employment creation. Its assistance program has also been broadened to include support for the initial phase of the government's macroeconomic and institutional reforms. The Transition Assistance Credit, approved by the Board in September 1996, was the first operation focusing on major institutional issues of the Federation and a series of structural reforms that are needed for advancing the transition to a market-economy. Further policy-enhancing investment or adjustment operations are envisaged to support institution-building at the state and entity level, in the financial sector as well as trade liberalization. In the area of reconstruction, Bank operations will support the recovery of industry and employment generation, the rehabilitation of infrastructure (energy and transport), agriculture (forestry) and basic social services (health and education). Limited IDA resources will continue to make partnerships with other donors key.

Rationale and Objectives

13. By providing credible guarantees against political and war risks, a Political Risk Guarantee Facility (PRGF) would mitigate the risks that are inhibiting private input suppliers, trading companies, and commercial lenders from financing working capital for commercially viable BH enterprises. A traditional line of credit operation would not eliminate the political and war risks, and so would not catalyze private foreign financing. MIGA cover would not be available for these short term non-equity transactions, while IFC cannot separate political from commercial risks, as it does not have the ability to deal directly with the Government. As the

PRGF would support self-liquidating, short term transactions, it would not create any long term debt for local enterprises. The PRGF would complement and support the enterprise reform program that BH intends to launch by:

- enabling the private sector to act as a screening mechanism, identifying and channeling private resources to commercially viable enterprises and transactions;
- helping restore employment and viable production in the short term, while political stability takes hold;
- helping BH enterprises re-establish links with foreign partners, diversifying their sources of supply and improving their access to markets;
- being sufficiently flexible to support more sophisticated financial instruments, as these are introduced in the BH market;
- promoting a transparent business climate in which the rule of law prevails.

Demand for Coverage

14. During project preparation, a survey of potentially interested foreign companies and financiers has been conducted, based upon information and records of visiting trade missions from the Chamber of Economy in Sarajevo. Some 40 firms - about 50% of the firms with interest in doing business in BH - indicated that they had a specific partner and transaction in mind, for which the availability of political risk cover would be crucial. Not a single respondent was prepared to extend any form of credit without political risk cover. The 25-30 interviews with BH firms showed that about 50% of them could probably devise projects suitable for the proposed PRGF within 6 - 9 months, 40% would need a longer time and the remaining 10% would be unlikely to be able to prepare suitable projects as they need very extensive restructuring. These preliminary data indicate a high demand for political and war risk cover. The amount needed to meet the demand would be around DM 30-50 million to start with as the small, quick-turnaround projects are dealt with; but this could easily grow to DM 150 million or more as bigger projects are tackled. In view of this expected demand, the Government has set itself a target of at least DM 75 million for the total size of the PRGF.

15. A database of potential clients for the PRGF is being built from the survey and interview results. It will serve as the basis for marketing the guarantees in order to ensure that the facility would be used as soon as it becomes available. This will also be supported by the enterprise survey underway under the auspices of the Private Sector Assessment for BH, which is to provide data on local enterprises' productive capacity, former and present business links and target markets.

The Project

16. The project would consist of two components: (i) support to IGA (Investment Guarantee Agency), an independent corporation established by the Government to operate the Political Risk Guarantee Facility (PRGF), which would aim at attracting foreign private financing to re-start production in viable parts of Bosnian industry, and whose marketing department would support the PRGF by providing information and matchmaking services to help enterprises close deals with foreign partners; and (ii) financing for critical imports for industry which would be provided from IDA (ITF) funds not used to pay claims when the PRGF is closed.

IGA and the Political Risk Guarantee Facility

17. IGA would sell guarantees, backstopped by an IDA (ITF) credit facility and funds from other donors, against clearly defined political and war risks (see para. 19 below). Guarantees would be sold to any foreign commercial entity financing a transaction in BH, regardless of the sector or geographical location of individual projects, subject to para. 29 below. IGA would be managed by a General Director and two Deputy Directors --one for the Federation and one for Republika Srpska-- supported initially by three professional staff members, and technical assistance for its initial establishment, for structuring of guarantees, marketing, and the engagement of technical specialists for specific transactions. A full description of the organizational structure of IGA, including the marketing department is contained in Annex I. Assurances have been obtained from IGA that it will carry out its guarantee facility operations in accordance with an Operations Manual, the contents of which have been found satisfactory by IDA. The complete Operations Manual is available in the project files.

18. **Agent Bank.** To facilitate its operations, IGA would employ an Agent Bank. An international tender has been conducted for the selection of the most appropriate bank for this assignment. Negotiations on the Agency Agreement with the winning bidder are well advanced. Agreement has been reached regarding the main features of the Agency Agreement. Conclusion of an Agency Agreement satisfactory to IDA would be a condition of effectiveness.

The Agent Bank would perform the following services:

- **Letter of Credit Issuance.** The Agent Bank would issue a Standby Letter of Credit simultaneously with the issuance of each guarantee contract by IGA. This letter of credit would stipulate that if due, the agent bank would pay claims on behalf of IGA with funds withdrawn from the IDA (ITF) credit facility. In deciding whether to pay a claim, the Agent Bank would respond to documents only -- either an admission of liability by IGA, or an arbitrator's judgment against IGA. The Agent Bank would not have to assess the underlying validity of a claim, the amount of loss, or become involved in any way in assessing whether a transaction is eligible for coverage.

