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Report No. P-7024-BIH

MEMORANDUM 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 4.9 MILLION
TO
BOSNIA AND HERZEGOVINA
FOR A
FORESTRY PROJECT

April 29, 1998

Rural Development and Environment Sector Unit
Europe and Central Asia Region

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CURRENCY EQUIVALENTS

Currency Unit = Konvertible Marka (KM)

1 KM = 1 DM = US \$0.57

(as of March, 1998)

WEIGHTS AND MEASURES

Metric System

ABBREVIATIONS AND ACRONYMS

AAC	Annual Allowable Cut
BH	Bosnia and Herzegovina
BHŠ	Bosanskohercegovačke Šume
CAS	Country Assistance Strategy
CFI	Communal Forest Inspector
EA	Environmental Assessment
EC	European Commission
EU	European Union
FAO	Food and Agriculture Organization
FIS	Forest Inspection Service
FMP	Forest Management Plan
GPN	General Procurement Notice
GSP	Gross Social Product
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IPCHNH	Institute for Protection of Cultural, Historical and Natural Heritage of BH
ITF	Interim Trust Fund
MAFW	Ministry of Agriculture, Forestry and Water Resources of Republika Srpska
MAWF	Ministry of Agriculture, Water Resources and Forestry of the Federation of BH
NGO	Non-Governmental Organization
PIU	Project Implementation Unit
RIU	Regional Implementation Unit
RS	Republika Srpska
SFE	State Forest Enterprise
SOE	Statement of Expenditure
SŠ	Srpske Šume
ŠPP	Šumsko Privredno Preduzece
TA	Technical Assistance
UNHCR	United Nations High Commissioner for Refugees
VAT	Value Added Tax

GOVERNMENT FISCAL YEAR

January 1 - December 31

Vice President	:	Johannes Linn
Country Director	:	Christiaan Poortman
Sector Director	:	Kevin Cleaver
Sector Leader	:	John Hayward
Task Manager	:	François Wencélius

BOSNIA AND HERZEGOVINA

FORESTRY PROJECT

Credit and Project Summary

Borrower:	Bosnia and Herzegovina								
Beneficiaries:	Ministry of Agriculture, Water Resources and Forestry (Federation of BH); Ministry of Agriculture, Forestry and Water Resources (Republika Srpska); and State Forest Enterprises (Šumarstvos in the Federation of BH, and Šumsko Gazdinstvos in Republika Srpska)								
Poverty Category:	Not Applicable								
Amount:	SDR 4.9 million (US\$7 million equivalent)								
Terms:	Standard IDA, with 35 years maturity and 10 years grace								
Financing Plan:	<table> <tr> <td>IDA Interim Trust Fund</td> <td>US\$ 7.0 Million</td> </tr> <tr> <td>EU Grant</td> <td>US\$ 8.7 Million</td> </tr> <tr> <td>Others (to be confirmed)</td> <td><u>US\$ 4.5 Million</u></td> </tr> <tr> <td>Total</td> <td>US\$20.2 Million</td> </tr> </table>	IDA Interim Trust Fund	US\$ 7.0 Million	EU Grant	US\$ 8.7 Million	Others (to be confirmed)	<u>US\$ 4.5 Million</u>	Total	US\$20.2 Million
IDA Interim Trust Fund	US\$ 7.0 Million								
EU Grant	US\$ 8.7 Million								
Others (to be confirmed)	<u>US\$ 4.5 Million</u>								
Total	US\$20.2 Million								
Economic Rate of Return:	Not applicable (see para. 40).								
Staff Appraisal Report:	Not applicable. A Technical Annex is attached.								
Project ID Number:	45134								
Map:	IBRD 28534								

This report is based on the findings of an appraisal mission that visited Bosnia and Herzegovina in August 1996, comprising François Wencélius, Task Manager (EC1/2AR), and Benoist Veillerette, Economist (FAO/CP), and a subsequent post-negotiations mission that visited Bosnia and Herzegovina in March 1998, comprising François Wencélius and Charis Wuerffel. Preparation work was carried out by Lennart Ljungman, Mission Leader, Daud Khan, Economist, Benoist Veillerette, Economist, Katia Medeiros, Environmentalist (FAO/CP), and Peter Otterstedt (Consultant). The Peer Reviewers are Louis Carbonnier (AGRAF), and Harald Stier (MN1NE). The Sector Director is Kevin Cleaver, the Country Director for Bosnia and Herzegovina is Christiaan Poortman, and the Vice President in charge is Johannes Linn.

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**MEMORANDUM AND RECOMMENDATION OF THE MANAGING DIRECTOR TO THE
PRESIDENT OF THE INTERNATIONAL DEVELOPMENT ASSOCIATION (THE
ASSOCIATION ACTING AS ADMINISTRATOR OF THE INTERIM TRUST FUND) IN THE
AMOUNT OF SDR 4.9 MILLION (US\$7.0 EQUIVALENT)
TO BOSNIA AND HERZEGOVINA
FOR A FORESTRY PROJECT**

1. I submit for your approval the following memorandum and recommendation on a proposed Credit to Bosnia and Herzegovina (BH) in the amount of SDR 4.9 million (US\$7.0 million equivalent) to help finance a Forestry Project in both the Federation of Bosnia and Herzegovina and Republika Srpska (RS). The proposed Credit would be on International Development Association (IDA) terms, with 35 years maturity, including 10 years of grace. Cofinancing in an amount of US\$13.2 million is being secured: the European Union (EU) has committed to providing a ECU8 million grant, equivalent to US\$8.7 million; cofinancing of US\$4.5 million from Italy and Norway is being confirmed.

Country/Sector Background

2. Bosnia and Herzegovina (BH) has a total area of 51,500 km². As a consequence of the Dayton agreement, BH is administratively divided into two parts: the Federation of Bosnia and Herzegovina (the Federation), which is mainly inhabited by the Muslim and Croat ethnic communities (25,000 km²); and RS, which is mainly inhabited by Serb ethnic communities (26,500 km²). The population before the war was 4.4 million people, of which it is estimated that about 600,000 people now live abroad and another one million are displaced, within the boundaries of BH. In many parts of the country, rural areas have been totally abandoned by their former inhabitants.

3. Before the war, forestry and wood based industries were an important part of the economy, accounting for more than 10 percent of GSP¹. Forest resources were well managed, and forestry alone accounted for about 2 percent of GSP. In 1990 the sector employed 22,000 persons and accounted for high quality exports valued at US\$250 million.

