Document of
The World Bank

FOR OFFICIAL USE ONLY

Report No. 65379-YF

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

AND

INTERNATIONAL FINANCE CORPORATION

COUNTRY PARTNERSHIP STRATEGY

FOR

THE REPUBLIC OF SERBIA

FOR THE PERIOD FY12–FY15

November 15, 2011

South East Europe Country Unit
Europe and Central Asia

Europe and Central Asia
International Finance Corporation

CURRENCY EQUIVALENTS

(Exchange Rate Effective November 8, 2011)
Currency Unit = Dinar
Dinar 1.00 = US$ 0.014
SDR 1.00 = Dinar 1.59

GOVERNMENT'S FISCAL YEAR

January 1 – December 31

ABBREVIATIONS AND ACRONYMS

AAA	Analytical and Advisory Activities
ADR	Alternative Dispute Resolution
APL	Adaptable Program Loan
BEEPS	Business Environment and Enterprise Performance Survey
BERIS	Business Environment Reform and Institutional Strengthening Project
CAP	Common Agricultural Policy
CEFTA	Central European Free Trade Agreement
CEM	Country Economic Memorandum
CPS	Country Partnership Strategy
CPS PR	Country Partnership Strategy Progress Report
CRIF	Catastrophe Risk Insurance Facility
CRR	Comprehensive Regulatory Reform
DFID	Department for International Development
DILS	Delivery of Improved Local
DG ECFIN	Directorate General for Economic and Financial Affairs
DG	Directorate-General for Employment
DPL	Development Policy Lending
DRG	Diagnose Related Group
EBRD	European Bank for Reconstruction and
EC	European Commission
ECA	Europe and Central Asia Region
ECSEE	Energy Community of South East Europe
EFTA	European Free Trade Association
EIB	European Investment Bank
MoF	Ministry of Finance
NBS	National Bank of Serbia
OECD	Organization for Economic Co-operation and Development
ESW	Economic and Sector Work
EU	European Union
FDI	Foreign Direct Investment
FRL	Fiscal Responsibility Legislation
FY	Fiscal Year
GDP	Gross Domestic Product
GEF	Global Environmental Facility
HBS	Household Budget Survey
HEI	Higher Education Institution
HIF	Health Insurance Fund
IBRD	International Bank for Reconstruction and
ICTY	International Criminal Tribunal for the
IFC	International Finance Corporation
IFI	International Financial Institution
IMF	International Monetary Fund
IPA	Instrument for Pre-Accession
IRB	Independent Regulatory Bodies
JSS	Justice Sector Support
LPI	Logistics Performance Index
LSMS	Living Standards Measurement Survey
MDTF	Multi Donor Trust Fund
M&E	Monitoring and Evaluation
MIGA	Multilateral Investment Guarantee Agency
MIPD	Multi-annual Indicative Planning
MSME	Micro, Small and Medium Enterprise
SAA	Stabilization and Association Agreement
SEE	South East Europe

PAD	Project Appraisal Document
PBG	Policy Based Guarantee
PIU	Project Implementation Unit
PPB	Public Procurement Bureau
PPP	Public-Private Partnership
PSIA	Poverty and Social Impact Analysis
QA	Quality Assurance
RCPR	Republic Commission for the Protection of Rights in Public Procurement Procedures
REPARIS	Road to Europe Program of Accounting Reform and Institutional Strengthening
RGA	Republic Geodetic Authority
RIA	Regulatory Impact Analysis
SIDA	Swedish International Development Cooperation Agency
SME	Small and Medium Enterprises
SPIL	Social Protection Investment Loan
TA	Technical Assistance
TBD	To Be Determined
TF	Trust Fund
UNDP	United Nations Development Program
WTO	World Trade Organization
y-o-y	Year-on-year

	World Bank	**IFC**
Vice President	Philippe H. Le Houerou	Dimitris Tsitsiragos
Country Director	Jane Armitage	Tomasz Telma
Task Team Leaders	Loup Brefort	Per Kjellerhaug
	Anthony Gaeta	Gjergj Konda

CONTENTS

Tables:

Boxes:

Graphs:

Annexes:

EXECUTIVE SUMMARY

i. **Serbia has passed through a period of dramatic change.** At the time the Board considered the Progress Report for the FY08-FY11 Serbia Country Partnership Strategy (CPS), the country was managing a rapidly changing political and economic environment. A new, reform oriented government committed to European Union (EU) accession confronted the politically sensitive issue of Kosovo's unilateral declaration of independence and the unfolding of the global economic and financial crisis.

ii. **Despite these pressures, the Government has by and large advanced the reforms on which it campaigned in 2008**. Serbia has sustained fiscal discipline, including, beginning in 2009, a 15-month IMF Stand-by Arrangement (SBA) which required difficult wage and pension freezes. In September 2011, it secured IMF support for a new precautionary 18-month SBA with potential support of €1.45 billion. Most recently, in October 2011, the European Commission (EC) recommended "candidate" status, an important milestone toward EU membership. The authorities have also taken tough political decisions, including the arrest and extradition of the last of the fugitive indicted war criminals. At the same time, the Government pursued its opposition to Kosovo's unilateral declaration of independence peacefully and within multilateral legal *fora;* and despite an adverse ruling continued to cooperate with the EU and United Nations toward the continuation of talks with Pristina. Serbia has made significant efforts to re-establish its place in the international community. However, escalating tensions with Kosovo over customs and border issues, and the failure, to date, to make much progress toward a negotiated solution, could affect the EC's formal granting of candidacy status.

iii. **Serbia has pursued these reforms while struggling to recover from the crisis which led to a 50 percent spike in poverty and a similar jump in unemployment.** The country is also preparing for elections scheduled for spring of 2012. Managing the former while preparing for the latter will place increasing pressure on the Government. As in many countries, the challenge is translating tenuous economic recovery into jobs and poverty reduction in a tight fiscal environment. Serbia needs to become more competitive and increase productivity. As detailed in the 2012 Country Economic Memorandum (CEM), this will require attraction and adoption of new technologies, which will in turn depend on a supportive business environment, capable institutions, a skilled labor force and high quality infrastructure.

iv. **The CPS will support Serbia's EU accession and help the Government strengthen competitiveness and improve the efficiency and outcomes of social spending in the context of severely constrained budgets.** The CPS proposes targeted financing, knowledge services and coordination with donor partners and an expanding partnership with the EC, with a focus on two pillars.

- ***Competitiveness:*** New interventions in FY12 and FY13 would include a DPL series to reform non-private enterprises; investments in road rehabilitation; reform of the judiciary, and a new partnership with the EC on innovation. These would build on the current portfolio of road transportation, cadastre, and irrigation projects. The recently completed CEM, prepared with the Government and with contributions from the EC, will provide the platform for engagement in areas where the Bank Group may not necessarily provide financing but are still critical to promoting strong, export-led growth. The focus of IFC's activities will be to create opportunities for growth through supporting the competitive sectors in the country, investment climate, strengthening domestic financial markets, and facilitating private sector participation in infrastructure. IFC will facilitate private sector involvement with fresh capital and know-how to improve productivity, energy efficiency and environmental focus in the corporate sector.

- ***Improved Efficiency and Outcomes of Social Spending:*** Assistance in the next two years would come from: (i) a proposed Public Expenditure Management DPL, which will help reduce Serbia's large public sector while strengthening social assistance to cushion the impact of the crisis, and (ii) the current portfolio in health, education, and social protection services. New interventions include a health project for FY13. The EC has also asked the Bank to support Serbia in strengthening its capacity to monitor and evaluate social spending. This is increasingly important in light of Serbia's aging population and its commitment, anchored in recently adopted fiscal responsibility legislation, to reduce budget deficits.

v. **These two pillars were arrived at following close consultation with the Government and are consistent with the first two components of ECA's Regional Strategy, as well as the EC's *Europe 2020 Growth Strategy*.** Indeed, the Bank's interventions in Serbia are designed to advance the EU agenda of *Smart Growth*, with its focus on education, skills, and innovation, as well as *Inclusive Growth*, especially its emphasis on job creation for vulnerable groups and modernizing labor markets and welfare systems. It should also be noted that while not a pillar of this CPS, the Bank Group will remain engaged in support of the third component of the ECA and *Europe 2020* strategies: environmental sustainability.

vi. **World Bank Group support will be guided by three principles of engagement.**

- **Results:** The two programmatic DPL series and the Policy Based Guarantee (PBG), underpinned by high quality AAA, achieved their intended results of supporting difficult policy reform and institutional strengthening. This CPS proposes to build on these operations. With respect to investment operations, results were much slower to materialize than originally expected because of delays in project implementation. Progress is underway, but continued effort is required to accelerate project execution.

- **Selectivity**: The CPS will see a significant consolidation of the portfolio as Bank support shifts to fewer, larger investment operations. At the same time, the Bank will expand its engagement with European partners active in Serbia in sectors consistent with the CPS; where the Bank has a comparative advantage, and where there is demand for Bank expertise in implementation, monitoring and supervision. This will be particularly helpful in assisting Serbia in executing EC financed investments.

- **Partnership:** Virtually all assistance will be designed to support Serbia's EU accession; and the Bank will continue to expand innovative partnerships with the EC, European IFIs and bilateral donors to leverage external support. Ongoing cooperation in monitoring macroeconomic developments with the EC's DG ECFIN; Instrument for Pre-Accession (IPA) support for Bank implementation of EC financed projects; and the Bank's membership in the Western Balkans Investment Framework are key examples.

vii. **IBRD financing during the first two years of the CPS is expected to amount to US$340 million.** The Government has asked for lending during the entire CPS period of US$800 million. The Bank is sensitive to the challenging external environment for Serbia (and the rest of the Western Balkans), as well as the importance of supporting the country during this critical period as it prepares for EU accession. Management has indicated the Bank will be as responsive as possible to meet the Government's borrowing needs. Final lending amounts will depend on IBRD's lending capacity and demand from other borrowers, as well as performance during the course of CPS implementation. The lending program for the last two years of the CPS will be discussed at the time of an early CPS Progress Report. The CPS envisions total lending to be divided evenly between DPLs and investment operations. The first DPL, for FY12, is the last in a programmatic series of a Public Expenditure Management DPLs, and FY13 would begin a new series focusing on the reform of non-private enterprises.

viii. **IFC expects to provide financing of US$600-800 million to the private sector during the CPS period.** The program will depend on the government's support for the private sector participation in the infrastructure sectors at the national and municipality levels, further improvements of the business environment, and the growth outlook in Europe**.**

ix. **The CPS is subject to risks.** Serbia's overriding challenge is to consolidate macroeconomic stability to strengthen its resilience against eurozone turmoil. The second risk would be a weakening of commitment to policy reform as a result of the elections; this could slow EU accession and disrupt the Bank's programmatic DPL series. A related challenge will be to guard against deepening frustration with the protracted waiting period for EU membership (which could last a decade) that now follows October's recommendation for candidate status. Third, there are implementation risks stemming from the lack of capacity of public institutions responsible for the reforms under DPLs and executing Bank financed projects. Failure to sustain improvements in portfolio management could lead the Bank to cancel or postpone projects. These risks are mitigated by the current government's strong record and the recognition by major parties that domestic and external events will continue to demand prudence.

I. COUNTRY CONTEXT

A. Political Context

1. **During the past five years Serbia has undergone a remarkable period of political and economic change.** In 2006, Montenegro narrowly voted for independence (which the Serbian Government immediately recognized); Kosovo followed two years later with its own unilateral declaration of independence (which the Government to date has refused to accept); the economic and financial crisis hit Serbia in early 2009, returning hundreds of thousands of people into poverty and unemployment; and throughout this period Serbian society generally endorsed the Government's actions as it captured the last of the high profile war criminals and turned them over to the ICTY[1]. These events, which in earlier years might have been expected to strengthen nationalist or radical opposition elements, have to date not deviated the center of Serbian politics from the agenda of EU accession, fiscal discipline and structural reform. Serbia has left the past behind and is moving toward a new future.