- **Marketing.** The Agent Bank, through its existing network of offices and otherwise, would facilitate IGA's efforts in marketing the availability of the facility with the international business community.

- **Record Keeping.** The Agent Bank will be responsible for ensuring that the outstanding guarantees do not exceed the total amount available under the facility. Thus, the Agent Bank would keep records of the amount, effective date, and termination date of each guarantee. The Agent Bank would also keep records of all pending claims and keep IDA informed on a regular basis of all newly issued letters of credit.

19. **Risk Coverage.** The precise terms and conditions of each guarantee sold by IGA would be specified in a standard guarantee contract (SGC) as agreed with the Government and IGA at negotiations. The agreed text of the SGC is available in the project files. The SGC would cover guarantee holders for losses that occur as a direct result of the following risks, occurring after the effective date of the guarantee:

- **Inconvertibility or Inability to Transfer.** This would include coverage for losses arising from the introduction by the Government of any restrictions on the conversion of local currency into foreign exchange or the transfer of foreign exchange out of BH. This coverage would also include protection against the Government's failure to permit the free conversion of local currency into foreign exchange. However, this coverage would not grant the guarantee holder the right to convert local currency into foreign exchange at a guaranteed future exchange rate.

- **Cancellation of Licenses and Restrictions on Import and Export.** This would include coverage for losses arising from the cancellation or non-renewal of an import or export license by the Government or the imposition by the Government of restrictions on the import into BH of working capital inputs or the export from BH of outputs which were not previously subject to restriction.

- **Imposition or Increase of Import or Export Taxes.** This would include losses arising from the imposition by the Government of new or increased tax, levy or duty relating to the import of inputs or the export of outputs. It would not cover losses as a consequence of increases in general taxes such as VAT and corporate or personal income tax.

- **Expropriation.** This would cover losses caused by expropriation by the Government of the local enterprise involved in the transaction. The definition of expropriation would not include so-called "creeping expropriation".

- **Seizure of Goods, Prevention of Sale, or Prevention of Export.** This would include losses arising from the taking and holding of inputs or outputs by the Government for reasons other than ensuring public health, safety, welfare and protection of the environment.

- Interference with the Carriage of Goods. This would include coverage against interference by the Government with carriage or storage of the goods involved in the covered transaction.

- Embargo. This would include coverage against losses as a consequence of an embargo or sanctions imposed by the Security Council of the United Nations pursuant to Chapter VII of the Charter of the United Nations. This coverage is not designed in any way to circumvent the embargo or sanctions, but simply to cover against losses caused by UN sanctions on contracts entered into when no sanctions were in effect. In other words, it would cover against losses caused by retroactive imposition of sanctions. This would not have any impact on the effect of the sanctions themselves: the transactions would stop, as intended, and the economic effect on the country would be the same. The only difference would be that the risk of imposition of sanctions would be shifted from the foreign financier to IGA, and therewith ultimately to the Government (whose actions, presumably would have triggered the sanctions).

- War or Civil Disturbance. This would include coverage against losses arising from war or civil disturbance in BH. Other types of *force majeure* -- e.g., flood, drought, other natural disasters, war in neighboring transit countries, etc. -- would not be covered.

- Diversion of Voyage. This would include coverage against losses arising from an increase in transport or insurance charges due to the diversion of the inputs to a different destination if one or more of the above risks occur while the inputs are in transit to BH.

20. **Coverage against retroactive actions only.** The guarantee holder would be covered only against actions or events which would have the effect of retroactively changing the “rules of the game”. Therefore, the PRGF would not limit in any way the Government’s ability or freedom to change policies or otherwise conduct its operations. However, in order to avoid claims being caused inadvertently, IGA would review all draft legislation related to the risks covered by the SGC before it is presented to Parliament.

21. **Guarantee Fees.** IGA would sell its guarantees for a fee of 300 basis points per annum on the covered amount of the transaction. This is in line with the fees for political risk coverage charged by MIGA and ECAs doing business in high risk countries. Guarantee fees would be paid up-front in DM and deposited in an account that IGA would maintain for that purpose with the agent bank. The guarantee fee charged by IGA would be reviewed as needed in consultation with IDA, taking into account the relative supply and demand for guarantees.

22. **Maximum and Minimum Access by a Single Guarantee Holder.** In order to prevent one or two guarantee holders from monopolizing the available coverage, the maximum amount of guarantees that could be outstanding at any one time to support transactions sponsored by a guarantee holder would initially be set at DM 3 million. This maximum would be reviewed periodically in light of the result of efforts to increase the total size of the facility through co-financing. In order to keep IGA’s transaction costs to a reasonable level, the minimum guarantee size would be DM 50,000.

23. **Eligible transactions** would have the following characteristics:

- **Basic Structure.** A foreign trading company, input supply company, or commercial bank would provide financing for working capital inputs or short to medium term investment to a BH enterprise. The parties to the transaction would be free to determine their own commercial arrangements without interference from the Government or IDA, provided the inputs would be used for investment or to produce goods for domestic consumption or export, and that the transaction did not involve tobacco products, weapons, illegal drugs or spirituous liquors.