4. Forest land covers about 2.7 million ha or 53 percent of the total land area, which is among the highest forest cover in Europe. The State owns 80 percent of forest land (about 2.1 million ha), of which high forests constitute about 55 percent and the remaining 45 percent comprise an equal proportion of coppice and bare land. About 20 percent of total forest land (or 0.6 million ha) is privately held, of which only 20 percent is high forest. In 1990, the total growing stock on State land amounted to 359 million m³ (60 percent broadleaves and 40 percent coniferous), or 215 m³/ha of forested land, which is again among the highest stocking in European forests. In 1982, corresponding figures for the private forests were 27 million m³ of total growing stock, or 68 m³/ha, indicating that private forest land, although it represents 20 percent of total forest land, had only about 7 percent of the standing stock.

5. The estimated annual yield in the State forests in BH for the period 1989-1998 was 10.5 million m³. The Annual Allowable Cut (AAC) for State forests, as established through the process of forest management planning, was established for the same period at 6.9 million m³. The average recorded harvesting for the period 1982-1988 amounted to 6.2 million m³ or 88 percent of the AAC, indicating

¹ Within the former Yugoslavia, the measure of national income was Gross Social Product (GSP), a measure which excludes services, except those involved in the transport and distribution of goods.

conservative harvesting. Figures for the war period are not available, but it is estimated that the extraction level, including fuelwood and illegal cutting, was about 20 percent of the pre-war level. After the war, as a consequence of minefields making forests inaccessible, the AAC had to be reduced to about 5 million m³. Since 1996, wood harvesting has resumed significantly in accessible areas; recorded figures in 1996 and 1997 are 1.9 million m³ and 2.9 million m³ respectively; the 1997 harvesting level is close to 60 percent of the AAC adjusted for mine areas. Since adequate control over harvesting has not yet been re-established, there are increasing accounts of illegal harvesting and log smuggling. Since normal accessibility to forests has not yet been restored, over-harvesting is increasingly likely to take place in accessible areas.

6. Bosnia's forests have a rich biological diversity, including an estimated 400 rare species of flora and over 200 rare species of fauna. The government is finishing the preparation of the list of flora species which are either threatened or endangered. Currently, there is no Environmental Law, but three major pre-war laws contain environmental provisions: the Natural Heritage Law (issued in 1985, concerning the establishment and management of protected areas), the Water Resources Law, and the Forest Law. New laws on land use, environmental protection and forest are currently being drafted in the Federation and RS. Environmental legislation will be formulated in compliance with EU and agreed international conventions. In BH there were 31 protected areas², most of which are in RS including the two national parks of BH: the National Park of Sutjeska, with one of the last remnant of the primary forest of Europe, and the National Park of Kozara. The Federation has only three small virgin/primary forests and three small reserves. About one percent of the territory of BH was protected which is lower than international norms. In 1980, it was proposed that four percent of the territory of BH be set aside as protected areas. In the same year, an environmental strategy was developed to increase this to 16 percent by the year 2000. Due to the war situation and subsequent division of the Republic into two entities, the 4 percent objective was not reached nor is it likely that the 16 percent strategy will be implemented by the year 2000.

7. The high forests in BH are well stocked and used to be well managed before the war. The predominant (95 percent) use of natural regeneration ensured the sustainability of the ecosystem and the preservation of biological diversity. Furthermore, a provision in the forest law stipulates that a fixed proportion of gross forest income should be used for afforestation of bare forest land. Forests in BH have been managed under forest management plans (FMPs) with a duration of 10-20 years, approved at both the ministerial and communal levels, which aimed at sustainable management on the basis of a detailed collection of data on the status of the forests and of modern forest management principles.

8. The war has severely affected forest management, in varying ways:

- (a) the development of FMPs has been discontinued since the beginning of the war and has not yet resumed. The result is that FMPs have now expired in about two third of the State Forest Enterprises (SFEs). In addition, a revision of some valid FMPs is necessary due to the impact of the war (i.e., changed boundaries of the SFEs close to the confrontation line, and direct or indirect damage to the forests). There is an urgent need to resume the preparation of FMPs;
- (b) a significant amount of forests is now inaccessible because of minefields -- from an estimated 15 percent - 20 percent of the total area in the Federation to 20 percent - 25 percent in RS;

² Two National Parks (20,625 ha); one Park of Nature (2,000 ha); four small virgin forest reserves (total area of 570 ha); one large virgin forest reserve inside a National Park (1,434 ha); three small forest reserves (total area of 597 ha); fourteen very small special reserves (total area of 269 ha); and six parks of forest (total area of 1,459 ha).

- (c) about 80,000 ha – or about 4 percent of the actual forest cover – were destroyed during the war. Destruction has affected small but numerous areas of forests, either as a direct consequence of the war through artillery and grenades (both in the form of destroyed trees and trees with shrapnel damage), or as an indirect consequence through uncontrolled over-exploitation of accessible forests for fuelwood;
- (d) there is an outbreak of insect attacks on coniferous forests mainly. Populations of bark beetles have exploded because of direct war damage to spruce and fir trees which made them more susceptible to insect attacks, and because sanitary fellings -- and other management practices that keep insect attacks normally under control -- were discontinued during the war and have not yet resumed. Controlling this outbreak is an urgent necessity;
- (c) during the war, all reforestation and afforestation efforts came to a halt. The production of seedlings was discontinued, and the units for seed collection and processing in operation before the war have been destroyed. There is an urgent need to rehabilitate the nursery capacity, for the forestry reconstruction program, and to make funding available for immediate reforestation needs in sensitive areas affected by war damage; and
- (f) the conditions of forest roads deteriorated dramatically during the war, and forest road rehabilitation has not resumed since the end of the war. Unless forest roads are repaired and maintained, ongoing over-exploitation of the only areas that are now accessible will expand dramatically.

9. BH has a long tradition in manufacturing mechanical wood products. The pre-war forest industry was based on suitable and high quality wood raw material, advanced technology, high professional and labor skill, largely modern plant technology, and a good market both domestically and abroad. Before the war, the furniture industry was one of the most important sectors counting for more than 10 percent of the total industry production and generating a net export income of US\$200 million. Due to the war situation, forest harvesting and wood industry production have been much reduced. For the period 1992-1995, it is estimated that the total utilization of installed capacity has only been between 10 percent to 15 percent of the pre-war capacity. After the war, about 80 percent of the pre-war wood processing facilities remained intact, but are still grossly under-utilized. With the emergence of small private sawmilling enterprises, present wood processing capacity is about 30 percent of what it used to be before the war. This means that the employment potential in a fully utilized forest and forest industry is substantial. Some of the export market for furniture has been taken over by other Central European countries and has become more competitive, but there is no reason to believe that BH could not regain a significant share of this export market, given the technological skill of its wood industry. Furthermore, the need for building material to reconstruct the large number of houses destroyed during the war, means that there is a substantial domestic market for wood based products such as window frames, doors, building materials and pre-fabricated houses.