2. **Nevertheless, eleven years after the democratic removal of Slobodan Milosevic and the final disintegration of Yugoslavia, Serbia's transition remains incomplete**. Forging a new identity has not been easy. A recent poll conducted by the World Bank and EBRD—*A Life in Transition: After the Crisis*—revealed that only about 30 percent of Serbians are satisfied with their lives, well below the average for other transition countries (42%) and the average for western Europe (72%); and the sentiment is little better with respect to expectations for the future—only 30 percent of Serbs believe the next generation will have a better life, which is again well below the average for all transition countries of 50 percent. Moreover, a large segment of the population is growing anxious for the rewards for their patience. Polls show growing frustration with the slow recovery and continued high unemployment, as well as growing fatigue with the reform process and the perceived "moving goalposts" of EU accession.[2]

3. **The elections scheduled for April 2012 are not likely to change Serbia's fundamental policy direction.** Despite the current government's solid economic management throughout the crisis, steady progress toward EU candidate status, and deftly managed foreign policy, which has returned Serbia firmly to the international community, growing frustration with "bread and butter issues" (jobs and poverty) could result in a protest vote. Most observers, however, agree that a change in government is unlikely to result in a material departure from the current policy orientation. All of the major parties likely to form a coalition have expressed commitment to EU accession and recognize the need for continued economic reform to boost employment. That the consensus around this policy direction is consistent with a pragmatic reading of the electorate suggests both the ultimate resiliency of public support for continued prudent macro-economic management, as well as the clear recognition that the current regional economic reality limits the options for radical change.

B. Economic Context

4. **Serbia is an open economy with unexploited export potential and a GDP per capita of approximately US$5,150 in 2010.** Some 55 percent of total exports go to the EU-27 countries; the main sectors are: agriculture products, which make up about 20 percent of total exports (mostly grains, sugar, fruits and vegetables, confectionary products and beverages); iron, steel and metal products (20%); machinery and transport equipment (17%); and chemicals (9%). Serbia's exports stalled in the aftermath of the 2008-2009 economic crisis but have shown signs of rebounding, and are now well above pre-crisis levels. Nevertheless, there is substantial room for improvement, as its exports as a share of GDP,

[1] International Criminal Tribunal for the Former Yugoslavia
[2] http://www.ebrd.com/downloads/research/surveys/LiTS2e_web.pdf

currently at about 25 percent, could be 2-3 times larger. Using neighboring Europe and Central Asia (ECA) economies for comparison, all have export shares of GDP in the range of 60-80 percent. (e.g. Czech Republic, Hungary, Slovakia, and Poland).

Pre-Crisis

5. **The Serbian economy grew rapidly until 2008, fueled in part by new export dynamism and largely by a significant boost in domestic demand, supported by significant economic reforms since 2000.** GDP growth averaged 5 percent per year during 2001-2008, with exports growing at an average annual rate of around 30 percent, albeit from a low base[3]. Output rose in real terms by nearly 50 percent between 2000 and 2008, as the corporate sector started to post profits and the banking sector restructured. The supply response also reflected increases in productivity and output in recently privatized and *de novo* firms, as evidenced by the particularly rapid rates of output growth in those sectors which underwent extensive privatization (e.g., steel, cement, rubber, tobacco, dairy, sugar and banking) or attracted foreign investors.

6. **But the expansion was also driven by domestic consumption, large capital inflows and a credit boom.** It was accompanied by a widening current account deficit and increasing private sector debt**.** While real GDP expanded by 47 percent in real terms from 2000 to 2008, domestic demand expanded by as much as 71 percent. Although exports grew rapidly, consumption and imports also grew very strongly and as a result the trade deficit reached 26 percent of GDP in 2008. Driven by widening trade deficits, the current account deficit increased from 8.8 percent in 2005 to 21.6 percent in 2008.

7. **Fiscal policy contributed as well, with the general government balance moving from a surplus of 0.8 percent of GDP in 2005 to a deficit of 2.7 percent in 2008**. Two *ad hoc* extraordinary pension adjustments in 2008 increased spending on pensions from 11.4 percent of GDP in 2007 to 14.3 percent in 2009. Large wage increases were also granted in this period (e.g. wages of health workers were increased by 24 percent in real terms in 2007). In parallel, revenues declined from 44.2 percent of GDP in 2006 to 42.8 percent in 2008, primarily due to lower collection of Value Added Tax (VAT), excises and personal income tax. Inflationary pressures also reemerged in the run up to the crisis, driven primarily by supply side factors.

Impact of the Crisis

8. **The crisis led to a drop in real GDP of 3.5 percent in 2009.** Industrial output declined by about 20 percent between mid-2008 to mid-2009. Exports fell by nearly 30 percent over the same period, while imports declined even more sharply. The reduction in the trade deficit paired with strong unrecorded remittances resulted in a sharp correction in the external account, from 21.6 percent of GDP in 2008 to 7.1 percent in 2009. With decreased economic activity, and lower food and energy prices, inflation pressures also receded (to about 4 percent). Credit activity fell sharply with the onset of the crisis. The real year-on-year (y-o-y) growth rate of credit to the private sector fell from more than 20 percent in early 2008 to negative values in the second half of 2009.

9. **The authorities responded with determined fiscal adjustment.** These efforts were supported by the IMF through a new SBA and the Bank through its ongoing macro dialogue in the context of the two DPL series and the Policy Based Guarantee (PBG), as well as the Public Expenditure Review, entitled *Doing More with Less.* The IMF approved a 15-month precautionary SBA for Special Drawing Rights (SDR) 350.8 million in January 2009. Spending was contained by a range of expenditure

[3] The ratio of exports of goods and services to GDP increased from 20 percent in 2002 to 30 percent in 2008, still low compared to regional peers.

measures, including most potently a nominal wage and pension freeze, and cuts in subsidies and capital expenditures; but revenues fell sharply, reflecting the contraction in aggregate demand as well as lower collection of trade taxes in line with the implementation of the Stabilization and Association Agreement (SAA) with the EU. As a result, the 2009 fiscal deficit increased to 4.5 percent of GDP. In May 2009, the IMF approved an augmented arrangement for SDR 2.6 billion (around €3 billion, or 10% of GDP). The program period was extended to 27 months and the arrangement was made non-precautionary.

C. Social Development Context

10. **Impressive declines in poverty achieved throughout the 2000s reversed abruptly with the 2008 global economic and financial crisis.** Poverty fell from 13.4 percent in 2002 to 6.1 percent in 2008, which translated into about half a million people moving out of poverty. The deceleration of economic growth which resulted from the crisis halted this progress. Poverty jumped back to 6.9 percent in 2009 and further to 9.2 percent in 2010, according to the Household Budget Survey (HBS). This is equivalent to around 230 thousand people falling back below the poverty line since the beginning of the crisis. Growing unemployment from already high levels has been an important result of the crisis, reaching 20 percent in October 2010. The large unemployment shock might explain why, according to the Life in Transition Survey conducted in 2010, almost three-quarters of respondents declared to have been hit significantly ("a great deal" or "a fair amount") by the crisis. This compares with about 50 percent for all of Eastern Europe and Central Asia.[4] The labor market shock had an interesting gender aspect: while male dominated sectors were harder hit than those in which females were more prevalent, women found it harder to move out of unemployment and inactivity during the first year of the crisis. From a wage perspective, women were less affected than men, though considering that their wages are lower on average they continue earning less than men.

11. **The poorest and most vulnerable have been most affected by these trends.** The largest increases in unemployment were registered in the bottom consumption quintile. For this group, total unemployment increased by 40 percent between October 2008 and October 2009, and total employment decreased by 12 percent. A rapid crisis assessment in 2009 explored how the most vulnerable groups in Serbia were affected by the crisis.[5] For these groups the crisis exacerbated long standing challenges by making it more difficult to find occasional and seasonal jobs in the informal sector, resulting in lower wages and often delayed payments, causing losses of formal jobs for those who had them, and plunging households further into debt for items such as utility bills which they postponed paying. Households had few options to cope with the crisis. Many resorted to changing consumption patterns, and in particular switching to cheaper foods and reducing the numbers of meals, and looking for additional work in the informal economy. Not paying utility bills, buying on credit from the stores and resorting to informal loans were other important strategies. Available evidence points to the positive impact that social assistance programs had for those who receive it as a regular source of income, even if payments were often considered insufficient to mitigate the additional pressures confronted by households.[6]

[4] A recent ECA Regular Economic Report (RER) highlighted how in most ECA countries labour market adjustments to the crisis happened mostly through lower earnings rather than through fewer jobs. Serbia was an exception to this regional pattern.

[5] The report looked at the Roma population, Internally Displaced Persons (IDPs), single mothers and poor rural communities and conducted focus groups and key informant interviews. IPSOS Strategic Marketing (2009) " Crisis assessment" -- background for the Social Inclusion and Poverty Reduction Unit report on the crisis supported by the World Bank. Similar findings on coping strategies for poor pensioners, another vulnerable group, were found by the "Qualitative assessment of the pension freeze" -- background report for the preparation of DPL II.

[6] In the LITS survey Serbia stands out in the whole region (together with Azerbaijan) as a country where more respondents favour increasing spending on social assistance rather than spending on health and education as policy priority.

II. RECENT ECONOMIC DEVELOPMENTS, OUTLOOK AND RISKS

12. **On September 29, 2011, the IMF approved an 18-month US$1.45 billion Precautionary Stand-By (SBA) for Serbia, just as the European and international environment worsened and Serbia's economic growth began to slow**. As insurance in case of need, the SBA supports the Government's underlying economic program until end-2012 in order to maintain macroeconomic and financial stability and improve the investment climate under unsettled global and regional conditions. After 3.1 percent growth in the first half of 2011, the Serbian economy slowed to a 1 percent pace in the rest of the year, reflecting the ongoing turbulence in the EU on trade as well as continued weaknesses in domestic demand. With more than half of Serbia's exports destined to the EU-15 countries, Serbia needs traction from the EU to support its own growth; and the trade channel transmitting shocks from Europe is particularly strong. Annual inflation, which had peaked at 14.7 percent y-o-y in April 2011, decelerated sharply to reach 9.3 percent in September 2011 and remains on a downward trend, allowing the Central Bank to reduce the benchmark interest rate by 250 basis points to 10 percent in the six months leading to November. But high unemployment at 22 percent, continued restrictions on pension and civil service wage increases, and sluggish credit growth continue to constrain domestic demand.

Table 1: Serbia: Main Macroeconomic Indicators and Projections

				projections				
	2008	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**
Real economy								
GDP real growth	3.8	-3.5	1.0	2.0	3.0	4.5	5.0	5.0
GDP in USD billion	*47.7*	*40.1*	*38.0*	*46.4*	*49.0*	*52.5*	*57.1*	*62.1*
Investments, percent GDP	29.7	23.0	22.8	24.8	24.6	24.2	23.9	23.5
Consumer price inflation (end-of-	8.6	6.6	10.3	7.9	3.5	4.0	4.0	4.0
Public sector (as percent of GDP)								
Revenues	42.8	42.3	41.0	39.1	39.3	39.4	39.7	39.6
Expenditure	45.5	46.7	45.6	43.7	43.1	42.3	41.6	40.8
o/w Capital expenditure	3.9	3.4	3.5	3.4	3.7	4.0	4.2	4.4
Fiscal Balance, after grants	-2.7	-4.5	-4.7	-4.5	-3.9	-2.8	-1.9	-1.2
Total public debt	34.2	38.2	44.9	44.1	44.5	43.1	40.8	38.2
External position								
CAD after grants (percent of GDP)	-21.6	-7.1	-7.2	-7.6	-8.8	-8.5	-7.5	-6.4
External debt (percent of GDP)	66.7	79.4	82.2	75.3	70.1	69.6	67.7	65.8
o/w Private ext. debt (percent of	47.2	54.0	53.4	49.0	48.0	51.0	51.3	50.4
Reserves (US$ billion)	*11.5*	*15.3*	*13.1*	*14.4*	*13.2*	*13.3*	*13.9*	*15.2*

Source: IMF, World Bank staff, and the Ministry of Finance.

13. **The Serbian banking sector has improved.** Performance y-o-y through end-June 2011 has strengthened, as total loans and deposits are both up about 5 percent, along with interest income and equity. The combined capital adequacy ratio (CAR) for banks is near 20 percent. However, headline NPLs remain unchanged, at about 17 percent. In response, banks continue to add to provisioning levels (now in excess of 100 percent of classified assets), which should insulate them against credit losses. On balance, Serbian banks are well capitalized and continue to demonstrate resiliency towards a slowing

domestic economy. The National Bank of Serbia (NBS) views credit risk as a key near-term vulnerability, exacerbated by the fact that most bank loans are Euro linked or denominated: thus, many borrowers are exposed to higher debt service costs in the event of local currency depreciation.