- **Eligible Local Enterprises.** All corporatized enterprises in BH which have a partner who is prepared to bear the performance risk of doing business with that enterprise would be eligible.

- **Tenor.** The tenor of transactions could range from a few months to a maximum of three years, depending on the under-lying transaction.

24. **Currency Availability and Foreign Exchange Rate Risk.** Individual guarantees would be denominated in DM, as contacts with the market consistently revealed that this would be the currency of choice for this type of transaction in BH. The guarantee holder would bear all currency risk between the DM and the input supplier, trading company, or foreign commercial bank's domestic currency.

25. **Cure Period.** In order to give the Government an opportunity to correct any policy related actions or inactions that would trigger a claims payment, a 45 day cure period would commence when IGA is notified of a potential claim. In addition, the State Minister of Finance, as Chairman of the Supervisory Board of IGA, would be designated to correct any problems that might lead to a guarantee being called or to notify other officials of the need to correct such problems (see also para. 30).

26. **Claims Procedure.** Upon expiration of the cure period, a Guarantee Holder would have the right to file a claim if the problem has not been resolved satisfactorily. Upon receipt of a claim, IGA would have 15 days either to (i) accept the claim and make the required payment, or (ii) reject the claim. If IGA rejects a claim, the Guarantee Holder would have the right to initiate binding arbitration proceedings. IGA would pay the claim if the arbitrator rules in favor of the Guarantee Holder. When IGA is required to pay a claim, the Government could pay the claim with its own resources or draw upon the IDA (ITF) funds with the Agent Bank. (A more detailed description of the guarantee processing and claims payment procedure is presented in Annex II).

27. **Arbitration.** In the event that a dispute arises between IGA and the Guarantee Holder as to whether (i) government action or inaction should lead to a call of the guarantee or (ii) the Government has in fact corrected the initial problem, the Guarantee Holder has the right to initiate arbitration proceedings set forth in the SGC. The arbitration procedure would be similar to what is typically found in international trade contracts. It would stipulate *inter alia* that the

arbitrator would be independent, appointed according to UNCITRAL rules; that the arbitration would take place in The Hague, and be subject to Dutch law; and that the decision of the arbitrator would be final and binding on both parties. The losing party would bear the costs of the arbitration. IDA would not be a party to the arbitration proceedings.

28. **Role of Local Banks.** The SGC could also cover a transaction in which a foreign bank's accepted or confirmed letters of credit or other legal instruments issued by BH banks to finance working capital for their BH clients. The guarantee would work exactly the same as in other cases, as the foreign commercial lender accepting or confirming the financial instruments issued by BH banks would be the financier of the transaction, having transformed the commercial risk in the transaction into local banking risk. As in all other cases, coverage would only be provided against those risks specified in the SGC. While these type of transactions are unlikely to happen before BH banks get into shape, it would enable these banks to assume their "normal" role in the provision of finance as soon as they have the necessary technical and financial capacity.

29. **Regional balance.** As the PRGF will be completely demand driven, it is difficult to predict where the actual investments supported by the project will occur. The results of the survey and the work done at appraisal indicate, however, that there is investor interest in all regions of Bosnia and Herzegovina. To allow maximum flexibility and economic benefits during the start-up period --which will build credibility for the guarantee instrument-- guarantees will be sold regardless of the sector or geographical location of individual projects. In the first two months of operation, however, IGA will use no more than 50% of its guarantee authority, whereas in the following two months, it will be limited to 75% of available guarantee authority. This will smooth the introduction of the guarantee instrument, allowing enterprises from all regions access during the important start-up period. Based upon the experience gained during the initial period, formal reviews to evaluate the evolving regional balance would be held between the Government and IDA six months and one year after effectiveness.

30. **Involvement of Local Authorities.** As stipulated in the Constitution, the foreign trade regime is the responsibility of the State. In practice, however, local authorities at various levels implement many of the policies concerned. As a consequence, these local authorities' actions could easily cause claims under the guarantees. To minimize this risk, and to extend the incentive structure created by the project to local authorities, the State would enter into cooperation agreements with the Federation and the Republika Srpska prior to making enterprises in the respective entities eligible for guarantees, as reflected in IGA's Operations Manual. In these agreements, each entity would agree to:

- implement the foreign exchange and trade regime of the State;
- refrain from interfering with transactions covered by IGA;
- accept liability to the State for any claims it might cause;
- abide by the Operations Manual of IGA.

These main features of the cooperation agreements were agreed during negotiations.

Conclusion of at least one cooperation agreement would be a condition of effectiveness.

31. **Prior Review.** In order to ensure that all transactions guaranteed by IGA and backstopped by the IDA (ITF) credit facility comply with the eligibility requirements, IDA will retain the right of prior review for all guarantees issued by IGA. IDA would review the eligibility of the transaction based upon the information in the application, and would undertake to respond to each prior review request within five business days.