10 Before the war, the 1978 Forest Law -- which basically defines rules for production forestry but also includes aspects on forest protection -- was in force in Bosnia. That Law is still in force in the Federation since the end of the war but is ill adapted to its new organizational structure. A new Forest Law has been prepared for the Federation but has not yet been approved. This is a major issue since essential legal provisions for the organization of forest management and surveillance are not in force. As regards RS, a new Forest Law (02-764/94) is in force since 1994 which provides an adequate legal framework for forest management in that entity.

11. On the institutional side, the Ministry of Agriculture, Water Resources and Forestry (MAWF) and the Ministry of Agriculture, Forestry and Water Resources (MAFW) are responsible for forestry, respectively, in the Federation and in RS. The State forests are managed by SFEs -- Šumarstvos in the Federation and Šumsko Gazdinstvos in RS -- which in the past operated as fairly autonomous units. The SFEs have largely been financed by their own revenues. The SFEs have been recently grouped under State forest holding companies: Bosanskohercegovačke Šume (BHŠ) in the Federation and Srpske Šume (SŠ) in RS. The SFEs and private forest owners are controlled by a network of State Inspectors in both the Federation and RS.

World Bank Strategy and Program in Bosnia and Herzegovina

12. On April 1, 1996, BH fulfilled the conditions of succession to the former Socialist Federal Republic of Yugoslavia's membership in the Bank, IDA and IFC. Membership is retroactive to February 25, 1993. The resolution of BH's arrears with the World Bank, through consolidation of its IBRD debt, allowed regular Bank lending to begin in June 1996. With a war-devastated economy, low post-war per capita GDP and lack of creditworthiness, BH was declared IDA eligible.³

13. Since early 1995, the Bank Group has been deeply involved in developing, with the BH authorities, a blueprint for reconstruction of the country's economy. A three- to four-year Priority Reconstruction Program totaling some \$5.1 billion was endorsed by donors following signing of the Dayton-Paris Peace Accords in December 1995. Since then, three donors' conferences co-sponsored by the World Bank and the Commission of the European Union (EC) have mobilized pledges of some \$3.1 billion from sixty bilateral and multilateral donors for reconstruction and economic recovery in both the Federation and RS.

14. In the immediate post-war period, the Bank's assistance strategy aimed at jump-starting economic activity through emergency projects in a broad range of areas, including rebuilding of government institutions and funding of a line of credit to small business, rehabilitating agriculture, water and sanitation, transport, health, education, energy, and housing, clearing landmines, establishing a guarantee facility for industry, and generating employment through public works, re-training and loans to micro-businesses. The Bank's assistance program also supported the initial phase of the government's macro-economics and institutional reforms. Leveraging Bank resources with funding from donors has been an important element of this strategy.

15. The Bank's first formal Country Assistance Strategy (CAS) (FY98-99) was discussed by the Board of Executive Directors on August 28, 1997, and emphasizes sustainability and ensuring the medium- to long-term viability of policies and investments.⁴ While donor resources will be needed for the next several years, BH must increasingly become more self-reliant in preparation for the time when these inflows are no longer available. This will mean viable government institutions, sustainable government budgets, improved cost-recovery policies and mechanisms and structural reforms that stimulate private investment. Three overarching objectives form the basis of this strategy: (i) further development of the basic institutional infrastructure for economic management, including public finance; (ii) transition to a market economy through deepening of major structural reforms in banking and private sector development; and (iii) increasing the financial sustainability of physical reconstruction programs and projects.

³ Membership, arrears resolution and a limited country assistance strategy are outlined in the Memorandum of the President titled "World Bank Membership for Bosnia and Herzegovina and Proposed Financial Assistance," dated March 4, 1996.

⁴ Memorandum of the President entitled "Country Assistance Strategy of the World Bank Group for Bosnia and Herzegovina," dated July 31, 1997 (Report No. 16866-BiH).

16. Policy-enhancing adjustment operations are envisaged to support institution-building at the State and Entity level, as well as key reforms in the areas of public finance, banking, privatization, including a planned Public Finance Structural Adjustment Credit and an Enterprise and Bank Privatization Adjustment Credit. We will also continue to support reconstruction in selected sectors, including infrastructure and the social sectors. Limited IDA resources will continue to make partnerships with other donors essential: Mobilizing co-funding for future operations, and coordinating strategies -- e.g., eventual exit from those sectors where other donors are more fully engaged or have greater comparative advantage -- will be important elements of this partnership.

17. The proposed Forestry Project would form an important element of the current strategy aimed at moving from reconstruction to sustainable growth. Indeed, the project would support policy reforms in the forestry sector, institutional strengthening in forest conservation and management, and sustainable management of forest resources to secure both sustained provision of environmental benefits and sustained supply of raw material to the wood industry. In that respect, the project is an essential complement to the IFC agency line project that supports the development of modern and efficient wood processing in Bosnia.

Project Objective

18. The objective of the project is to resume sustainable management and protection of Bosnian forest resources, in order to: (i) ensure the sustainability of the rapid recovery of the wood harvesting and wood processing sectors; and (ii) control the potential environmental impact of this recovery.

Design Considerations

19. The project was initially designed and prepared in 1996 as emergency assistance to the Bosnian forestry sector. The project aimed mainly at jump-starting the wood harvesting capacity of SFEs, which had been almost completely destroyed during the war, to supply wood industries (largely intact despite the war) in order to meet an urgent demand for reconstruction material. The project was also designed to provide initial support to resuming sustainable management of Bosnian forests, which had been disrupted during the war.

20. Due to the delay in project approval, it has been necessary to adjust project design in view of the recent developments in the forestry sector over the past 2 years. Since 1996, harvesting has resumed quite substantially thanks, inter alia, to international financial assistance through credit schemes and grants. However, forest management planning and enforcement of forest legislation has not resumed; forest health is deteriorating with growing threat of insect attacks; the capacity of SFEs to control wood harvesting and to resume sustainable management of forest resources has not improved; and the accessibility to forests has worsened, since little action has been taken to rehabilitate forest roads damaged during the war. The real need now is urgent support for rehabilitation of forest protection and management, to ensure that forest resources are sustainably utilized.