14. **Going forward in 2012, the Government remains committed to the FRL fiscal targets, recognizing that it will be a challenging year because of modest growth and more fiscal adjustment.** The Government's fiscal difficulties are compounded by recently adopted amendments to the law on local self-government, which mandate a significant shift of revenues from the central government to local governments[7] without a corresponding transfer of expenditure assignments. This alone is expected to reduce the central government's 2012 revenues by some 1.3 percent of GDP. Further, early Ministry of Finance (MoF) plans included somewhat optimistic projections of revenues and expenditure cuts. In the absence of further spending cuts, the consolidated deficit in 2012 would exceed 6 percent of GDP, more than two percentage points over the target level specified in the FRL. The Government is fully aware of this situation and is working intensively on a plan to reduce the fiscal deficits to levels foreseen in the FRL, primarily through further cuts in non-priority expenditures, shifting expenditure responsibilities for local projects and road maintenance from the central government to local governments, increasing payment discipline in the public sector, and, possibly, implementing some base-broadening revenue measures[8]. The IMF and the authorities discussed policy options during the first review of the new program in November, 2011. The IMF mission and the authorities reached staff level agreement (subject to approval by IMF Board in December 2011), and the IMF program remains on track.

15. **Over the medium-term, with prudent fiscal management and the ongoing shift towards export-led growth, real GDP growth could average 4.5-5.0 percent with high but financeable financing needs (Table 1).** The current account deficit is expected to stabilize at around 7 to 8 percent of GDP, in part because of sizeable exports of Fiat vehicles (the Government formed a strategic partnership with Fiat to start production in Kragujevac early in 2012). Although a significant improvement compared to pre-crisis levels, this is still above the levels seen in more successful new EU member states. External financing needs will be high, but fully covered under the baseline scenario. According to the IMF estimates, gross financing needs in 2011 and 2012 will be about €8 and €8.7 billion respectively, or approximately 25 percent of GDP in each year. With the current account deficit much lower than the pre-crisis period, debt amortization will account for proportionally more external financing needs, largely due to high private sector debt amortization of the corporate sector. Financing needs will be covered by private inflows, including a combination of private investment inflows (FDIs and portfolio), modest net flows to banks, and disbursements from international financial institutions (IFIs) and other multilaterals, including IMF, EU and the Bank.

Macroeconomic Outlook and Debt Sustainability

16. **Given the unfavorable external environment at least over the near term, growth will remain modest in 2012, picking up in 2013 and outer years, reflecting the gradual shift towards an export-led economy.** Growth has been revised down to 3 percent for 2012 from 4.5 percent, with further risks,

[7] In particular, the amendments stipulate that 80 percent of the collected wage tax revenues will be transferred to local governments, significantly higher than the current 40 percent.

[8] According to Governments Letter of Intent, the identified 2012 fiscal gap will be brought in line with FRL primarily through cutting spending. According to the Letter, the fiscal package for 2012 is envisaged to include as the main measures: (i) shifting spending responsibilities, particularly on capital spending and local road maintenance, from the Republican to local governments (reducing gap by ¾ percent of GDP); (ii) cuts in subsidies at the Republican level (¼ percent of GDP); (iii) a sharp reduction of net lending operations (½ percent of GDP); (iv) cutbacks in planned low-priority capital and goods and services spending (¾ percent of GDP); and (v), several minor revenue measures, including increasing royalties for mining rights and measures to increase tax compliance (¼ percent of GDP).

reflecting gradual stabilization and slow recovery in consumption, and improvements in net exports, including from the Fiat production. The process would accelerate to a more robust overall growth of 4.5 to 5 percent in 2013 and in the outer years, increasingly relying on exports and investments. This medium-term growth requires continued fiscal and structural adjustment, consistent with the Government's reform program and the EU accession agenda. Higher exports and savings will drive medium-term growth with improvement in the savings rate coming from public and private sectors. Public sector savings will be aided by anchoring fiscal policy with the FRL[9]. Although certainly a positive development, the FRL is facing "growing pains" – despite its adoption, changes to the law on local self-government that clearly have detrimental fiscal impact have been passed by the Parliament. But although not yet as effective in designing policy as hoped, the FRL has been instrumental in framing the discussion regarding fiscal consequences and providing a mechanism to find offsetting adjustments.

Table 2: Debt Dynamics

Indicators	2008	2009	2010	projections					
				2011	2012	2013	2014	2015	2016
External debt									
TDO/GDP	66.7	79.4	82.2	75.3	70.1	69.6	67.7	65.8	62.9
TDO/XGS	214.7	270.1	235.6	209.3	180.4	183.1	173.0	162.1	149.9
TDS/XGS	33.6	38.7	33.8	36.6	39.3	40.5	38.0	38.6	40.4
INT/XGS	7.2	7.5	6.7	4.6	4.4	4.1	3.6	3.3	2.9
Public debt									
TDO/GDP	34.2	38.2	44.9	44.1	44.5	43.1	40.8	38.2	35.6
TDO/Public Revenue	79.8	90.3	109.4	112.7	113.3	109.3	102.7	96.4	90.3

Source: Government of Serbia, IMF, World Bank.
NOTE: TDO/GDP – ratio of total debt outstanding to GDP; TDO/XGS – ratio of total debt outstanding to exports of goods and services; TDS/XGS – ratio of debt service (amortizations and interest on medium and long term debt) to exports of goods and services; INT/XGS – ratio of interest payments on medium and long term debt to exports of goods and services.

17. **Under the baseline scenario, both external and public debt remains sustainable.** External debt is projected to decline from a peak of 82 percent of GDP to around 63 percent by 2016; in nominal terms, external debt will increase modestly over the forecast period, but due to gradual recovery in growth and exchange rate developments[10] it will decrease as a share of GDP (Table 2). Despite this projected improvement, Serbia's external debt remains high, and as discussed in Box 1 very sensitive to exchange rate developments; in the case of further significant depreciation external debt could potentially exceed 100 percent of GDP. Public debt is forecast to peak in 2011-12, at just under 45 percent of GDP, and

[9] FRL was adopted in December 2010; it sets the medium-term deficit target at 1 percent of GDP, allowing for some cyclical adjustment, and outlines wage and pension indexation formulae until at least 2015

[10] With the exchange rate stable through 2011, and relatively high inflation, just in this year nominal GDP expressed in Euros will grow by almost 14 percent (despite very modest real growth). Overall, from 2010 to 2016 external debt stock expressed in Euros is forecast to increase by about 30 percent, while nominal GDP expressed in Euros is forecast to expand by about 70 percent.

then gradually decline to below 40 percent of GDP by 2015. Strong policies and structural reforms (including those supported by Bank programs) will underlie higher growth rates and improved public and external balances, underpinning the declining path of both external and public debt over the forecasting period. In addition, other debt and debt service indicators do not point to immediate areas of concern.

Spillover Risks and Mitigation Mechanisms

18. **There remain considerable risks going forward, including from the spillovers from the European debt crisis**. Serbia has more than 30 percent of loans and deposits held by Italian and Greek owned banks. With the late-October decisions by the EU, *inter alia*, to require leading European banks to increase their capital, further stress on their respective parent banks' funding may put pressure on local subsidiaries to provide liquidity or dividends to their parents, which if realized could potentially cause a credit crunch. However, the NBS has stepped up its monitoring of banks' liquidity and other key performance indicators in light of recent eurozone turbulence. Further mitigating near-term risks, the local foreign bank subsidiaries currently are rather liquid and well capitalized, providing further assurance that rapid unwinding of their positions is unlikely. Nonetheless, if there are adverse eurozone spillovers into Serbia, this could create additional external financing pressures. Also, further major negative developments in the EU could cause a major drop in exports, which was the driver of growth in 2010-11, possibly triggering a new recession in Serbia. Under these circumstances, unemployment would remain high for a protracted period, with attendant social risks.

Box 1: Sensitivity of the Debt Outlook to Shocks

Standardized debt stress tests point to sizeable risks if some assumptions do not materialize: the sustainability of Serbia's external debt depends on the stability of the exchange rate and the performance of net exports and growth. External debt does not decline under scenarios in which exports and growth consistently underperform, thus underlining the need for strong reforms and prudent macroeconomic policies. Also, there are risks from exchange rate and other shocks. First, real depreciation of 30 percent would bring the external debt to GDP ratio to about 110 percent. While the debt to GDP ratio declines afterwards, gross financing needs remain elevated. However, further large real exchange rate depreciation is considered unlikely. Second, a current account shock would see the external debt to GDP ratio stop declining and stand at around 78 percent in 2016. In this scenario, external financing needs would be around US$2 to 3 billion (around 3 to 5 percent of GDP) above the baseline in each of the forecast years.

Serbia's public debt outlook is sensitive to underperformance of growth, delays in fiscal consolidation, and exchange rate shocks. In the case of a growth rate shock, public debt would start gradually increasing again through the forecast period and reach about 48 percent of GDP by 2016. Towards the end of the forecast period, gross financing needs in case of such a growth rate shock would be some 6 to 7 percentage points of GDP higher than in the baseline scenario. However, Serbia's track record under the IMF, the EU and the World Bank supported programs, and it is macroeconomic and development policy programs provide comfort that the policy mix will be adjusted to avoid such a scenario.

Moreover, with more than 75 percent of public debt denominated in foreign currency, a real depreciation shock of 30 percent would push public debt to around 55 percent of GDP. Public debt would then gradually decline. Without policy change, public debt would increase through the forecast period and by 2016 it would stand at 53 percent of GDP. This further illustrates the need to adjust policies in accordance with the baseline. Financing needs in this scenario would be significantly higher than in the baseline.

19. **The Government's performance under previous SBAs and Bank DPLs provides considerable confidence that external financial pressures will be managed.** In addition, although downside risks are clearly increasing, the IMF estimates that Serbia's external position is able to withstand new large shocks: the current account deficit, while still requiring substantial financing, is much smaller than in 2008, and there is no significant exchange rate misalignment. Further assurance comes from solid liquidity and capital buffers in the banking system, and a comfortable level of foreign exchange reserves, significantly exceeding short-term debt. (As of August 2011, gross foreign exchange reserves are at €10.4 billion, about 30 percent of GDP). However, if even more adverse financial

spillovers combine with a more pronounced slowing of global and regional growth, higher access may be needed to cover external financing gaps. Under such an extreme downside scenario (which would likely include disorderly resolution of the euro area sovereign debt and banking system), consideration could be given to retooling the IMF program, as happened under the previous SBA, and also stronger support from other IFIs including the Bank, combining appropriate policy responses with higher access.

III. SERBIA'S DEVELOPMENT CHALLENGES

20. **This CPS builds on an analysis of Serbia's key development challenges.** To achieve its EU aspirations and continue to improve the quality of people's lives, Serbia will need to address two critical and interrelated development challenges: (i) restore strong, sustainable and job creating growth through improved competitiveness; and (ii) strengthen social sector reforms to improve the efficiency of spending the quality of outcomes. The Government has demonstrated commitment to address each of these challenges. Sustaining this commitment in the face of continued, or even increased, economic headwinds will likely be a key challenge during this CPS period.

Pillar I: Competitiveness

Investment Climate and Public Enterprise Reform

21. **Serbia's regulatory quality has improved in recent years.** Starting and closing a business has speeded up, getting credit is easier, competition legislation has been harmonized with the EU, there is greater labor market flexibility, the time needed to register a property has been cut by 40 percent and the property transfer tax has been reduced. There have also been improvements in the judicial and court systems, including, importantly, some increased reliability in contract enforcement. These and other improvements are confirmed in surveys of perceptions by managers.

22. **Key regulatory reforms have contributed significantly to these improvements.** The Government adopted a Regulatory Reform Strategy to reduce administrative operational expenses, simplify administrative procedures, and improve the legislative process. This goal was primarily achieved through the Regulatory Impact Analysis (RIA) and Comprehensive Regulatory Reform (CRR) also known as "the regulatory guillotine". In addition to identifying the costs of proposed legislation, the RIA provides a framework for regular consultations with relevant stakeholders. Since 2006, a total of 413 RIA opinions were issued, with 111 opinions in 2009 alone (demonstrating the intensity of regulatory activity in Serbia). Further, all RIAs were made publically available at *www.ria.merr.gov.rs*. Finally, a detailed RIA was performed for several systemic new laws, including the new Law on Bankruptcy in 2009 and Law on Business entities in 2010.