32. **The marketing department.** There is a need for pro-active promotion of the PRGF to BH and foreign firms, both in the sense of informing the firms of the potential help they can receive by using the facility, and to assist in re-establishing links between foreign and BH firms. The extensive links that existed before the war were largely suspended during the four years of conflict, if not severed completely. BH firms are doing the best they can with their limited financial resources to establish foreign links and would welcome any assistance they could get. Preliminary promotional work during preparation of the project showed that there are three types of BH firms: (i) those that are able to benefit from the facility immediately as they have well prepared plans and have maintained links with foreign partners; (ii) those which can see the benefits of the facility but need time and help to prepare projects and to establish links with foreign firms; and (iii) those which are still immersed in old-style management systems geared to the obsolete centrally planned economy and which therefore have difficulties in understanding even the concept of the facility.

33. IGA's marketing department will be adapted to deal with the three types of firms as required. The department will reach out and deal with foreign firms as needed. Its specific duties will include the following :

collecting, preparing and disseminating information and materials regarding the PRGF, investment conditions and business opportunities in BH, and, notices of the interests of foreign firms;

maintaining a database of interested local and foreign firms and banks which will be built up from preliminary databases constructed during project preparation;

recruiting and supervising industrial specialists to assist BH and foreign firms structure and close deals suitable for the PRGF; and,

collaborating with Chambers of Economy, Industry associations, Multilateral Institutions and NGOs to promote links between BH and foreign firms.

Financing for Critical Imports

34. To create a strong incentive for the Government to avoid actions that would trigger claims from the PRGF, the project would include a component for the financing of critical imports for industry from unused funds, whether with the Agent Bank or still held by IDA. Similar to the structure of a set-aside in debt reduction operations, the proceeds will be used

initially for backstopping guarantees, and possibly disbursed against claims until the end of the availability period (see para. 39 below). Subject to certain conditions (para 36), funds available at that time would be re-allocated to the financing of critical imports for industry based upon a positive list of imports and/or a new guarantee facility established by the Government or IGA which will not be backstopped by IDA (ITF). Thus, there will be an incentive to the Government to promote a business environment in which the rule of law prevails.

35. Imports that would be eligible for this funding would be those that fit in with the needs of sound industrial development at the time the funds become available. The list of eligible goods and the selection of the enterprises that will benefit from these imports will be agreed between the Government and IDA at a formal review to be held at the end of the availability period. In order to provide the proper incentives for authorities in the two entities not to interfere in transactions, these funds will benefit the Federation and Republika Srpska in a division to be agreed between parties, which is expected to be proportionate to the use of the PRGF. The benefits of these funds for the Federation will be geographically balanced.

36. The funds would be made available in two tranches: one tranche consisting of any funds against which no guarantees were outstanding at the end of the availability period, and a second tranche consisting of the remainder of the funds upon expiration of the final guarantee. The two tranches would be released, subject to the following conditions:

- political risk claims under the facility not to have exceeded DM 1 million;
- the issuance of new guarantees not having been suspended by IDA at any time for reasons other than renewed hostilities (see para. 38 below);

The funds which are not used for purchasing critical imports will be returned to IDA.

The IDA (ITF) Credit

37. The State Government would be the borrower of record for the credit and would delegate withdrawal authority to IGA which, in turn, would delegate this authority to the Agent Bank. The funds would be disbursed into an interest bearing escrow account to backstop guarantees as they are issued. This would allow IGA to earn interest on the funds in a separate escrow account, which interest would be used to help finance IGA's operating costs until these costs would be covered by guarantee fees only. After that, the interest would be kept in escrow to increase the available guarantee facility. The funds in escrow could be used to backstop subsequent guarantees for the duration of the availability period (see para. 39 below). Agreement was reached during negotiations on the procedures for operating the escrow accounts.

38. Agreement was reached during negotiations that IDA would retain the right to suspend commitments for new IGA guarantees backstopped by the IDA (ITF) credit if (i) the

Government is in arrears on its debt service payments to the IBRD and/or IDA such that loan disbursements have been suspended, (ii) IGA is not being administered in accordance with the Project Agreement between IDA and IGA, (iii) a payment for a claim is made by the Agent Bank to a Guarantee Holder using IDA (ITF) funds, or (iv) there is a substantial reversal of the existing trade and foreign exchange regime, even if the changes do not result in outstanding guarantees being called. However, no suspension would affect the payment obligations for IGA guarantees issued prior to the suspension. These suspension rights, appropriately modified (see para. 36), establish the conditionality for eventual disbursement of the funds to the Government for the financing of critical imports.

39. **Availability Period.** The IDA (ITF) credit would be available for backstopping new guarantees for a period of three years after effectiveness, thereby potentially enabling IGA to support a multiple of the size of the total facility in transactions during this period, assuming that the average tenor of each transaction would be less than three years. Guarantees issued prior to the end of the three year period would remain valid for the remaining life of the underlying transaction, which could be a maximum of three additional years.

40. **Loan Charges and Repayment Terms.** The credit will be on standard IDA terms for BH, but it would be repayable in DEM. The Government would be responsible for all debt service payments. If IGA has sufficient revenue after covering its administrative expenses, it would reimburse the Government for the payments made to IDA during the availability period.