21. To address these changing needs in the forestry sector, the Government and the Bank agreed to revise project design in March 1998. The project would remain essentially a reconstruction operation; it would however focus on resuming sustainable management of forests and would no longer finance harvesting equipment. Funds which initially were available for such equipment have been re-allocated to support sustainable forest management operations, including an expanded forest management planning program, immediate action to protect forests from insect attacks, protected areas development, rehabilitation of nurseries, and maintenance and repair of war damaged forest roads. Another project

design consideration is to support the SFEs according to a strict selection procedure which was agreed upon during project preparation.

Project Description

22. The project would fund the following activities under four components:

- (a) ***Support to Forest Management.*** This component would include support for: (i) policy changes, through studies on the institutional aspects and fiscal and marketing aspects of the forestry sector in the Federation and RS; (ii) forest management planning, including the preparation of forest management plans for about 600,000 ha in 24 SFEs, re-establishing a forest inventory and management planning unit in BH Sume and strengthening the forest research and management unit in SŠ through technical assistance, training and equipment; and (iii) re-establishment of the forest inspection services in the Federation and RS, to resume and secure adequate enforcement of forestry legislation.
- (b) ***Protection and Rehabilitation of Forests.*** Activities would include: (i) a comprehensive program to control insect attacks on Bosnian forests based on biological insect control methods; (ii) reforestation of about 500 ha in areas of the Federation heavily damaged during the war; and (iii) rehabilitation of the National Park of Sutjeska and development of new protected areas, including technical assistance and training for protected areas management, ecological surveys, and equipment and infrastructure rehabilitation.
- (c) ***Rehabilitation of SFEs Operational Capacity.*** This component would restore the operational capacity of selected SFEs in both the Federation and RS by providing them with the equipment necessary to: (i) repair and maintain existing forest roads damaged during the war; and (ii) resume normal surveillance and protection of forests, carry out forest regeneration and other silvicultural works, and organize and control sustainable forest harvesting.
- (d) ***Project Management and Monitoring.*** The project would fund: (i) incremental staff needed to implement procurement disbursement, auditing and reporting procedures required under the project; and (ii) technical assistance to undertake studies and setup a monitoring and evaluation system, including monitoring of the environmental impact of the project.

23. An over-riding condition for project support to an SFE under component (c) is the availability of an established, valid and ecologically sound FMP. If the FMP has expired, an approved annual plan should be made available before implementation of project activities in the SFE⁵. The allowable cut under the annual plan should not be higher than the AAC under the expired FMP. Furthermore no area within a Šumarstvo, which is under considerations for protection purposes in the Federation, should be subject to logging until the management plan of this area has been established and agreed upon.

⁵ The Forest Law explicitly provides for the extension of expired FMPs on an annual basis. These extension plans are based on the same level of sustainable AAC as the expired plans.

24. The selection of SFEs eligible for project support was based on the following criteria: (i) an AAC in high forests, after adjustment for mined forest areas, of at least 20,000 m³; (ii) availability of a wood processing unit within 80 km with sufficient capacity to process the available AAC from the SFE; and (iii) the degree of war damage to the equipment of the SFE. The project will not support any SFE with a director or manager who has a criminal record or who has been indicted for any felony.

Project Cost and Financing

25. The total project cost, including contingencies, is an estimated US\$20.2 million including US\$13.2 million for the Federation and US\$7.0 million for the RS. The present breakdown of estimated cost is the following:

	Federation	RS	Total
Support to Forest Management	1.7	1.6	3.3
Protection and Rehabilitation of Forests	2.4	1.2	3.6
Rehabilitation of SFEs Operational Capacity	8.8	3.9	12.7
Project Management and Monitoring	0.3	0.3	0.6
Total	13.2	7.0	20.2

26. The State of Bosnia and Herzegovina would be the Recipient of the funds to be provided by various donors. Of the total project cost, the Bank would finance US\$7 million equivalent with a Credit from the Interim Trust Fund (ITF) administered by IDA. The EU is committed to provide an ECU8 million grant, equivalent to US\$8.7 million. The financing of the remaining US\$4.5 million (or 22 percent of total project costs) by other donors is being confirmed. Italy has earmarked a DM4 million grant, equivalent to US\$2.1 million, to cofinance the project; Norway has indicated interest in complementing the financing of the project (See financing plan in Schedule A).

Project Implementation

27. **Responsibilities** for project implementation would be the following: (i) the MAWF and the MAFW would have overall responsibility and direct authority over project implementation, in the Federation and RS respectively. They would also be responsible, in particular, for carrying out the institutional and fiscal and marketing studies funded under the project, and for implementing forest inspection activities supported by the project, both at the central and local levels. The MAWF would also be responsible for reforestation activities in the Federation and for the feasibility study for the creation of the Igman Bjelasnica National Park; (ii) BHŠ and SŠ would be responsible for implementing forest management planning activities and forest protection from insect attacks funded under the project; (iii) the SFEs selected to participate in the project would be responsible for implementing project activities under the "Rehabilitation of SFEs Operational Capacity" component; (iv) the Institute for Protection of Cultural, Historical and Natural Heritage (IPCHNH) would be responsible for carrying out the ecological surveys of sensitive areas in the Federation SFEs, and monitoring the environmental impact of the project in the Federation; (v) the National Park of Sutjeska would be responsible for project funded activities in that Park; and (vi) the Faculty of Forestry in the University of Banja Luka would be responsible for monitoring the environmental impact of the project in RS.

28. **Project Management** would be the responsibility of: (i) the Project Implementation Unit (PIU) established under the MAWF to implement internationally funded projects in the Federation; and (ii) the new PIU recently established under the authority of the MAFW to implement the project in RS. The PIUs

would coordinate project implementation and implement procurement, disbursement, auditing, and reporting procedures required under the project, according to the respective rules of the project financiers. These PIUs would be provided with incremental staff (with expertise in forestry, procurement, and accounting), vehicles and office equipment.

29. **Financing Mechanisms** for IDA project funds would be the following. The State of BH would be the recipient of the funds to be provided by IDA, and subsidiary on-lending agreements would be made between the State, on the one hand, and the Federation of BH and RS, on the other hand. The Ministries of Finance of the Federation and of RS would allocate funds for the purchase of equipment and services by the PIUs.

30. Supply and credit arrangements would be made to transfer the ownership to SFEs for road maintenance and repair, and wood transport equipment. The following terms for these supply and credit arrangements were agreed upon with Federation and RS representatives during the negotiations of the IDA financing; they would apply to the equipment funded by both IDA and the EU: (i) the interest rate would be "LIBOR plus 3 percent"; (ii) one year grace period would be applied for all equipment; and (iii) repayment would be made over eight years for road maintenance and repair equipment, and five years for wood transport equipment. Credit repayment to either the Federation or RS would be through local credit institutions, selected based on their fees, quality of services, and representation in local branches. The Bank and the EU would be informed by the Governments of both the Federation and RS on the subsequent utilization by the latter of the funds generated by the repayment of supply and credits.