23. **Based on the completed regulatory review, the GoS approved 304 (out of 340) recommendations requiring the amendments of laws and regulations, and approved the elimination of 192 regulations.** As of end October 2011, 196 recommendations were implemented through amendments of various laws and regulations, and it is estimated that this will result in annual cost savings to businesses of around €121 million according to the standard cost model. Implementation of the remaining 108 recommendations is expected to result in additional reductions in business compliance costs, bringing the total estimated savings to about €183 million annually. It is important to note that all regulatory reforms were designed and implemented by temporary bodies—the Secretariat of the Council for Regulatory Reform and the CRR Implementation Unit—which were staffed with consultants. In order to ensure sustainability of regulatory reform, the Government has established the Office for Regulatory Reform and Regulatory Impact Analysis, which will be a first step toward institutionalizing regulatory reform and RIA.

24. **However, in a world (and region) in which most countries are improving their business environment, attracting investment is a competition.** And despite the progress in absolute terms, Serbia's relative competitiveness has actually deteriorated. Serbia has dropped four places in the Bank's most recent *Doing Business* report (2012), with an overall ranking of 92 out of 183 countries. In particular, Serbia continues to fare poorly in terms of dealing with construction permits, which are mostly the purview of municipal rather than the national Governments (175th place); paying taxes (143); starting a business (92); and (despite improvement) enforcing contracts (104).

25. **The Government will need to accelerate reforms in a number of areas.** Given the findings of Doing Business, one key area would be a detailed re-design of building permits, including approvals that have to be provided by public utilities. This can significantly reduce the costs involved and shorten the time required for businesses to invest and start operations. Regulatory steps can be reduced by taking an inventory of all administrative procedures at the national level. The same can be done at the sub-national level.

26. **To enhance its competitiveness and export potential while at the same time reducing the fiscal burden, Serbia must improve the performances of its public enterprises.** This includes further reducing the presence of the state in the enterprises sector. While the privatization of socially-owned enterprises[11], pursued in the early 2000's with the support of the World Bank, has achieved substantial results and has allowed a significant influx of FDI, the agenda is far from complete. Privatization and restructuring of large (and often problematic) public enterprises remains an unfinished part of the reform agenda, while performance of municipal utilities needs to be monitored to ensure efficacy in the use of public funds and quality of service provisions. Indeed, the 2011 EC Progress Report notes that overall, "state influence on competitiveness through legal and financial mechanisms is substantial."[12] In this environment such non-private enterprises (owned by all levels and parts of the government) are creating and accumulating losses and are in need of restructuring, downsizing and much improved standards of productivity, governance and accountability. This calls for the introduction of a transparent mechanism for allocating direct and indirect state subsidies - also required by EC State Aide rules – as well as for a redesign of the role of the state in the enterprise sector to reduce its scope and maximize its effectiveness. There are governance reasons why the reform of non-private enterprises has slowed, including clientelism and corruption, but also concerns over social issues arising from labor redundancies. As a result, attempts to privatize them or to enforce harder budget constraints are often failing. This remains a significant challenge to any future government as it moves forward in the reform of the public enterprise sector with a view to improve economic competitiveness in the context of fiscal rectitude.

Governance and the Rule of Law

27. **In October 2011, the European Commission, in recommending Serbia for EU "candidate" status, noted that "Serbia has a comprehensive constitutional, legislative and institutional framework which overall corresponds to European and international standards."** The accompanying Progress Report observes that Serbia's public administration is generally well developed at the central level, though more needs to be done to establish merit-based recruitment and a career system for the civil service. It also finds that independent regulatory bodies (IRBs) have been established in all important areas. This was helped in early 2011 by the clarification of rules governing relations between parliament and IRBs to provide for a parliamentary review of the regular annual reports of the

[11] The concept of socially-owned enterprises was unique to ex-Yugoslavia and was at the center of the economic organization at the time.

[12] Opinion on Serbia's Application for Membership in the EU: Analytical Report, 2011; page 53.

Ombudsman, the Commissioner for Free Access to Public Information and for Data Protection, the State Audit Institution, and the Equality Protection Commissioner.

28. **The EC notes that Serbia's efforts in judicial reform intensified in 2009-2011.** Specific steps identified include the re-appointment process for judges and prosecutors, the introduction of a code of judicial ethics, the re-organization of the courts, and the adoption of new Criminal and Civil Procedure Codes aimed at increasing the efficiency of court proceedings. A new administrative court became operational in 2010. Likewise, Serbia has strengthened the legal and institutional framework for fighting corruption by establishing an independent Anti-Corruption Agency and a new law on funding of political parties in line with European standards. Nevertheless, the Report finds that a stronger effort is needed to significantly improve the performance in combating corruption, which will require more proactive engagement of law enforcement and the judiciary and a more clearly defined separation of these functions from politics to ensure independence. Serbia's progress in strengthening the rule of law, especially by tackling organized crime, was reflected in the EU's decision to grant Serbia visa-free travel to the Schengen area in late 2009.

29. **Still, Serbia needs to strengthen transparency and integrity.** The most recent BEEPS[13] survey (conducted in 2008; published in 2010) showed that reported bribe frequency affecting firms remained at somewhat higher levels than the South East Europe (SEE) and ECA averages, despite having declined by half from 32 percent to 16 percent in the period 2005-2008. Reported bribe frequency in dealing with tax administration, customs, and the courts also dropped by more than half during the same period, but remained above the SEE averages. However, the bribe tax for firms that admitted paying bribes more than doubled to 4.1 percent of annual sales in 2008, indicating a growing tendency toward grand corruption. Reported kickbacks paid by firms that admitted to such payments stood at 15.6 percent of the value of the contract, which was significantly higher than the SEE and ECA averages. The business transactions most affected by unofficial payments were obtaining an electrical connection (29% of firms reported that such payments were expected); obtaining a construction permit (19%); and obtaining a water connection (17%), levels significantly above the ECA average.

30. **Reported informal payments in public service delivery also persist, distorting citizens' equitable access to services.** In the 2010 *Global Corruption Barometer*, a cross-country survey of corruption experience conducted by Transparency International, 17 percent of respondents from Serbia reported having paid a bribe in the past 12 months – twice that of neighboring Croatia, but lower than Macedonia or Bosnia-Herzegovina.

31. **With its step toward EU candidate status, Serbia will need to accelerate efforts to bring the performance of the public administration closer to EU levels**. In particular, the country needs to further increase the efficiency and professionalism of the judicial system, and reduce corruption. Toward this end, it will be important for the Government to systematically monitor the performance of public sector and regularly evaluate the results of reform efforts, especially those aimed at EU accession.

[13] Business Enterprise in Eastern Europe

Box 2: World Bank-EC Regional Cooperation in Strengthening M&E

The EC has expressed interest in cooperating with the World Bank to provide technical support to countries of the Western Balkans and Turkey to strengthen their institutional capacity for **Monitoring and Evaluation (M&E) of Strategy Implementation** in sectors of focus for the EU. Over the last decade, the Bank has worked extensively with Turkey and the Western Balkans to strengthen government functions associated with the monitoring and evaluation of policies and programs (e.g. program budgeting, audit, statistical capacity) and is therefore well placed to carry this work forward. The objective of the project is to increase performance monitoring and evaluation capacity of IPA beneficiaries in selected sectors at both the level of sectoral strategies and IPA project proposals. In terms of types of indicators, some will focus on institutional capacity (e.g. in the case of Public Administration Reform) and others may focus on the quality or efficiency of service delivery. Higher-level goals include developing sustainable institutional capacity; beneficiary ownership of M&E systems; and ensuring indicators are useful for public officials in making decisions on policy/ program design and resource allocation. The Bank and the EC are in discussions for a Bank-executed Trust Fund with a total budget of €1.2 million, including grant administration fees. The project would begin in January 2012 and last for 18 months. The EC is especially interested in strengthening its capacity to monitor progress in the social sectors, to track the progress in policy implementation and evaluate outcomes against identified targets. This work will be particularly relevant given Serbia's emphasis on improving on the outcome of its spending on social spending.

Public Financial Management

32. **Improvements in public financial management have been significant since 2007 but there remains considerable scope for further strengthening.** The establishment of a modern, integrated information system and single chart of accounts has facilitated better accounting and reporting used by all budget organizations but electronic access to the system is limited to direct budget beneficiaries. The State Audit Institution has become increasingly effective in auditing the financial accounts of the Republic of Serbia as well as individual organizations and social funds but still lacks capacity and experience needed to perform its full mandate. The Budget Systems Law was strengthened in 2009 and 2010 to incorporate many improvements in budgeting, accounting, financial control, internal auditing, debt management, and fiscal responsibility but few of the changes have been fully implemented. In particular, integrated strategic planning and medium term budgeting have not taken root, despite support from the EC, DFID and IMF. The Government has launched an internal audit and financial control strategy as part of its pathway to EU candidacy, but effective implementation has been difficult. Steps have been taken to improve on debt and cash management but there remain challenges in monitoring, coordination and efficient management.

Public Procurement

33. **There have been significant advances in the implementation of public procurement reforms.** Ten essential bylaws have been adopted and published on the Public Procurement Office (PPO) web-site covering procedures and administrative arrangements since the establishment of the Public Procurement Law (PPL) in 2009. In addition, the PPO has published a set of standard forms, templates and model documents to facilitate better practices. The Republic Commission for the Protection of Rights in Public Procurement Procedures (RCPR) has been appointed by the National Assembly and has been established as an independent body with generous resources and provision for 75 staff, approved by the Parliament.

34. **Further improvements are necessary, however, to achieve public procurement arrangements that fully reflect EU requirements and are comparable to international standards.** The current PPL does not fully reflect EU public procurement directives and recent amendments are under consideration. The RCPR was appointed after considerable delay but it appears further work will

be required to meet SIGMA standards.[14] The Government is preparing an amendment to the PPL approved in 2009 to improve the efficiency of public procurement which would imply merging the Public Procurement Office (PPO), which works as a relatively independent entity supervising public procurement, with a centralized procurement entity under the Ministry of Finance (Central Procurement Office). The Bank is working closely with the authorities to arrive at an appropriate outcome. Review of this proposal, including by the EC, OSCE, UNDP and other external donors, is ongoing to ensure that efficiency gains can be realized without compromising the transparency and political independence of the public procurement function.

Box 3: Serbia Multi Donor Trust Fund for Justice Sector Support

Numerous legislative activities have been initiated and completed as part of the harmonization of legislation of Serbia with the EU *Acquis Communautaire* and introduction of European standards in the area of the judiciary. A National Judicial Reform Strategy was adopted in 2006, and a package of judicial laws was passed in the National Assembly in 2008. The institutional set-up of the judiciary has been adapted and cooperation between the relevant institutions in the field of justice and home affairs has been strengthened.

Serbia's parliament provided the legislative framework for a new network of courts and prosecution offices that became effective in January 2010. The laws on public prosecutors and judges reduced their number to align with the new court structure. All judges and prosecutors were to be reappointed through open competition based on qualification and competence, resulting in a 23 percent reduction of positions in the judiciary. Although the EU has noted Serbia's progress in a number of reforms and for demonstrating a high degree of consensus in making EU integration a strategic priority, together with other international partners, the EU voiced "serious concern" in its Serbia 2010 Progress Report, regarding how recent reforms to the justice system, including the reappointment process, have been implemented.

The Multi Donor Trust Fund for Justice Sector Support (MDTF-JSS) was established in 2008 to support the Government's reform agenda and the EU accession process, and became effective in early 2009. The MDTF is strengthening aid effectiveness and donor coordination in Serbia's justice sector through implementation of a coordinated work program, financed by pooled financial contributions from Serbia's development partners.

The MDTF-JSS was initially established as a Bank-executed facility. During 2010, the trust fund was amended to become a hybrid facility that is jointly executed by the Bank and the Ministry of Justice as it became clear the trust fund could better achieve its objectives though execution of activities by the beneficiary as well as by the Bank. Component 1 is Bank-executed and provides advisory services primarily through analytical reports, training of relevant judicial staff, policy dialogue and surveys. Component 2 is Recipient-executed and provides technical assistance through support to a Reform Facilitation Unit in the Ministry of Justice.