Procurement

41. The facility will stimulate the provision of foreign finance for the purchase of inputs and equipment for BH enterprises which is expected to generate production in BH for sale locally or for exports. IDA (ITF) funds would be used only to backstop guarantees against war and civil disturbance, and interference of the Government in transactions being financed by Guarantee Holders. Since IDA (ITF) would not finance these transactions the procurement requirements are outside IDA's jurisdiction, but they should satisfy standards of economy and efficiency. Discussions with BH enterprises during preparation of the project showed that they are well aware of the various sources of supply available to them in the international markets and they generally seek multiple quotes from the various suppliers.

42. The financing of critical imports for industry will be subject to standard bank procurement guidelines. IGA would administer the procurement of the critical imports, under supervision of the borrower's Procurement Monitoring and Audit Unit (PMAU). Normally, International Competitive Bidding will be applied. Limited International Competitive Bidding will be applied for goods which, the Bank agrees, may be purchased from a limited number of suppliers. International Shopping may be used for goods estimated to cost less than \$250,000 and Direct Contracting for goods which must be purchased from the original supplier to be compatible with existing equipment or are of a proprietary nature. The formal review will determine the positive list of goods which will be financed under the critical imports component.

Environmental Safeguards

43. The proposed project has been classified in Environmental Assessment Category B. To ensure that no guarantee would be available to support the importation of environmentally hazardous inputs, IGA will be provided with a list of products and transactions that do not meet Bank and/or BH environmental requirements. A negative list of banned pesticides, derived from the WHO categories of "Extremely Hazardous" materials would also not be permitted to be imported under the auspices of the PRGF.² IGA will hire a local environmental expert who will review and approve applications, in consultation with IDA when necessary.

44. During supervision of the facility, IGA operations and procedures will be monitored by environmental specialists from IDA to ensure their compliance with World Bank requirements. IDA will promptly notify IGA of any changes in IDA's environmental regulations specifically regarding pesticides and industrial chemicals. The sub-projects will have to comply with local environmental laws, rules and regulations in force at that time, as set forth in the Operating Manual, during the whole period of operation of the facility.

Disbursements

45. IGA, via the Agent Bank, would draw upon the IDA (ITF) credit as guarantees are issued, as evidenced by a copy of the signed guarantee agreement. Upon expiration of the availability period, the funds would be made available in two tranches for financing critical imports for industry from a positive list to be agreed between the Government and IDA (see para 35). As funds become available for critical imports they will be disbursed using procedures and documents which will be agreed at the formal review (see para 35).

Co-financing

46. Switzerland has offered to co-finance the PRGF in the amount of \$5 million. Interest to co-finance the project has also been expressed by the European Union, Luxembourg, the Netherlands and Sweden. In addition, IGA and the project team are in contact with a number of other donors to raise their interest in contributing to the PRGF. The objective of this exercise is to increase the total size of the facility to DM 75 million, in order to meet the expected high demand for coverage. Arrangements for the disbursement of funds would be made with each donor individually. Some of them may backstop guarantees by issuing promissory notes acceptable to the Agent Bank. All co-financiers would be expected to work with the basic guarantee mechanism agreed between the Government and IDA. Support for drafting of the legal documents and the Operations Manual, and other start-up cost of the project has been provided by consultants financed by the US Trade Development Agency and the Netherlands Government.

² World Health Organization, International Programme on Chemical Safety. "The WHO Recommended Classification of Pesticides by Hazard and Guidelines to Classification 1994-1995". Geneva: WHO/PCS, 1978.

Auditing, Supervision, and Evaluation

47. IGA would be responsible for maintaining its accounts, for preparing and submitting withdrawal applications (via the Agent Bank), and for maintaining all records relating to the implementation of the facility. Auditing of the facility would include audits of IGA's financial statements and its accounts at the agent bank, including the escrow account. Audit reports will be submitted to the World Bank not later than six months after the close of each year or the closing date of the facility.

48. Supervision would include continuous contact with IGA, monitoring the trade and foreign exchange regime, semi-annual missions by the project team, and the right of prior review of guarantees issued by IGA. Supervision would focus initially on IGA's compliance with the rules and regulations specified in the operating manual, the structure of transactions supported by IGA, and the volume of guarantees issued. Special attention would be devoted to ascertaining that IGA has been operating without political interference, and to the evolving regional balance of guaranteed projects. During the latter years, supervision would focus on the volume of guarantees issued by IGA and its compliance with the procedures specified in the operating manual. Throughout the life of the PRGF, supervision will also focus on the volume of claims payments and an assessment of the government policies, if any, giving rise to claims payments.

49. During the first year of operations, two formal reviews would be held to assess progress and to review the evolving regional balance of guaranteed projects. These reviews would also serve to adjust other aspects of the project, if warranted. After that, formal reviews would be held each year. The review at the end of year three --at the end of the availability period of the PRGF-- would be used to review the final use of the IDA (ITF) funds, including reaching agreement on the positive list of imports for industry.