Project Sustainability

31. The project would be an essential building block for resuming sustained forestry by supporting a country-wide revision of forest management planning, forest protection and rehabilitation, and the development of protected areas to preserve the country's natural ecosystems and biodiversity. By meeting the basic needs of the SFEs, the project would help restore their operational and income generation capacity. Thanks to income generation, the SFEs would be able to carry out sustainable forest management, including forest regeneration and silvicultural works, and contribute to sustained rural employment. Sustainable forestry supported under the project would also contribute to sustained supply of the wood processing industry with raw material.

Rationale for Donor Involvement

32. The project has high priority in the Government's reconstruction program, because of the economic and environmental importance of the forestry sector in the country. The forestry sector is subject to growing demand to provide raw material for the reconstruction of war damaged buildings, from local sources rather than imports, and for the production of wood products with high potential for export. In order to cope with that demand, the Government aims at securing sustained supply of high quality raw material, while safeguarding the environmental functions of Bosnian forests. The rationale for emergency donor assistance to implement the project includes the urgent need to:

- (a) resume sustainable management of forest resources. Project assistance would halt resource degradation in accessible areas where wood harvesting is concentrated now, and make it possible to take the necessary immediate measures to address direct and indirect consequences of the war to the forests;

- (b) secure environmental functions of forests. Project assistance would help resume multi-purpose management of forests, improve forest health, and develop conservation of forest biodiversity; and
- (c) provide employment to demobilized soldiers in rural areas. Project assistance would help revive local economy in areas which depend almost entirely on forest based activities.

33. The project would be consistent with the World Bank Forest Policy since it would help: (i) re-establish the pre-war institutional framework of the forestry sector which was able to ensure sustainable conservation and use of existing forests; (ii) resume environmentally sound management of forests with communal participation; and (iii) restore and expand the pre-war system of protected areas for biodiversity conservation.

Agreements Reached

34. During negotiations, agreements were reached regarding the selection criteria of the SFEs eligible for project support, a timetable to complete the appointment of the forest field inspectors, the arrangement for project management (PIUs), the procedures for the procurement of the equipment, and the terms and conditions of the supply and credit agreements and related cost recovery mechanisms. In addition, agreement has been reached that the Federation and RS shall cause BH Šume and Srpske Šume respectively to maintain records and accounts in accordance with sound accounting practices. In particular, their records, accounts and financial statements would be audited for each fiscal year by independent auditors acceptable to the Bank.

35. The conditions of effectiveness of the IDA financing would be that: (i) the subsidiary agreement between the State and the Federation or between the State and RS would be signed; (ii) the PIUs in the Federation and in RS would be appropriately staffed with forestry personnel; (iii) the 1998 one-year work plans -- for the SFEs for which the forest management plan has expired without being renewed -- would be developed under provisions acceptable to IDA and approved at the ministerial level; and (iv) in the case of the Federation, a draft new Forestry Law would be approved by the Government and submitted to the Parliament of the Federation.

Environmental Aspects

36. The project was given the Environmental Category "B" status, which requires remedial measures for possible environmental impacts. The Environmental Assessment (EA) of the project, presented in Appendix 6, was carried out in 1996, when the project was initially designed as an emergency operation (see para. 45). The EA report made an assessment of environmental conditions, laws and institutions; identified the environmental impacts likely to result from the resumption of harvesting and the rehabilitation of forest roads; and proposed a mitigation plan together with a project environmental monitoring plan. The potential negative environmental impacts identified by the EA were: (i) possible unsustainable wood harvesting; (ii) loss of biodiversity; (iii) loss of critical habitat; and (iv) increased soil erosion and degradation of water quality. These impacts would result mostly from harvesting activities. Road rehabilitation would have only limited impact, since project activities would consist of small-scale operations confined to rehabilitation of existing roads, and would not require any mitigation measures.

37. Since project preparation in 1996, wood harvesting has resumed significantly in Bosnia. Enforcement of sustainable forest management and protection are now the growing emergency needs. Consequently, the project has been restructured to focus on strengthening forest protection and

management, and no longer supports harvesting. Despite these changes, the EA continues to remain valid. Its concerns and measures, which concentrate primarily on mitigating the potential negative impacts of harvesting, are equally important as guidelines for addressing sustainable forest management concerns and are, therefore, fully integrated into the project's design and activities.

38. The project's Environmental Category rating was recently reviewed, to take into account these changes in the project design, and it was agreed that the project will retain its category "B" classification, which was originally assigned taking into consideration the emergency nature of the project. Since the revised project (i) does not support harvesting activity; and (ii) fully incorporates the mitigation measures proposed in the EA, the criteria under which the project received its category "B" rating have not changed, and consequently there is no justification for changing the rating.

39. During preparation in 1996, due to logistical reasons, the EA was carried out at the level of the Federation of BH only. Carrying out a subsequent and specific EA for RS was not considered necessary since (i) project activities in RS are of the same nature as in the Federation, but more modest in scope; (ii) environmental conditions and policies in the Federation and in RS are similar; and (iii) the EA is mostly based on pre-war and Bosnia-wide information which apply to both the Federation and RS, which is still the only information available.

Project Benefits and Economic Justification

40. The project would have environmental benefits and would permit increased and sustained production of wood; these benefits are discussed below:

- (a) Technical support to analysis of *policy changes* would examine the implications of institutional reforms and changes in marketing, pricing and trade, which would result in improved management of forest resources and, eventually, in increased revenues to the State;
- (b) The technical support to *improved forest management planning* would permit more timely harvesting and maintenance of trees, improving the value of the product. Improved land-use planning would also enhance the broader value of the forest by permitting better multi-functional forest planning and use, categorizing forests into those with primarily sustainable production, watershed protection, ecological or recreational purposes;
- (c) *Control of insect populations* over 150,000 ha of highly infested forests would abate spreading of insect attacks over 350,000 ha of coniferous high forests and prevent a significant destruction of the standing stock, which would in turn prevent the loss in annual marketable production of at least 100,000 m³ of logs. *Reforestation* in 500 ha of land susceptible to erosion would protect human infrastructure from the risk of landslide. Technical and logistical support to development of the *protected areas* system would improve management and land use planning and enhance the ecological and environmental value of these sensitive areas;
- (d) The equipment for *rehabilitation of forest roads* funded under the project would permit rehabilitation of about 4,000 kms of forest roads in high forests over an estimated 10 years. This would benefit approximately 40,000 ha of high forest annually, making an estimated additional annual amount of 400,000 m³ of marketable wood in mature stands eventually available for harvesting. This would also lower the cost of harvesting wood by

reducing the required distance for “skidding” wood from the harvest site to the roadside. The component also has two types of environmental benefits. First, by reducing the skidding distance it reduces soil disturbance and erosion in areas which are harvested. It also reduces damage to remaining stands and permits more rapid regeneration. Second, by rehabilitating roads it permits geographically more balanced harvesting, avoiding over-harvesting at the (previously) limited accessible sites;

- (e) The provision of *transport equipment* would permit extraction of sanitary fellings of about 100,000 m³ per year, increasing also the growth rate and harvest value of the remaining healthy growing stock. The *nursery equipment* would permit an increase in seedling production of about 6 million seedlings per year. The *telecommunications equipment* and *vehicles* would improve overall forest management by permitting improved monitoring and earlier detection of illegal harvesting and fires. It would also help ensure overall law enforcement and implementation of management plans.