Bank-executed activities, which have largely been completed, include advisory services to the Ministry of Justice, capacity building for an automated case management system, development of an MDTF-JSS website, a review of the Serbian National Judicial Reform Strategy, support to a Partners' Forum of key stakeholders and a trust fund Management Steering Committee, completion of a Justice Sector Performance and Service Delivery Survey and a Justice Sector Public Expenditure and Institutional Review. The MDTFJSS is in the process of delivering a review of cost drivers in courts, a review of the criminal chain process, and support to the Ministry of Justice to develop the next Justice Sector Strategy

Skills and Education

35. **Serbia is experiencing major labor market challenges.** As noted, the economic crisis has resulted in high levels of unemployment. By 2010, only 47 percent of the working age population (15-64 years old) was working; 11.7 percent were unemployed (equivalent to a 19.9% unemployment rate), and the remaining 41.1 percent were inactive. Employment rates are particularly low for those with less than a secondary education, among women, among youth and older cohorts, and among Roma. As such, there

[14] Support for Improvement in Governance and Management (SIGMA) is a joint initiative of the EU and OECD which supports EU candidates, potential candidates and European Neighborhood countries in their public administration reforms.

is considerable scope to promote economic growth and social inclusion through greater labor market participation.

36. **Going forward, Serbia will likely experience a strong demand for skills which at present are inadequately represented in the labor market.** A 2009 Enterprise Survey on emerging occupations in Serbia indicated that only one-third of Serbian firms consider that there is sufficient skills in the existing workforce—shortages were observed in both specific technical competencies and the softer skills such as flexibility and adaptability, problem solving and decision-making, communication and organizational ability. Closing this skills gap will be frustrated by two factors. First, demographics—by 2025 Serbia's population is expected to fall by nearly a half a million people; and surveys show that many young people are looking at emigration to enhance their opportunities. Second, while improving, student learning outcomes are still low compared with other EU countries (indicated by the scores on international tests, such as the Program for International Student Assesment) and the school curricula do not sufficiently develop key competencies required for competition in the global marketplace.

37. **Sustained effort in the education sector is leading to improvements.** Notwithstanding the issues identified above, more of Serbia's young people are enrolling in school—net secondary school enrollment increased between 2001 and 2008 from 76 to 83 percent—and fewer are dropping out; today some 25 percent of youth aged 18-24 are not involved in education or training, down from nearly 33 percent in 2008. The trends are also brighter for women—some 68 percent of women aged 25-34 have completed upper secondary school, with notable improvements at the tertiary level. Recent initiatives, such as the 2009 extension of mandatory preparatory pre-school programs, which has led to a significant increase in preschool attendance, will help build on these gains.

38. **Nevertheless, Serbia confronts challenges in educating its citizens**. First, when compared to its neighbors (and competitors), still not enough of its young people are enrolling in school and too many are dropping out before finishing. This starts in the earliest grades. In 2008, the net enrollment rate for pre-school (3-6 year olds) was 52 percent. This compares with 75 percent for Bulgaria, 76 percent for Romania and 89 percent for Hungary. Recent pre-school reforms are making a difference and these efforts should continue. At the same time, only one-half (49%) of Serbians have completed at least upper secondary school; the EU27 average is 71.5 percent. There are also issues of access, especially for more vulnerable populations. Roma youth, for example, are especially disadvantaged, with only 11 percent having a lower secondary education and 5 percent having reached upper secondary.

39. **The second challenge is eliminating rigidities which result in a mismatch between supply and demand in curricula**. Indeed, the EC in its 2011 Progress report noted that the ongoing skills mismatch continues to act as a drag on the development of new segments of the economy and requires further reforms of the education and training system that would respond better to labor market demand. Despite the oversupply of schools and teachers for the number of secondary school-aged youth, many students are not able to pursue the curricula of their choice. For instance, there is an abundance of spots available to take courses in textiles, wood processing, agriculture and other vocational trades, while the courses in healthcare, economics, law and general secondary education are oversubscribed. Serbia's system forces students to select narrow educational tracks at a young age; this has resulted in more than 76 percent of secondary school students attending vocational education (the second highest percentage in Europe). Advancement to university education has been expanded, but almost a half of students entering universities do not graduate. Despite efforts to better tailor vocational curricula to current labor market needs, the result is a labor force ill suited to the flexibility and intellectual agility required in today's knowledge based economy. This mismatch in curricula is compounded by the lack of systematic adult education and training. The proportion of adults attending formal training courses (of any type) is very low in Serbia, and at 0.1% of GDP, Serbian expenditures on active labor market policies are considerably

below that of new EU member states. A concerted effort to establish a process of life-long learning is needed.

Innovation

40. **Fundamental to Serbia's efforts to become more competitive will be improving its ability to innovate.** At present, however, the country's system of R&D institutions and funding is inadequate to support its ambitious modernization agenda. Serbian R&D is dominated by the public sector, largely inefficient, and most importantly de-linked from industry needs, particularly those of SMEs. Private industry's capacity, both in terms of human capital and financial resources for R&D and innovation, is low. Brain drain remains a major concern, not only for the private sector, but also for the scientific community.

41. **Serbia spends roughly €100 million annually (0.3 percent of GDP) on R&D, with a goal to reach 1 percent by 2014.** While R&D spending has increased from €28 million in 2001, Serbia still lags significantly behind its neighbors. Slovenia, the Czech Republic, and Croatia spend more than 1 percent of GDP and the European average is 1.8 percent. In Serbia, the majority of R&D spending goes to basic research, which accounts for 50 percent of all R&D funding. A significant shift from basic to applied research is needed for the development of an innovative SME sector. This, along with developing stronger connections between science and industry, will be key in raising R&D expenditures to 2 percent of GDP by 2020, with a target of leveraging half of this from the private sector.

42. **The Government has undertaken efforts over the last two years to revamp the regulatory and institutional framework governing science, technology and innovation**. It has enacted a number of laws to promote science and innovation and formulated the Serbian Scientific and Technological Development Strategy 2009-2014. In addition, the Ministry of Education and Science was created as the central body responsible for science and innovation.

Box 4: Improving Innovation: EU Partnership

Serbia is also looking for external support and ideas, and has turned to the Bank and EU for assistance. The recently signed Administrative Agreement to create an **Innovation Serbia Trust Fund** is an important early contribution, and the cornerstone of a novel partnership between the Bank and the EU in Serbia. It is, first, the product of the Bank's ongoing dialogue with the Government on how to ensure Serbia can create the conditions for a dynamic entrepreneurial sector and, ultimately, job creation. The Trust Fund also reflects the growing relationship between the Bank and the EU and the latter's recognition of the Bank's long expertise in the area of research, entrepreneurship and innovation support. The Project will finance the capacity building of the newly established Innovation Fund of Serbia, matching grant programs for the earliest stages of development in technology-intensive start ups, and will pilot a technical assistance program tailored to the needs of select research and development institutes in Serbia to promote technology transfer and commercialization. This work, financed by the EC's Instrument for Pre-Accession, is being complemented by Bank analytical work in the Western Balkans and across the ECA region more broadly that looks at the impact of investment in science and technology on job creation.

Agriculture

43. **Agriculture is critical for Serbia's development and EU accession.** Primary agriculture directly generates about ten percent of GDP and further contributes indirectly by providing raw materials for the food industry. Its most significant products in the EU market are cereals and vegetables and fruit, specifically raspberries, plums and soybean, as well as maize and peppers. Serbs, whether living in rural areas or cities, see agriculture as the greatest development opportunity for the country. This has not, however, always led to constructive sector policies. Indeed, because such a large number of the population—including voters—are somehow connected to agriculture (44% of population lives in rural

areas), government policies have often been driven by political rather than economic concerns. The potential for improvement is massive.

44. **As Serbia approaches EU membership, its farmers can look forward to benefiting from support under the Common Agricultural Policy (CAP).** First, however, they will face the costs of compliance with its extensive regulation, and experience both the opportunities and the competition of the single market. Agriculture and farmers face the biggest difficulties on the road to EU membership but they will also benefit the most upon joining. The SAA will progressively expose Serbia's market to competition from EU imports. At the same time, the gradual harmonization of production, quality and sanitary standards will increase the opportunities for trade in both directions. Implementation of the SAA is already well under way, and by 2013 the average customs duty on agro-food imports from the EU will have dropped to just 1.7 percent, with most products having no tariff protection at all. Serbia is therefore under considerable pressure both to meet the conditions for export to the EU, and to achieve full membership so that it can benefit from all the support of the CAP.

45. **Reforms are taking place, but there is much to do.** In addition to the SAA, the Government has signed an agreement with the CEFTA (Central Europe Free Trade Area), and numerous bilateral agreements. Serbia is also approaching World Trade Organization (WTO) membership. These linkages helped Serbia to become a net food exporter for the first time in 2005, with a surplus of about US$255 million; this grew to over US$1 billion in 2010, but still remains well below its potential. With an average export value per hectare of €385 in 2009, Serbia has lower exports per unit of arable farmland than every EU Member State except Romania; and the new member states achieve an average of €800/ha. The sector is also becoming increasingly stratified, with commercial farms that have risen to the opportunities and challenges of modern agricultural technology and markets improving competitiveness, and the many small farms, which continue to produce in traditional ways, lagging behind.

46. **Changing agricultural policies in Serbia have created uncertainty.** Serbian agricultural policy has been redesigned in a two-year cycle since 2000, leading to an unstable policy environment. As a result, even policies that improve the profitability of the agricultural sector may not stimulate additional investment as expected, because farmers, food processors and input suppliers are not certain whether the policy measure will remain in place for the lifetime of their investment. Public expenditure on agriculture is also declining at a time when investment is most needed. The share of public expenditure devoted to the agricultural and food sector, which has been small by international standards, has declined to 2.5 percent in 2010, and is no longer adequate. And the public investment that is being undertaken has not been effective. Much of it is targeted to small farmers in specific regions, with little to do with the country's strategic objectives for the sector, including meeting EU requirements. Accordingly, more urgent and more important than increasing the overall budget is reallocation of the existing resources, so that they focus on the Government's priority goals of increasing agricultural competitiveness and preparing the sector for the opportunities and challenges of EU membership.

47. **Determined policy efforts will be required, such as establishing an effective extension service.** Perhaps the biggest single need is to prepare the supply chains for exporting more and better quality goods, in line with the issues and priorities identified by the EU's rural development (IPARD) sector studies. Priority should be given to those chains where the EU has demanding veterinary, phytosanitary and food safety standards, which currently present major trade barriers for Serbian exports. The approach to agricultural policy making must also be changed. This will require increased collection and use of data by professional policy staff. *Ex ante* evaluation of proposed policy changes would help to improve the efficiency of new government interventions, while regular *ex post* evaluations would ensure that policies stayed on track and were improved and adjusted as necessary.

Land

48. **In Serbia cadastre and land registration functions relatively well**. The Republic Geodetic Authority (RGA) is fairly effective in processing the registration of properties and transactions, and the RGA system will soon cover the entire country. If reforms proceed at their recent pace, the RGA can hope to reach EU standards within five years.

49. **Nevertheless, the land sector is still constrained by insecure property rights.** One particular problem Serbia faces is with respect to questions of restitution of land seized by governments dating back to World War II. Conversion and restitution issues undermine the security of property rights. The Government has taken many steps in the right direction, including new legislation to resolve old land rights disputes through restitution or indemnification. The new law on restitution has laid out a clear process, methodology and timeline for dealing with this issue. The challenge that remains is to fulfill these commitments with the very limited resources available to the government.

50. **Another fundamental area for strengthening competitiveness is reducing the cost of construction permits.** Due to a lack of urban plans, overly restrictive planning and permitting processes and corruption at the local level, investors are having difficulty obtaining permits for construction. The cost in percent of income per capita for obtaining a permit is much higher than in similar economies and has resulted in Serbia having one of the worst rankings in the world in "ease of obtaining a construction permit" (176 out of 180). Specifically, it costs more than 1,800 percent of per capita income to register a property in Serbia; the next highest comparator country is Poland, at 121 percent and the Czech Republic at 16 percent. Closing this gap is crucial to Serbia's competitiveness.

51. **There are other areas of concern that the Government needs to address.** Because of the difficulty in obtaining building permits the population has often built without them. Estimates for the level of informality vary between about half a million to a million buildings. There are proposals to develop a full building cadastre in which every building, including those owned by the state, is recorded and its status identified (whether formal or informal). The second is to launch an agricultural land consolidation program. The benefits of such a program easily outweigh the costs of implementation, and would include increased production and employment in the agricultural sector, increased market values for consolidated properties, improved ownership conditions, improved infrastructure, and accurate property registers and cadastral maps.