50. Evaluation will focus on the performance of IGA. The principal performance indicator will be the amount of guarantees issued relative to the maximum authorized amount of guarantees. In addition, the analysis will focus on (i) the increase in production and/or exports generated by transactions supported by the facility, (ii) the number of transactions resulting from IGA's marketing efforts, (iii) the number of financial institutions, trading companies, and input suppliers applying for coverage, and (iv) the extent to which the later rounds of pre-export transactions begin to involve the local banking system. During the initial period, leading indicators would be the numbers of repeat inquiries from potential foreign financiers, and extent to which marketing efforts lead to concrete inquiries.

Lessons of Experience

51. The Bank Group is supporting one operation with features similar to the proposed project. The implementation of this operation, the Moldova Pre-export Guarantee Facility (3851-MD), has yielded the following lessons that have been incorporated in the project design:

- without a substantial marketing effort, the start-up period of the facility is likely to be sluggish;
- an active role for the Agent Bank in marketing the facility is essential for its success in attracting foreign finance;
- the facility needs to be flexible enough to accommodate a range of financial instruments, including confirmation of L/C's from local banks.

Benefits

52. The facility would have the following potential benefits:

- It would help BH enterprises, traders and banks establish links with private trading companies and input suppliers who are willing to finance commercially viable, self-liquidating transactions;
- It would contribute to the emergence of private input supply and output marketing channels and, by creating equal opportunities for all sectors, it would allow private markets to determine which enterprises will receive financing;
- It would address one of the most pressing financial constraints facing BH industry, the lack of financing for high priority inputs and working capital;
- It would foster joint ventures and investment relationships by encouraging potential partners to become familiar with each other in the course of short term input supply relationships. It would also help to identify viable enterprises, based on the private sector's willingness to bear the commercial risk of doing business with these enterprises and their assessment of the enterprise's ability to deliver an acceptable quantity and quality of output;
- It would help BH establish a track record of stability, thereby improving its reputation in foreign financial markets.

Risks

53. The main risk is that private lenders will not be induced to finance transactions despite the risk mitigation offered by the PRGF. This risk is compounded by the novelty of the proposed approach. However, the "novelty" risk has been minimized by following established practices in pre-export finance and credit insurance as closely as possible. In addition, by giving IGA the flexibility to support a wide range of financial instruments and mechanisms, it will be able to support transactions in the present environment as well as in the future when conventional finance channels becomes more developed. This risk has been further limited by consultations with a wide variety of BH firms and foreign commercial lenders, input suppliers, and trading companies who have provided useful design suggestions. Finally, the survey, marketing and matchmaking efforts during project preparation, and by the Marketing Department during implementation, are designed to mitigate this risk.

54. Another risk is that of a large number of claims due to a breakdown of the political environment or even a resumption of hostilities, which could lead to many claims on the guarantees. This will be mitigated by IDA's right to suspend IGA's authorization to issue new guarantees backed by the project's resources in the events of (a) major policy reversals, and (b) if a claim is paid by the project. Another mitigating factor against this risk is the fact that the Government will have access to the credit funds after the availability period of the guarantee facility (see paras 34-36), which creates a strong financial incentive against causing claims.

Agreements Reached and Conditions of Effectiveness

55. During negotiations, agreement was reached with the Borrower on (i) the text of the Operating Manual for IGA (para. 17); (ii) the main features of the Agency Agreement (para. 18); (iii) the text of the Standard Guarantee Contract (para. 19); (iv) the main features of the cooperation agreements (para. 30); (v) the procedures for operating the escrow accounts (para. 37); and (vi) IDA's remedies (para. 38).

56. The conditions of effectiveness would be:

- Conclusion of an Agency Agreement satisfactory to IDA (para 18).
- Conclusion of at least one cooperation agreement between the State and a local entity (para 30).

Recommendation

57. I am satisfied that the proposed Interim Fund Credit would comply with Resolution No. 184, adopted by the Board of Governors of the Association on June 26, 1996, establishing the Interim Trust Fund and I recommend that the President approve it.

Caio Koch-Weser
Managing Director

Washington, D.C.
November 19, 1996

Attachments

Schedule A

REPUBLIC OF BOSNIA AND HERZEGOVINA

**EMERGENCY INDUSTRY RE-START PROJECT
(INCLUDING A POLITICAL RISK GUARANTEE FACILITY)**

Timetable of Key Processing Events

- | | | |
|-----|---------------------------------|--|
| (a) | Time taken to prepare | 5 months |
| (b) | Prepared by: | Government, in close consultation with IDA staff and consultants |
| (c) | Preparation Mission | May 20 - June 8 1996 |
| | Appraisal Mission | July 29 - August 16 1996 |
| (d) | Negotiations | November 18, 1996 |
| (e) | Committee Discussion | December 12, 1996 |
| (f) | Planned date of effectiveness | March 15, 1997 |
| (g) | List of relevant PCRs and PPARs | Not applicable |

STATUS OF BANK GROUP OPERATIONS IN BOSNIA-HERZEGOVINA

A. STATEMENT OF BANK LOANS^{a/}

(As of November 1, 1996)