41. Most of the benefits of the project are environmental and could not be quantified and evaluated against project costs. A contingency evaluation method would be an appropriate way of evaluating these environmental benefits but, given the present situation in Bosnia and Herzegovina, concepts such as “willingness to pay” and “existence value” cannot be meaningfully estimated. In addition, a comprehensive analysis of the commercial benefits derived from project support was not possible mainly because: (i) the project was prepared under an emergency approach which did not allow for a comprehensive collection of relevant data; and (ii) recent and reliable data on prices and marketing are scarce in a post-war country.

42. However, a cursory economic analysis has been made (see Appendix 9) only for those project activities where benefits could be approached -- with a reasonable level of confidence given the reliability of available data -- in terms of increased production of wood (i.e., pulpwood, pit-props, and sawlogs) and seedlings. The analysis deals with these benefits only and does not take into account other commercial benefits (e.g., fuelwood, non-wood forest products); the analysis is based on very conservative assumptions and considers a 10-year period only -- whereas a 50-year period is normally considered for investment in forests -- since the project is by nature a reconstruction project from which benefits are mostly expected in the short or medium term. The activities analyzed are: (i) forest protection from insect attacks; (ii) forest roads maintenance and repair; (iii) provision of wood transport equipment; and (iv) nursery rehabilitation. The cost of project investments in these activities is US\$9 million or 45 percent of total project cost. The combined ERR for these activities is 59 percent.

Risks

43. The risk of *hostilities* still exists in BH; however, as permanent political and administrative institutions are gradually established and economic activities normalize, peace is expected to take hold and consolidate over time. The project would contribute to this trend by supporting sustainable development of a key sector in Bosnian economy.

44. The risk of *delays in implementing* the project should be considered, since such delays may reduce the benefits of the project. This risk would be mitigated by: (i) the fact that PIUs are already established to manage project activities; (ii) detailed preparation of implementation arrangements such as the early selection of participating SFEs, and early preparation of the technical specifications for the equipment; (iii) swift deployment of the technical assistance; and (iv) the favorable conditions in the forestry sector including the availability of skilled and experienced professionals and workers.

Recommendation

45. I am satisfied that the proposed Interim Fund Credit complies with the 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, DC
April 24, 1998

Attachments
Schedules A - E
Map

BOSNIA AND HERZEGOVINA

FORESTRY PROJECT

ESTIMATED COSTS AND FINANCING PLAN

Project Components and Activities	US\$ '000 Equivalent			% Foreign Exchange	% Total Base Costs
	Local	Foreign	Total		
1. Support to Forest Management					
- Support to Policy Reforms	90	240	330	73	2
- Forest Management Planning	628	1,116	1744	64	9
- Forestry Inspection Services	114	706	820	86	4
S/Total	823	2,071	2,894	72	16
2. Protection and Rehab. of Forests					
- Forest Protection	376	1,457	1,833	79	10
- Reforestation	500		500	-	3
- Protected Areas Development	373	610	983	62	5
S/Total	1,249	2,067	3,316	62	18
3. Rehab. of SFEs Operational Capacity					
- Road Maintenance Equipment	-	4,150	4,150	100	22
- Other forestry equipment	-	7,500	7,500	100	41
S/Total	-	11,650	11,650	100	63
4. Project Management & Monitoring	190	415	605	69	3
Total Base Costs	2,272	16,193	18,465	88	100
Physical Contingencies	200	1,162	1,362	85	7
Price Contingencies	96	296	392	76	2
Total Project Costs	2,568	17,652	20,220	87	110
of which					
- Federation of BH	1,652	11,560	13,212	87	109
- Republika Srpska	916	6,091	7,007	87	110

Note: Figures may not total exactly due to rounding.

PROJECT FINANCING (US\$ '000 Equivalent)

Project Components	IDA	EU	Others	Total
1. Support to Forest Management	-	400	2,900	3,300
2. Protection and Rehab. of Forests	-	2,000	1,600	3,600
3. Rehab. of SFEs Operational Capacity	7,000	5,700	-	12,700
4. Project Management & Monitoring	-	600	-	600
Total	7,000	8,700	4,500	20,200
- Federation of BH	4,700	5,900	2,600	13,200
- Republika Srpska	2,300	2,800	1,900	7,000

BOSNIA AND HERZEGOVINA

FORESTRY PROJECT

SUMMARY OF PROPOSED PROCUREMENT AND DISBURSEMENT ARRANGEMENTS
(US\$ million equivalent)

Project Element	Procurement Methods (US\$ m)			TOTAL
	ICB	OTHER	NBF	
Goods				
1.1 Forest road repair and maintenance equipment (graders, tractors with excavators)	3.1 (3.1)	0.3a (0.3)	1.1	4.5 (3.4)
1.2 Other forestry equipment (trucks with cranes)	2.3 (2.3)			2.3 (2.3)
1.3 Other forestry equipment (nursery equipment, mopeds for forest guards, and radio communication systems)	0.55 (0.55)	0.75b (0.75)	4.6	5.9 (1.3)
1.4 Other equipment			3.2	3.2
Subtotal	5.95 (5.95)	1.05 (1.05)	8.9	15.9 (7.0)
Works			1.1	1.1
Consultant Services and Training			2.4	2.4
Operating Costs			0.8	0.8
TOTAL PROJECT COST (including contingencies)	5.95 (5.95)	1.05 (1.05)	13.2	20.2 (7.0)

NOTE: Figures in parenthesis represent IDA financing; NBF = Not Bank Financed; ICB = International Competitive Bidding.

a- IS (International Shopping) including tractors with excavators for RS (US\$300,000).

b- IS including nursery equipment (US\$500,000) and mopeds (US\$250,000) for RS.