52. **All these are fairly new areas for the Government.** Capacity to address them must thus be built at all levels. The key areas for training are conversion, valuation and property management. It may be beneficial to consider ways of bringing the private sector into this process, as well as to ensure a broad public consultation process to keep decisions transparent.

Transport and Trade Facilitation

53. **The quality of Serbia's transport infrastructure appears to be significantly lagging that of its neighbors and competitors as a result of severe underinvestment and maintenance during the "lost decade" of the 90s.** This is a considerable problem for a country which hopes to capitalize on its central position in Southeast Europe to be a transport hub for an expanding EU. A 2010-11 World Economic Report survey indicates the poor quality of Serbia's transport infrastructure: road infrastructure ranked is 129th; the quality of rail infrastructure ranked 93rd; and port and air transport infrastructure both came in at 124. Road safety is also a major issue. Based on 2008 data, the cost of fatalities and serious injuries suffered on the country's roads cost the Serbian economy upwards of two percent of GDP.

54. **The road sector has seen some improvement, but much of the existing road network remains a bottleneck for transporters.** A survey of the main and regional road network, conducted in 2008, revealed that only 37 percent of the network was found to be in good condition. While this was a modest improvement, the design characteristics of much of the existing network are below European standards. This further increases vehicle operating costs and reduces safety and competitiveness. Maintenance, rehabilitation and construction activities should be planned in advance on a medium-term development plan for the network.

55. **Railway infrastructure is aging and in poor condition**. The average age of the network is 38 years.[15] Line speeds do not exceed 60 km/hour on 57 percent of the network, and only 3 percent of the network has a line speed that exceeds 100 km/hour—this, despite the fact that the average design speed is 94.5 km/hour. Insufficient investments in maintenance have reduced the operational effectiveness of much of the network. This has led to safety concerns and the imposition temporary speed restrictions, which further slow transport and, because of lack of maintenance, tend to become permanent. Achieving EU levels will require a thorough analysis of the structure of the fleet in comparison with market demands, which will mean real cuts in surplus capacity. Equally difficult decisions will need to be made with respect to staff levels.

56. **Inland waterways remain a potentially important transport mode in Serbia.** While the potential for inland waterway transport along the Danube and Sava Rivers is significant, a number of problems remain to be resolved including removing unexploded ordnance and sunken vessels. The fairway of the Danube River is below the parameters required by the Danube Commission and leads to restrictions on navigation and impacts adversely on navigation safety—the situation is much worse in the Sava River, where there is little traffic, due to years of inadequate maintenance. Rehabilitation of the Danube and Sava rivers is a government priority for the sector to make this low-cost and environmentally-friendly mode of transport more competitive and reduce inland waterway transport costs for imports and exports.

57. **Serbia's performance in trade facilitation and logistics lags behind regional neighbors.** It ranks 74th in the world using the trading across border index of the 2011 Doing Business report, and 84th in the world using the World Bank's 2010 Logistics Performance Index (LPI). The LPI shows that Serbia needs to improve significantly in the area of customs, where stronger integration of border management, simplification of customs clearance procedures, establishing inland customs clearance, reducing the number of physical inspections by improving the risk-management system, and mainstreaming performance indicators are necessary reforms to facilitate trade movements and bring Serbia's customs up to EU standards.

Energy

58. **Serbia is well endowed with power generation, transmission and distribution infrastructure.** Some 55 percent of installed generation capacity is lignite-fired thermal power plants; 40 percent is hydroelectric power plants, and natural gas participation is expected to grow in the future. While impressive, Serbia's energy capacity is coming under increasing stress. Most generation facilities are more than 30 years old and operating beyond their designed life span. The last power plant was built 15 years ago, with others dating back to the 1960s and 70s. The age and poor record of maintenance has severely impacted reliability and efficiency. This is also true for Serbia's power transmission system.

[15] Total network length includes 334 km in Kosovo and Metohija, 39 km used only as factory sidings, and 180 km which are out of service.

59. **But lack of investment has left Serbia with twin challenges.** The first is to ensure inadequate power supplies do not stifle the country's efforts to improve competitiveness. There is evidence that this is a growing risk. Following five years of reconstruction and stabilization in the early 2000s, the power sector stabilized. However, prior to the 2008 crisis, electricity supply had become a bottleneck, with some 30 percent of firms surveyed identifying electricity supply as a major constraint to doing business—doubling from the same survey in 2005; and many expect that continued shortages are inevitable if action is not taken. Indeed, in 2008 generation capacity was not able to meet peak demand and the country had to rely on imports. This suggests an impending supply crunch. The drop in demand resulting from the global financial crisis has taken the pressure off temporarily, but as demand for power picks up with recovery, the system could compromise growth for the entire economy. It also has regional implications as Serbia is an important transit center for electric power transmission, with nearly half of the annual electricity transiting through the country (2009) distributed to neighboring markets.

60. **The second challenge is to become more energy efficient.** The economy uses two times more energy per dollar of GDP than its neighbors in the Western Balkans and almost 2.5 times more than EU countries. This is largely due to the composition of its main exports—metals and electrical machines-which are highly energy intensive. Moreover, with some two-thirds of its electricity needs met by lignite power plants, Serbia's energy consumption is also highly carbon intensive, some 10 times more so than OECD Europe. The country has embarked on a path to adapt its energy and climate policies to meet EU accession requirements, and is making progress in this direction, but full compliance will be costly.

61. **Serbia can continue to produce adequate power supplies and do it more sustainably**. But it will require significant investments, amounting to a projected €16 billion by 2020, with some estimates indicating that at least three-quarters of this will have to come from the private sector. Attracting this level of private investment will require significant policy reforms. Here the first priority is tariff reform. Despite recent hikes, current tariff levels do not permit the main electric utility to cover its costs, let alone finance needed investments. The recent adoption of the Energy Law represents a major step towards incorporation of key provisions of EU *acquis*, including transfer of tariff setting authority from the Government to the independent energy regulator. The Government is also finalizing the preparation of a new legal framework for public-private partnerships. Other steps would include improving the distribution system, including bill collections, reducing commercial losses, unbundling of distribution and supply and strengthening efficiency.

Pillar II: Improving Efficiency and Outcomes in Social Sector Spending

62. **As noted above, the 2008 crisis returned some 230,000 people back into poverty**. This has placed substantial stress on Serbia's complex social protection system. The system, which is really a collection of poorly coordinated components, has performed with mixed results. These components include: (i) last resort social assistance for those who are lacking minimum resources; (ii) family and child protection benefits; (iii) non-contributory disability benefits and; and (iv) benefits for war veterans and their families. Spending on social assistance is at the average level for ECA countries, about 1.7 percent of GDP. However, close to two thirds of this spending is allocated to programs which are regressive in terms of targeting. These include veterans benefits and wage compensation during maternity for working mothers. On the other hand, while accounting for a much smaller percentage of spending, the last resort social assistance and the monthly child allowance programs are strictly means tested and well targeted to the poor. The main drawbacks with these programs are their low coverage and low take up by those who are eligible. During the crisis, both programs did expand to respond to the increased demand, but remained too small to reach most of the poor.

Box 5: Impact of Crisis on Roma

The crisis has exacerbated long standing challenges for the most vulnerable in Serbia. Bank analysis provides a vivid illustration of the challenges of the different Roma communities, with households living in slums and collective centers (informal tent settlements where displaced people from Kosovo, Roma and non-Roma alike, live) facing the worst living conditions, with precarious housing, no direct access to services such as water and sewerage, and dilapidated infrastructure. Moreover, low skills, lack of official documents and "prejudice" among employers remain major barriers to employment. This is borne out by quantitative data. While working-age Roma, (contrary to public perception) are actively seeking jobs (Roma men participation rates at 72 percent are comparable to those of majority men at 70 percent), the male employment rate for the Roma stands at 34 percent compared to 58 percent for non-Roma men. For those who work, earnings are about half of those of non Roma men. The situation is even worse for women, whose employment rate stands at 9 percent (against 43% for non-Roma women), and whose earnings are less than one-third of their non Roma counterparts. Gaps in education are an important explanation of the Roma population difficulty in finding jobs, with only 21 percent of men and 4 percent of women having at least some secondary education (against 81% for the majority male population and 73% for females). A significant part of the gap in earnings, however, remains unexplained by the quantity of education, work experience, and locational characteristics, suggesting that, indeed, prejudice among employers might be playing an important role.

While these challenges remain difficult to tackle, the Delivery of Improved Local Services (DILS) project is contributing to address some of the access to social services gaps faced by the Roma. In cooperation with the Ministry of Health (MoH) and Organization for Security and Cooperation in Europe (OSCE), DILS has supported the training and work of 75 Roma health mediators (all women) and the project directly funds the salaries of 15 of them. Roma Health Mediators have helped some 3,600 children obtain vaccinations; more than 2,500 have registered with a Doctor; some 600 pregnant and new mothers have received health checks and medical follow up of pregnancy and child birth in hospitals; and more than 1,200 women are now able to choose their gynecologist. This successful program is likely to be sustainable as the Government would like to institutionalize Roma health mediators, and in 2012, their salaries will be paid through the national budget of the Republic of Serbia.

Source: World Bank (2010) "Roma Inclusion: An Economic Opportunity for Bulgaria, Czech Republic, Romania and Serbia", IPSOS Strategic Marketing (2009) " Crisis assessment"

63. **The authorities have taken important steps to address some of these targeting issues, but challenges remain.** Important reforms have been implemented aimed at increasing the coverage of the poor with social assistance of last resort, while scaling back the categorical "rights based" programs. The Government enacted a new Law on Social Assistance following an evaluation of its impact on targeting accuracy, coverage and benefit adequacy of the last resort social assistance. As a result, coverage of the last resort social assistance program reached 10 percent of the poorest quintile, up from less than 7 percent before. Nevertheless, important areas for improvement remain. In addition to problems in targeting of cash transfers, the Government has indicated it wants to improve their coordination with non-cash social assistance, such as social care and employment services, which are now institutionally separated and poorly coordinated. Finally, the Government wants to review—and if necessary identify measures to mitigate—the poverty impacts of specific reforms which necessitate price liberalization and price increases. The authorities have asked for Bank support on a number of these challenges.

Health

64. **The Serbian health system has made significant progress over the last decade.** Outcomes have improved and more services are delivered at lower cost. Some measures to regulate medical practices and improve quality of care have also been implemented. At the same time the system faces major challenges. As in many health systems in Europe, Serbia confronts pressures for increased health spending, due to the aging of the population, the introduction of new (and expensive) pharmaceuticals, and the development of new technologies. These exacerbate the fiscal pressures already confronting the system as a consequence of the global economic crisis. The increase in unemployment and poverty, which has reduced the Health Insurance Fund's (HIF) revenue base and increased the pool of vulnerable groups who must be subsidized from the general budget. The Government will need to find ways to use

resources more efficiently, by improving management and furthering the reforms that will create incentives to use resources more productively.

65. **Serbia now has an epidemiological pattern not unlike most countries in Eastern Europe.** In fact many indicators are equal or better than those in the most recent EU member states. Average life expectancy, at 73.7 years, is almost equal to the average of new EU member states. It is higher than in the Baltic countries and roughly equivalent to that of Hungary (73 years) and Slovakia (74 years). Progress in improving the health status of the population accelerated particularly after the 1990s. For example neonatal deaths decreased sharply in the period from 1999 to 2006 and its rate is now at a level comparable to the average of EU member states that joined after 2004. Standardized death rates, however, remain above the averages of both recent EU countries and older members. They are roughly equal to the rates in the Baltic countries and Hungary and considerably above the rates in Slovakia.

66. **Government spending on health in Serbia has remained roughly constant as a percent of GDP in recent years, rising from 6 percent in 2002 to 6.3 percent in 2008.** As this was a period of rapid growth in the economy, the budgets of both HIF and MoH have been increasing over time. From 2003 to 2008 HIF spending increased 23 percent in real terms, while the budget for the Ministry of Health (devoted mostly to prevention, purchase of equipment and infrastructure, and pay for health care for vulnerable groups) almost doubled.