Loan No.	Fiscal Year	Borrower	Project	US\$ Million	
				(Less Cancellations)	
				Loan Undisbursed	
Loans/Credits/Grants					
IBRD^{b/}					
4038-BOS	1996	Bosnia and Herzegovina	Consolidation Loan A	28.6	0.0
4039-BOS	1996	Bosnia and Herzegovina	Consolidation Loan B	284.9	0.0
4040-BOS	1996	Bosnia and Herzegovina	Consolidation Loan C	307.1	0.0
Total				620.6	0.0
Of Which: Repaid				24.9	
Total Now Held by the Bank:				595.7	
TFBH^{c/} (Under Disbursement)					
TF-024030	1996	Bosnia and Herzegovina	Emergency Recovery Credit	45.0	24.9
TF-024031	1996	Bosnia and Herzegovina	Emergency Farm Reconstruction	20.0	15.4
TF-024032	1996	Bosnia and Herzegovina	Emergency Water Supply	20.0	14.7
TF-024033	1996	Bosnia and Herzegovina	Emergency Transport	35.0	26.4
TF-024034	1996	Bosnia and Herzegovina	Emergency District Heating ^{d/}	20.0	15.0
TF-024035	1996	Bosnia and Herzegovina	Emergency War Victims Rehabilitation	5.0	4.0
TF-024040	1996	Bosnia and Herzegovina	Emergency Education Reconstruction	5.0	0.8
Total				150.0	101.2
IDA					
2897-BOS	1996	Bosnia and Herzegovina	Emergency Education Reconstruction	5.0	5.0
2896-BOS	1996	Bosnia and Herzegovina	Emergency War Victims Rehabilitation	5.0	5.0
2902-BOS	1996	Bosnia and Herzegovina	Emergency Housing Repair	15.0	10.1
2903-BOS	1997	Bosnia and Herzegovina	Emergency Power Reconstruction	35.6	22.5
2904-BOS	1997	Bosnia and Herzegovina	Emergency Public Works and Employment	10.0	8.6
2905-BOS	1997	Bosnia and Herzegovina	Emergency Landmines Clearance	7.5	6.9
2906-BOS	1997	Bosnia and Herzegovina	Emergency Demobilization and Reintegration	7.5	4.7
2914-BOS	1997	Bosnia and Herzegovina	Transition Assistance Credit	90.0	0.0
Total				175.6	62.8

B. STATEMENT OF IFC INVESTMENTS

(As of September 30, 1996)

Fiscal Year	Obligor	Type of Business	Gross Commitments		
			-----US\$ Million-----		
			Loan	Equity	Total
1977	Tvornica Kartona I	Timber, Pulp and Paper	4.38	0.0	4.38
	Ambalaze Cazin				
1985	Sour Energoinvest	Industrial Equipment and Machinery	10.00	0.0	10.00
Total Gross Commitments			14.38	0.0	14.38
Less: Participations, Cancellations, Terminations, Exchange Adjustments, Repayments, Writeoffs and Sales			23.5	2.6	26.1
Total Commitments Now Held by IFC			14.38	--	14.38
Total Undisbursed			--	--	--
Total Outstanding			14.38	--	14.38

November 19, 1996

a/ The status of these projects is described in a separate report on all Bank/IDA financed projects in execution, which is updated twice yearly and circulated to the Executive Directors on April 30 and October 31.

b/ Consolidation Loans A, B, and C were approved on June 13, 1996 and became effective on June 14, 1996.

c/ Trust Fund for Bosnia and Herzegovina.

d/ Disbursements to date are from the Project Start-Up Advance (of which US\$2 million is disbursed for Gas).

IGA: Organizational and Administrative Arrangements

1. IGA has been established on the basis of the following organizational and administrative arrangements:
2. **Supervisory Board.** A Supervisory Board chaired by the State Minister of Finance and consisting of representatives of the following Government departments and agencies: State Ministry of Trade and Communications, National Bank, Federation Ministry of Finance, Federation Ministry of Industry and Energy, Ministry of Finance of Republika Srpska, Ministry of Industry of Republika Srpska, Chambers of Commerce in Sarajevo, Mostar, and Banja Luka would oversee the operation of IGA, ensure that it is administered in accordance with its Operating Manual, appoint the General Director and the two deputies, and delegate to him/her the authority to issue individual guarantees. The presence of government representatives on the Board would help to familiarize government officials with the transactions taking place within the country and the government actions or inactions that could trigger a payment under the guarantee. It would also help to ensure that guarantees are not issued to protect input suppliers/trading companies against policies that the Government is in the process of changing or revising at the time the guarantee is under consideration.
3. **Charter and Administration.** IGA's charter establishes it as a distinct legal entity, describes the composition and duties of the Supervisory Board, and stipulates that IGA is authorized to (i) sell guarantees to foreign providers of credit, (ii) be designated by the Government to make withdrawals under the IDA (ITF) credit to the Government, (iii) enter into an agency agreement with a foreign bank and a project agreement with IDA, (iv) hold a foreign exchange bank account inside BH and hold accounts in foreign banks, (v) receive foreign currency payments, (vi) enter into employment contracts and consultant contracts, and (vii) be subject to arbitration outside BH in connection with disputed claims under the guarantees.
4. **Operating Manual.** A detailed Operating Manual provides guidance to the staff and Supervisory Board on detailed operating procedures, including such matters, *inter alia*, as (i) project eligibility criteria, (ii) application and transaction approval procedures, including IDA's right of prior approval, (iii) staff responsibilities, (iv) claims administration and arbitration procedures, (v) co-guarantee procedures with participating ECAs, if any, (vi) auditing and reporting requirements, (vii) the general terms and conditions of IGA guarantees and guarantee fees, (viii) environmental guidelines and procedures, and (ix) criteria for the retention and distribution of profits. Changes in the Charter and Operating Manual would require the prior written consent of IDA. Agreement on the detailed text of the Operating Manual was reached during negotiations.
5. **Management Committee and Staffing.** The General Director, with assistance from the Management Committee would manage IGA's day-to-day activities. The Management