DISBURSEMENT CATEGORIES
(US\$ thousand)

Category	Total Amount	Bank Financed Amount	percent of expenditures to be financed by the Bank ^{a/}
1. Goods	15,100	6,650	100 percent
2. Works:	1,100		
3. Consultant Services & Training	2,300		
4. Incremental Operating Costs	700		
Unallocated	1,000	350	
TOTAL	20,200	7,000	35 percent

^{a/} net of taxes and duties

Estimated Disbursements
(US\$ Millions)

	1st Sem. 1999	2nd Sem. 1999	1st Sem. 2000	2nd Sem. 2000	1st Sem. 2001
Semester	0.3	3.2	1.7	1.1	0.7
Cumulative	0.3	3.5	5.2	6.3	7.0

BOSNIA AND HERZEGOVINA

FORESTRY PROJECT

TIMETABLE OF KEY PROJECT PROCESSING EVENTS

(a) Time taken to prepare project	7 months
(b) Prepared by	FAO/CP
(c) First Bank Mission	May 1996
(d) Appraisal Mission Departure	July 29 - August 9, 1996
(e) Negotiations	November 20 - 22, 1996
(f) Post-negotiations Mission	March 1998
(g) Planned Date of Effectiveness	July 1998

STATUS OF BANK GROUP OPERATIONS IN BOSNIA-HERZEGOVINA

A. STATEMENT OF BANK LOANS ^{a/}
(As of February 28, 1998)

Loan No.	Fiscal Year	Borrower	Project	US\$ Million (Less Cancellations)	
				Loan	Undisbursed
<u>Loans/Credits/Grants</u>					
<u>IBRD ^{b/}</u>					
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				<u>620.6</u>	<u>0.0</u>
Of Which: Repaid				<u>24.9</u>	
Total Now Held by the Bank:				<u>595.7</u>	
<u>TFBH ^{c/} (Under Disbursement)</u>					
TF-024030	1996	Bosnia and Herzegovina	Emergency Recovery Credit	45.0	1.2
TF-024031	1996	Bosnia and Herzegovina	Emergency Farm Reconstruction	20.0	0.0
TF-024032	1996	Bosnia and Herzegovina	Emergency Water Supply	20.0	0.5
TF-024033	1996	Bosnia and Herzegovina	Emergency Transport	35.0	5.8
TF-024034	1996	Bosnia and Herzegovina	Emergency District Heating ^{d/}	20.0	1.4
TF-024035	1996	Bosnia and Herzegovina	Emergency War Victims Rehabilitation	5.0	0.0
TF-024040	1996	Bosnia and Herzegovina	Emergency Education Reconstruction	5.0	0.0
Total				<u>150.0</u>	<u>8.9</u>
<u>IDA</u>					
2897-BOS	1996	Bosnia and Herzegovina	Emergency Education Reconstruction	5.0	0.6
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	1.3
2903-BOS	1997	Bosnia and Herzegovina	Emergency Power Reconstruction	35.6	3.3
2904-BOS	1997	Bosnia and Herzegovina	Emergency Public Works and Employment	10.0	1.7
2905-BOS	1997	Bosnia and Herzegovina	Emergency Landmines Clearance	7.5	0.9
2906-BOS	1997	Bosnia and Herzegovina	Emergency Demobilization and Reintegration	7.5	3.7
2914-BOS	1997	Bosnia and Herzegovina	Transition Assistance Credit	90.0	0.0
N001-BOS	1997	Bosnia and Herzegovina	Emergency Industry Re-Start Guarantee	10.0	0.5
N002-BOS	1997	Bosnia and Herzegovina	Emergency Microenterprise/Local Initiatives	7.0	2.6
N003-BOS	1997	Bosnia and Herzegovina	Essential Hospital Services	15.0	11.4
0320-BOS	1997	Bosnia and Herzegovina	Transport Reconstruction II	39.0	30.0
0350-BOS	1997	Bosnia and Herzegovina	Education Reconstruction II	11.0	9.5
3028-BOS	1997	Bosnia and Herzegovina	Reconstruction Assistance Project	17.0	15.7
3029-BOS	1997	Bosnia and Herzegovina	Emergency Natural Gas	10.0	10.0
Total				<u>284.6</u>	<u>96.2</u>

^{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.

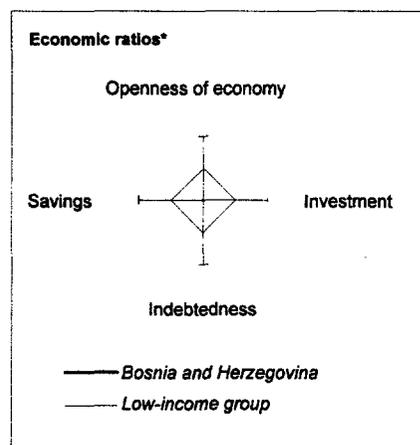
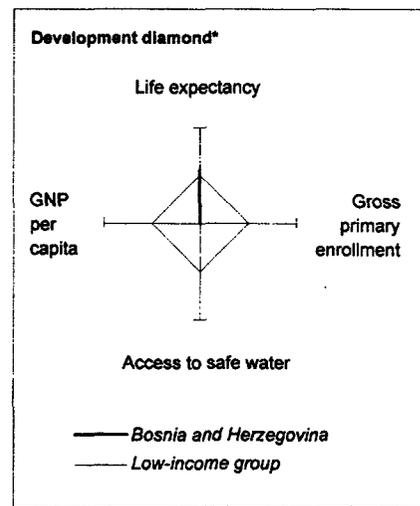
^{d/} Disbursements to date are from the Project Start-Up Advance (of which US\$2 million is disbursed for Gas).