67. **Given the lingering effects of the crisis and the projected period of slow growth, this level of spending is not sustainable.** The Government has to improve productivity. Serbia spends too much on hospital care (the percentage of health care spending on hospital care is roughly twice that of OECD countries) and too little on out-patient care (Serbia spends 24% and OECD 31% of their respective health budgets). Staffing levels and the mix of medical personnel are also at issue. What is clear is that Serbia can realize significant efficiencies by reforming the way the system is financed. At present, the budgets of health care providers, at both the primary and secondary level, are based on the costs of inputs. The health insurance fund pays providers on the basis of annual contracts, which specify the amounts to be spent on wages and salaries, utilities, medicines and other supplies. Allocations for staff are based on the number of authorized staff and salary coefficients. Payments for other recurrent costs are largely based on the number of beds. Consequently, providers have no incentive to economize on the use of inputs or the quantity of services they provide.

68. **The Government has initiated reforms in payment mechanism**s. For primary care, the Government has opted for a capitation based payment system. Patients register with an individual doctor of their choice who becomes the primary point of contact in the healthcare system. This helps limit the need for referrals and creates a direct connection with the source of payment. To date, progress on this reform has been stymied by the absence of enabling legislation. For higher level (hospitals) care, the Government is moving to the DRG (Diagnose Related Group) model, an output-based system, where hospitals are paid according to the average cost of treating a patient during an entire episode (paying the *average* cost creates an incentive to minimize cost of treating a certain case). Many of these reforms are being supported by the Bank's PEDPL3.

Pensions

69. **Serbia has the second highest ratio of pension spending to GDP in the ECA region.** The immediate problem is that there are too many pensioners, with many people collecting benefits who are below the retirement age, and with a level of benefits that is much higher than is affordable. The problem was exacerbated by two extraordinary pension increases in 2008. With the onset of the economic crisis later in the year, the revenues of the pension system declined just as the system's obligations were increasing. The Government addressed this problem by freezing pensions in nominal terms in 2009. The

pension freeze was extended in 2010, with the expectation that a new pension law would be enacted in 2010.[16]

70. **In 2010, a new pension law was enacted by the Serbian Government.** The law reduces the number of people receiving pensions, the level of benefits, special benefits and privileges for the Ministry of Interior employees and the military; while at the same time increases minimum pensions. Some of these reductions were politically difficult, including raising the pension eligibility age from 53 to 58 years; and for widows and widowers from 50 to 55 years. The law also reduces the 15 percent bonus received by women to 6 percent. These changes faced severe opposition from unions and other politically powerful groups. In January 2011, the Government raised the minimum pensions by 2 percent, as required by the new law and has moved forward with incremental hikes during the year. Moving to a system of indexation to inflation is expected to substantially reduce the fiscal burden of the pension system in the next few years, with pension spending as a share of GDP set to fall from 13.8 percent in 2009 to less than 12 percent in 2012.

71. **While these changes are significant, further measures will be needed to ensure the structural soundness of the system.** Pension benefits are based on a point system as defined in the April 2003 law. Individuals accumulate personal points based on the length of their contribution history and their contribution wage relative to the average wage. The Serbian system unusually links the value of the general point (a measure of the generosity of the benefit) to the indexation that individuals are given post-retirement. This de-links the benefits received from the wages on which contributions were actually paid. Indexing pension contributions to inflation before retirement allows their value to erode over time in a growing economy, which raises generational equity issues and implies that the younger cohort is generally worse off. International best practice suggests that the level of contributions should be indexed to wage growth, while pensions after retirement are linked to inflation. Given the high benefit ratio in Serbia, moving immediately to the international best practice would be quite expensive, but at some point the switch will need to be made.

IV. COUNTRY RESPONSE TO CHALLENGES AND PRIORITIES

72. **This CPS builds on Serbia's articulation of its own development goals and challenges.** In particular, it seeks to support the Government's goals of becoming more competitive and to shift the pre-crisis model of growth largely driven by consumption to a model where export and investment become greater engines of productivity-enhancement, growth and job creation. This goal is spelled out in detail in a document still under preparation entitled, *Strategy and Development Policy for Industrialization for the Republic of Serbia*[17]. In this paper, the authorities have set out a broad strategy to strengthen Serbia's manufacturing and industrial competitiveness while also ensuring environmental sustainability. Key elements of the strategy include approaches to increase employment, industrial production, regional development, labor productivity, exports of goods, investment and FDI. This is a comprehensive document, which in addition to proposing greater emphasis on education and innovation, establishes specific targets for improvements in efficiency in Serbia's most important industrial sectors, including agriculture, textiles, timber and wood products, and metals. The strategy incorporates the EU requirements on clean production and pollution and carbon emissions. In addition, the Government has set out a number of national strategies in specific areas, such as education, public procurement, science and technological development, and telecommunications.

[16] Higher-than-expected revenue growth in 2010 allowed the Government to allocate an additional RSD 5,000 to the lowest paid pensioners (those receiving less than RSD 30,000 per month) as a one-off payment to help compensate for the recent inflation.
[17] Government of Serbia, in progress.

73. **A second clear objective to which the Government has remained committed is sustained fiscal discipline.** Through engagement with the Bank and the IMF, the Government has made clear its commitment to improving the allocation of public expenditure; strengthening public debt management; and protecting social assistance to cushion the impact of the economic crisis and expand the coverage of social spending. The adoption by Parliament of fiscal responsibility legislation in early 2011 and the credibility acquired by the new Fiscal Council following its creation under this legislation are evidence of the country's commitment to fiscal discipline.

74. **Finally, the strategic setting for reforms in Serbia is defined by the Government's commitment to Serbia's integration into the EU.** As noted above, the overall direction comes from *Europe 2020*. Country specific guidance is provided by selected monitoring reports, which outline a roadmap for action. The Government's latest strategic document that defines the agenda of EU integration is contained in the 2008 National Plan for Integration. This detailed document explains the Government's priorities for the harmonization of Serbia's institutional and legal framework with the EU.[18] Important progress on EU accession has been made in 2010 and early 2011. As noted above, in October 2011, the Commission recommended Serbia for candidate status. Indeed, in its Recommendation, the EC notes that "Serbia has built up a positive track record in implementing its obligations under the Stabilization and Association Agreement and the Interim Agreement" and that "Serbia would be in a position to take on the obligations of membership in the medium term, in nearly all *acquis* fields, provided that the alignment process continues and that further efforts are made to ensure the implementation and enforcement of legislation". While EU membership is years away, Bank's support under the CPS is intended to support policy continuity.

V. WORLD BANK GROUP STRATEGY

A. Bank Program, Lessons Learned and Partnerships

75. **The FY12-FY15 CPS is designed to build on the strong policy reforms supported during the previous CPS.** First, it proposes DPLs in each year intended to deepen and expand upon important reforms undertaken under previous Bank supported policy lending. This is particularly true with respect to the third operation of the public expenditure management DPL series, which was launched in response to the crisis at the Government's request to help improve productivity and efficiency of public spending. Significant reforms undertaken in recent years, including revised fiscal legislation and a more strategic, efficient budget process, strengthened internal control and audit functions, and improvements in the regulatory framework for procurement, have all been supported by the DPL Series. The proposed DPL series on restructuring non-private enterprises will similarly build on the Private and Financial Sector DPL series and the Policy Based Guarantee from the previous CPS, which supported improvements in the business environment, strengthened financial discipline in the non-private enterprise sector, and assisted in building a more stable and efficient financial sector.

76. **This CPS will see a greater focus on selectivity, with a shift to fewer, larger, investment operations.** The Bank will continue to work closely with the authorities to consolidate the recent progress in accelerating project disbursements. New investment lending, which is back-loaded to later in the CPS, will be for fewer and larger investment operations carefully targeted to support the CPS pillars. This will help improve portfolio performance. It will also free up internal Bank resources for timely analytical products, thus strengthening the ability of the Bank to engage in advocacy, knowledge dissemination and dialogue in areas where it does not necessarily provide direct investment financing but where other development partners look to the Bank to play a leading or complementary "Knowledge

[18] The document is available at: http://kzpeu.seio.gov.rs/dokumenti/npi/npi_october2008_en.pdf

Bank" role. In addition, it will enable the Bank to respond to requests from the EC and other donors for project implementation assistance through an expanding agenda of externally financed trust funds.

77. **The Bank will continue to expand partnerships with the EC and other development partners in Serbia to advance its EU accession**. Trust Funds managed or implemented by the WBG total US$25.8 million and provide additional financing to support the CPS goals. The EC has approved a grant for innovation in the amount of €8.4 million, and is expected to approve a grant for justice sector strengthening for €2.6 million and statistical analysis for €830 thousand. Among bilaterals, SIDA is a particularly important development partner, with trust fund support in the justice sector. Recent TF programs, such as the ones agreed with the EC and SIDA, were designed to cover the World Bank costs to manage their implementation. In addition, Serbia is benefiting from a number of regional TFs, including, public financial management, private sector accounting—through the Vienna based REPARIS (Road to Europe Program of Accounting Reform and Institutional Strengthening)[19] facility—and R&D and innovation. Details of each of the TFs and the amounts allocated are included in Annex 3.

78. **IFC expects to provide financing of US$600-800 million to the private sector during the CPS period**. IFC seeks to improve Serbia's competitiveness through its investment and advisory service products, targeting competitive and export-oriented companies as well as the under-served segments of the economy such as the SMEs and agribusiness sectors, energy efficiency and renewable energy, and municipalities and rural areas. Also, through its regional programs, IFC will help Serbia to make further progress in improving the business environment.

Current portfolio

79. **The World Bank supports a portfolio of 12 operations with commitments totaling US$841.8 million (November 15, 2011).** These operations are financed by 8 IDA credits totaling US$217 million, 10 IBRD loans of US$620.3 million, and 1 GEF grant of US$4.5 million. The FY11 disbursement ratio was 10.3 percent, and through the first quarter of FY12 reached 8 percent.

80. **The disbursement ratio throughout the CPS FY08-11 period was well below ECA and Bank averages, and lagged behind Serbia's own historical averages** (see Table 3). This was to a great extent caused by challenging internal political developments (presidential elections, the declaration of independence by Kosovo, and parliamentary elections), and the global crisis in 2008-2009. These events led to widespread political uncertainty for an extended period and contributed to an 18-month delay in the ratification by parliament of five Bank operations approved at the end of the previous CPS period. The same political and economic factors also distracted decision-makers' attention from the implementation of projects already in the portfolio. Moreover, the formation of the government by a complex coalition comprised of 13 political parties frequently affected project implementation, most prominently in cases (such as the Corridor X project) where it was necessary to reach agreement among government institutions headed by officials representing different coalition partners with divergent philosophies.

Table 3: Trends in Disbursement Rates (% undisbursed balances)

	FY06	FY07	FY08	FY09	FY10	FY11	FY12 (as of Nov 1)
Serbia	18	20	14	11	9	10	9.2
ECA	17	19	18	18	19	21	8.6
Bank	23	23	22	27	27	22	6.5

[19] REPARIS is assisting will assist Western Balkan countries in aligning their accounting and auditing framework for the private sector with the EU *acquis communautaire.*

81. **With progress already evident, it is anticipated that disbursements will accelerate significantly under the new CPS.** Indeed, less than half way through the fiscal year the disbursement ratio of 9.2 percent is approaching the average annual figure for the preceding two years. Intense engagement is paying off. Steady dialogue with the authorities, including regular and high-level joint portfolio reviews have begun to lead to faster project disbursement. It is clear that strengthening the Ministry of Finance's coordination role and support function *vis-à-vis* the implementing agencies have helped improve portfolio performance**.** In particular, and especially in the context of Serbia's complex coalition government, the recent efforts to engage the concerned ministers themselves in a regular dialogue on the portfolio has reduced decision-making time, contributed to instill a sense of urgency in Project Implementation Unit staff and eliminated some cumbersome bureaucratic steps. Continued consolidation of the portfolio, moving toward fewer, larger projects, streamlining project components and objectives, continued proactive management of the portfolio, including selected restructuring and cancellation of projects, and, finally, moving forward on the large Corridor X project (accounting for more than 40% of the total portfolio in US$ terms), now that most of the major contracts have been signed, will help consolidate these promising gains.