Committee would consist of the General Director and two Deputy Directors, who would also serve as regional managers of the Marketing Department for the Federation and Republika Srpska respectively. The Management Committee would meet at least once a week to discuss all aspects of IGA's business. In addition, IGA's initial staff would consist of (i) a Guarantee Officer who would prepare the documentation and ensure that each transaction is in compliance with all eligibility criteria, (ii) an Information Officer, who would maintain the enterprise database and other data resources of the Marketing Department, and (iii) an Administrative Officer. A grant from the Government of the Netherlands will cover IGA's operation costs during the first six months of operation. Beyond that, staff wages, consultant fees, and all other operating expenses will be financed out of IGA's operating revenues.

6. In deciding whether to issue a guarantee, the staff would be guided only by technical eligibility criteria; it would not have authority to refuse coverage to anyone who satisfies the published eligibility requirements (provided that sufficient guarantee capacity is available), nor would it be authorized to issue guarantees for any transaction that has not satisfied the eligibility requirements as certified by the staff analysis presented to the General Director and retained in the unit's files. The General Director would be expected to submit periodic audited financial statements and activity reports to the Supervisory Board. In these reports, the Supervisory Board would be informed on IGA's work, and especially on the guarantees issued during the preceding period, and on any rejected applications and the reason for their rejection.

Guarantee Processing and Claims Payment Procedures

I. Issuance of Guarantee

1. Potential Guarantee Holder files an application with IGA.
2. IGA reviews the application to verify that: (i) the transaction is not on negative list; (ii) the transaction complies with World Bank and Government environmental standards; (iii) the transaction is for a productive purpose -- i.e., inputs will be used for investment or to produce exports; (iv) the application specifies the imported inputs, source of foreign financing, and the projected output goods; (v) the maturity of proposed transaction is consistent with industry practice; (vi) the size of transaction is within limits specified in the project agreement; and (vii) the World Bank has completed its prior review and issued a no objection.
3. IGA checks with the Agent Bank to ensure that the IDA (ITF) credit facility has sufficient capacity to support the proposed guarantee.
4. IGA either: A) approves the application and notifies the Agent Bank and applicant or B) rejects the application and notifies the Agent Bank and applicant, specifying the reasons for rejection.
5. If the application is accepted, the applicant remits the guarantee fee to IGA.
6. A completed copy of IGA guarantee and Agent Bank letter of credit are sent to the Guarantee Holder.
7. Guarantee Effective.

II. Claims Procedures

8. Guarantee either A) expires without claim being filed; or B) a loss occurs which, in the opinion of the Guarantee Holder, is caused by one of the covered risks.
9. If it is alleged that the loss is due to a covered risk, the Guarantee Holder notifies IGA, explains which covered risk triggered the claim, and makes arrangements to provide the required documents to IGA.

10. IGA has 45 days from date of notification and receipt of documentation to remedy the problem that triggered the claim.
11. If the problem is not remedied in a manner satisfactory to the Guarantee Holder, she/he submits a claim, no later than 90 days after the initial notification, or within 30 days of a request by IGA for its submission.
12. Within 15 days of receipt of the claim, IGA either (i) accepts liability under the claim, (ii) denies liability under the claim, or (iii) fails to respond.
13. If by 16th day, IGA admits liability, the claims payment procedure is initiated (Proceed to step 16).
14. If by 16th day, IGA rejects the claim, or fails to respond, the Guarantee Holder either (i) accepts IGA's decision, in which case the guarantee expires without a claim payment, or (ii) initiates arbitration proceedings.
15. The arbitrator either (i) rules in favor of IGA, in which case the guarantee expires without a claim payment; (ii) issues a default judgment against IGA for not appearing at the arbitration proceedings and the claims payment procedure is initiated when the Guarantee Holder presents the default judgment to the Agent Bank and IGA; or (iii) rules in favor of the Guarantee Holder, in which case the claims payment procedure is initiated when Guarantee Holder presents the arbitration award to the agent bank and IGA.

III. Claims Payment Procedures

16. As per the terms of the Standby Letter of Credit, the Agent Bank pays the Guarantee Holder upon presentation of IGA's admission of liability or the arbitration award in favor of the guarantee holder, together with a copy of the guaranteeholder's claim and the guarantee contract.
17. If the Agent Bank pays with IDA (ITF) funds, the amount remaining in the facility to support future guarantees is permanently reduced by an amount equal to the sums disbursed for claims payment.

IMAGING

Report No: P- 6993 BIH
Type: MDR