B. STATEMENT OF IFC INVESTMENTS
(As of November 30, 1997)

Fiscal Year	Obligor	Type of Business	Gross Commitments			
			Loan	Equity	Total	
1977	Tvornica Kartona I Ambalaze Cazin	Timber, Pulp and Paper		3.79	0.0	3.79
1985	Sour Energoinvest	Industrial Equipment and Machinery	8.82	0.0	8.82	
1997	Horizonte BiH Enterprise Fund	SME Investment	0.0	2.00	2.00	
1997	Microentreprise Bank	Microcredit	0.0	0.57	0.57	
1997	Sarajevska Pivara	Brewery	8.04	0.0	8.04	
		Total Gross Commitments	<u>20.65</u>	<u>2.57</u>	<u>23.22</u>	
		Less: Participations, Cancellations, Terminations, Exchange Adjustments, Repayments, Write-offs and Sales	<u>23.50</u>	<u>2.60</u>	<u>26.10</u>	
		Total Commitments Now Held by IFC	<u>20.65</u>	<u>2.57</u>	<u>23.22</u>	
		Total Undisbursed	5.01	2.00	7.01	
		Total Outstanding	<u>15.64</u>	<u>0.57</u>	<u>16.21</u>	

Bosnia and Herzegovina at a glance

	Bosnia and Herzegovina	Europe & Central Asia	Low-income		
POVERTY and SOCIAL					
Population mid-1995 (millions)	4.4	488	3,188		
GNP per capita 1995 (US\$) a/	..	2,240	460		
GNP 1995 (billions US\$) a/	..	1,093	1,466		
Average annual growth, 1990-95					
Population (%)	-0.3	0.4	1.8		
Labor force (%)	0.3	0.6	1.9		
Most recent estimate (latest year available since 1989)					
Poverty: headcount index (% of population)	..	..	..
Urban population (% of total population)	49	66	29		
Life expectancy at birth (years)	71	68	63		
Infant mortality (per 1,000 live births)	19	23	58		
Child malnutrition (% of children under 5)	..	..	38	
Access to safe water (% of population)	..	..	75	
Illiteracy (% of population age 15+)	..	..	34	
Gross primary enrollment (% of school-age population)	..	97	105		
Male	..	97	112		
Female	..	97	98		
KEY ECONOMIC RATIOS and LONG-TERM TRENDS					
	1975	1985	1994	1995	
GDP (billions US\$)	..	..	..	2.5
Gross domestic investment/GDP	..	..	..	..
Exports of goods and non-factor services/GDP	..	..	..	15.0
Gross domestic savings/GDP	..	..	..	..
Gross national savings/GDP	..	..	..	..
Current account balance/GDP	..	..	..	-20.2
Interest payments/GDP	..	..	..	..
Total debt/GDP	..	..	..	129.4
Total debt service/exports	..	..	..	116.0
Present value of debt/GDP	..	..	..	..
Present value of debt/exports	..	..	..	..
	1975-84	1985-95	1994	1995	1996-04
(average annual growth)					
GDP	17.2
GNP per capita
Exports of goods and nfs	36.7
STRUCTURE of the ECONOMY					
	1975	1985	1994	1995	
(% of GDP)					
Agriculture	..	9.5	..	..
Industry	..	43.0	..	..
Manufacturing	..	..	..	..
Services	..	47.5	..	..
Private consumption	..	..	..	..
General government consumption	..	..	..	..
Imports of goods and non-factor services	..	..	..	..
	1975-84	1985-95	1994	1995	
(average annual growth)					
Agriculture	..	..	..	..
Industry	..	..	..	..
Manufacturing	..	..	..	..
Services	..	..	..	..
Private consumption	..	..	..	..
General government consumption	..	..	..	..
Gross domestic investment	..	..	..	..
Imports of goods and non-factor services	..	..	..	..
Gross national product	..	..	..	..



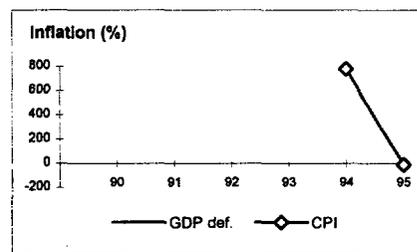
Note: 1995 data are preliminary estimates.

* The diamonds show four key indicators in the country (in bold) compared with its income-group average. If data are missing, the diamond will be incomplete.

Bosnia and Herzegovina

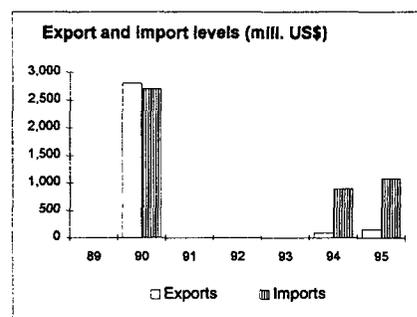
PRICES and GOVERNMENT FINANCE

	1975	1985	1994	1995
Domestic prices				
(% change)				
Consumer prices	780.0	-11.7
Implicit GDP deflator
Government finance				
(% of GDP)				
Current revenue
Current budget balance	17.0	29.0
Overall surplus/deficit	-0.2	0.0



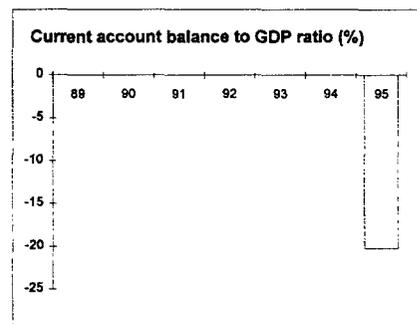
TRADE

	1975	1985	1994	1995
(millions US\$)				
Total exports (fob)	91	152
n.a.
n.a.
Manufactures
Total imports (cif)	894	1,082
Food
Fuel and energy
Capital goods
Export price index (1987=100)
Import price index (1987=100)
Terms of trade (1987=100)



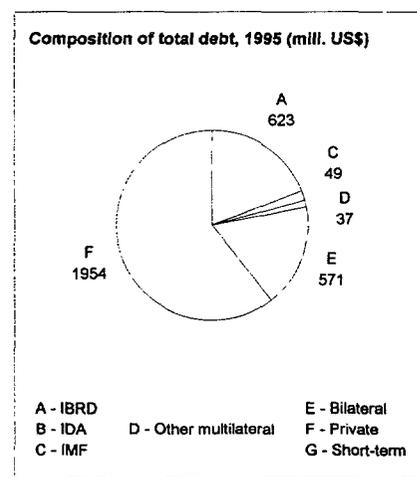
BALANCE of PAYMENTS

	1975	1985	1994	1995
(millions US\$)				
Exports of goods and non-factor services	194	381
Imports of goods and non-factor services	1,085	1,334
Resource balance	-891	-953
Net factor income	-177	-183
Net current transfers	625	630
Current account balance, before official transfers	-443	-506
Financing items (net)	437	649
Changes in net reserves	6	-143
Memo:				
Reserves including gold (mill. US\$)	69
Conversion rate (local/US\$)



EXTERNAL DEBT and RESOURCE FLOWS

	1975	1985	1994	1995
(millions US\$)				
Total debt outstanding and disbursed	2,960	3,234
IBRD	546	623
IDA
Total debt service	475	508
IBRD	60	73
IDA
Composition of net resource flows				
Official grants
Official creditors
Private creditors
Foreign direct investment
Portfolio equity
World Bank program				
Commitments
Disbursements
Principal repayments
Net flows
Interest payments
Net transfers



MAP SECTION