Table 4: Portfolio Performance as of November 1, 2011

Sector	Project Name	Board	Revised Closing	IDA/ IBRD/GEF US$m	Disbursement (%)	Age (yrs)	Latest IP	Latest DO
HD	HEALTH PROJECT	May 2003	Dec 2011	33.5	82.7	8.3	MS	S
	CNSLTD COLLECT	May 2005	Sep 2012	25.0	75.6	6.3	MS	MS
	LOCAL SERV DELIVERY	March 2008	Dec 2012	46.4	35	3.3	MS	S
SD	TRNSPT REHAB	May 2004	March 2012	105.0	73.6	7.3	S	S
	ENERGY EFFICIENCY	March 2004	June 2013	49.0	74.3	7.5	MS	MS
	REAL ESTATE CAD	May 2004	Feb 2012	30.0	92.1	7.1	MS	S
	IRRIG/DRAINAGE	July 2005	May 2013	74.4	45.5	6.2	S	MS
	ECSEE APL #2	June 2005	June 2012	21.0	69.9	6.2	S	S
	TRANS AG REFORM GEF	June 2007	Dec 2011	4.5	38.6	4.3	MU	MU
	TRANS AG REFORM	June 2007	Dec 2011	17.0	45.6	4.3	MU	MU
	CORRIDOR X HIGH	July 2009	Dec 2015	388.0	7	2.2	MS	S
	SEEC CRIF	March 2011	Dec 2012	5.0	0	0.5	S	S
ECSPF	BOR REGIONAL DEV	June 2007	Sep 2014	43.0	8	4.3	MS	MS
				841.8	**34.9**	**5.2**		

82. **IFC expanded its activities sharply in Serbia during the past CPS period** (FY08-FY11). Commitments rose to US$455 million (US$351 million its own account and US$104 million through mobilization), from US$260 million in the previous four years. IFC's committed investment portfolio in Serbia stood at US$439.8 million (as of September 30, 2011), spread across 15 projects in the financial sector (72 percent) and in the real sector (28 %), making it IFC's largest portfolio in the Western Balkans. IFC's portfolio is concentrated in the financial sector helping with the capitalization of three systemic banks, including the largest state owned bank and the second largest bank in the country. In addition, IFC has financed US$104 million through mobilization with other financial institutions that sends a strong positive signal at the time when the economic recovery in Serbia needs to gain momentum and international demand outlook remains uncertain.

83. **In parallel with increased investment activities, IFC has been helping Serbia improve its business environment through its advisory programs focused on:** (i) strengthening sub-national competitiveness in four municipalities; (ii) improving corporate governance; (iii) strengthening

international standards and technical regulations; (iv) improving access to finance with special attention to energy efficiency finance; and (v) promoting private sector participation (PSP) in solid waste management.

84. **The current net exposure of the Multilateral Investment Guarantee Agency (MIGA) as of August 31, 2011, amounts to US$401 million in 11 projects, which makes Serbia the Agency's third largest net exposure country.** The majority of these projects are in support of foreign banks' loans to their Serbian subsidiaries, some of them in the aftermath of the 2008-09 global financial crisis. However, the majority of the exposure comes from a series of recent reinsurance contracts supporting a foreign retail operation in the country. MIGA's continuing support to these projects signals the Agency's efforts to continue to underwrite projects in Serbia, encourage inward FDI, and add to the World Bank Group's strategy of encouraging private sector development in the country.

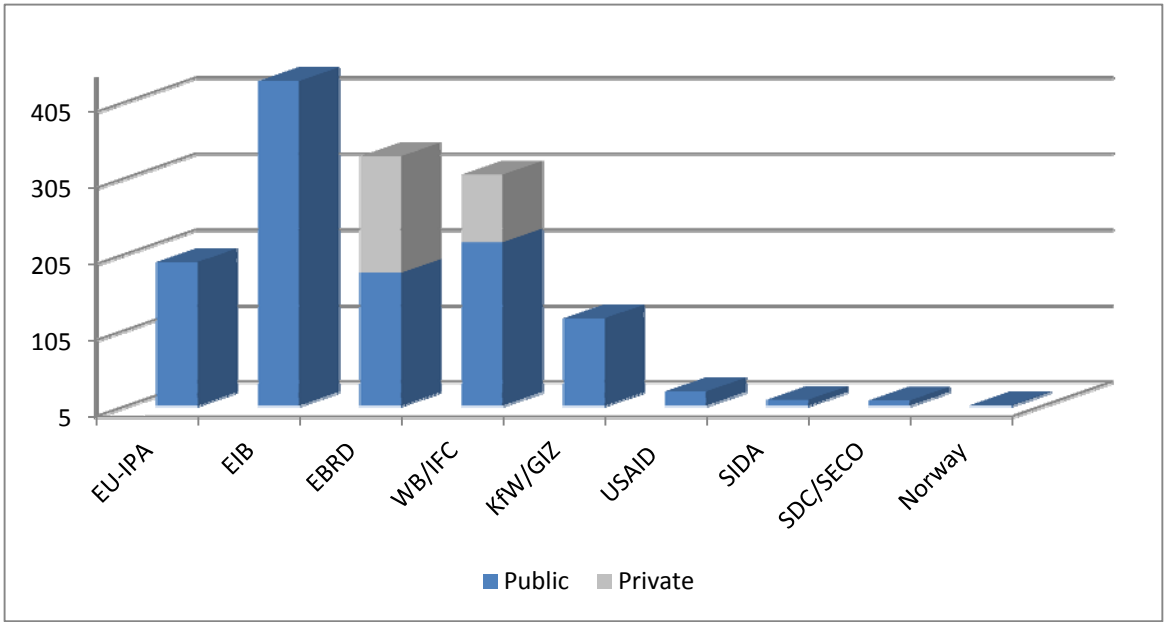
Lessons from the CPS Completion report

85. **World Bank Group support over the FY08-FY11 CPS was highly relevant under both pillars of the FY08-11 CPS.** The CPS Completion Report identified a number of lessons related to the overall strategy, project implementation, and Bank and borrower performance that are helping to guide the new CPS. Key lessons are noted below:

86. **Key lessons and recommendations for the new CPS can be summarized as follows:**

- The emphasis on reform areas associated with EU Integration should be maintained, given the wide political and popular consensus on the EU perspective for Serbia.
- DPLs underpinned by high quality analytical work are an important tool in effecting change in the Serbian context, including by helping to define a comprehensive reform program and to maintain the commitment of diverse actors.
- Investment operations are most successful when relatively narrowly focused on a few related objectives and when primary responsibility for implementation rests with a single agency.
- Institutional arrangements and implementing agencies' commitment to project activities should be carefully considered during preparation; additionally, attention should be paid to the availability of dedicated staff resources to carry out implementation activities in a timely way.
- Steady consolidation of the portfolio with a focus on fewer, larger projects is likely to help maintain focus and ensure attention from high-level officials; strengthening the Ministry of Finance's coordination role and support function vis-à-vis the implementing agencies could also improve portfolio performance.
- Close coordination with the EC, other International Financial Institutions (IMF, EBRD, EIB), and bilateral partners is vital to maintaining the momentum of the reform agenda and reducing strain on limited capacity.
- The Results Framework, and monitoring and evaluation should be strengthened in the next CPS and careful attention should be paid to the availability of appropriate instruments to support the achievement of stated outcomes.
- The Bank should continue to strengthen ties with development partners. With the EC and IFIs (IMF, EBRD, EIB, CoEDB) in particular, but also with bilateral donors.

Graph 1: Financial support to Serbia: Annual average commitments: 2008-2011 (in mil. €)



87. **Donor assistance in Serbia has come significantly from European institutions, including assistance through the EU IPA mechanism.** Under IPA 2011, EU pre-accession funds worth €178.5 million will be allocated to 23 projects in Serbia (plus an additional roughly €25 million for Cross Border Programs). Key sectors include justice and rule of law; reform of public administration; private sector development; agriculture, and rail modernization. Substantial sums are also being invested in social development and reconciliation among peoples in the region and environmental protection and combating climate change. This represents the fifth installment of grant funding, totaling €1.4 billion allocated by the EU for Serbia in the period 2007-2013. [20]

88. **European IFIs also play a major role in Serbia.** The European Investment Bank (EIB) is increasingly active in Serbia, with total approvals during 2001-2010 amounting to €3.1 billion, of which €885 million was approved in 2010. Nearly half of EIB's financing has been to support badly needed upgrading of Serbia's road transport network. The current portfolio also, however, includes projects financing SMEs in the knowledge economy, energy, environmental protection, industry, health, education and services. EIB is also investing in *FIAT Small Cars Serbia* for the modernization and expansion of production capacity of the existing Zastava auto motive plant in Kragujevac. EBRD has been the country's second largest investor since 2001 committing almost €2.5 billion to the country. Its focus in Serbia has been development of transport infrastructure, boosting small business and promoting renewable energy. In 2010, EBRD committed €590.5 million across 24 projects in the following categories - Corporate: 17 percent (agribusiness, manufacturing and services, property and tourism and telecommunications); Energy: 15 percent (natural resources and the power sector); Financial institutions: 27 percent (includes investments in micro, small and medium-sized enterprises via financial intermediaries); and Infrastructure 41 percent (municipal environmental infrastructure and transport). Bilateral assistance from Germany (KfW and GIZ), USAID, Switzerland, Sweden and Norway is significant, with a number of other donors also present. Bilateral assistance focuses on supporting the Serbian government create democratic legal and state framework and institutions, as well as a modern market economy.

[20] http://ec.europa.eu/enlargement/pdf/serbia/ipa/2011

Box 6: A successful partnership - EC and the WB in Serbia and the Western Balkans

The European Commission (EC) and the World Bank are cooperating productively in Serbia. Planned activities include IPA financed trust funds to support work in innovation, described in Box 4, justice sector strengthening in Box 3, a survey on income and living conditions, and for regional monitoring and evaluation of public spending in Box 2. The EC has already supported the Public Expenditure Management DPL series under the previous CPS with direct budget support and extensive TA in the area of PFM, and has contributed to the Delivery of Local Public Services project and the Real Estate and Cadastre and Registration project. The Bank is also in discussions with the Directorate-General for Employment (DG-EMPL) toward cooperation in the Western Balkans on poverty and inclusion, Roma and pensions, and collaborates closely with the Directorate General for Economic and Financial Affairs on Bank DPLs and analytical work, as well as EC macro financial assistance and country progress reports. Finally, opportunities for deepening cooperation are regularly discussed with the EU delegation as well as by means of an annual country coordination meeting with DG Enlargement in Brussels.

Further possibilities for cooperation between the EC, European IFIs and the Bank in the Western Balkans have been opened by the agreement in June 2011 to grant associate membership of the World Bank Group to the Western Balkans Investment Framework (WBIF). The WBIF is a financing mechanism designed to pool grants, loans and expertise from the countries of the Western Balkans, the EC, IFIs and bilateral donors to prepare financing for a common pipeline of priority investment projects. This framework provides for the possibility to allocate some of the funding to analytical, policy reform and sector strategy work as well as capacity building. This new type of project, called a "sector development project" would be complementary to the other types of support currently provided by the WBIF (mainly technical assistance and co-financing). These grants would be linked to future investment plans and open possibilities to finance projects through the blending of grants and loans. Similarly, the policy based work and sector strategies funded in this way could also lay a solid foundation for sector based approaches to be implemented under national IPA envelopes, such as in Serbia, as well as to improve the overall policy, institutional and regulatory environment for all domestic and IFI investment projects. [21]

89. **This CPS has been designed in close cooperation with Serbia's development partners to build on these investments and advance its EU accession.** As noted, the CPS is closely aligned with the EC's *Europe 2020 Growth Strategy.* It has also been closely informed by the EC's Annual Progress Reports and the Multi-annual Indicative Planning Document (MIPD), the primary strategic planning instrument for assistance to Serbia in the framework of IPA. Finally, it reflects expanding dialogue between Bank Group and EC staff and management in Brussels and Belgrade. This is increasingly important given, as noted above, the significant financial resources with which the EU is providing Serbia. The EC monitors progress in each potential candidate country along three key areas: political criteria; economic criteria; and ability to assume the obligation of membership in various sectors, and issues annual reports on the progress achieved. The matrix in Table 5 illustrates where current and proposed Bank Group assistance is supporting these three priority areas.

[21] WBIF database on investments: http://www.wbif.eu/reports/investments

Table 5: WB Program Alignment with EU Criteria

EU Criteria	POLITICAL CRITERIA	ECONOMIC CRITERIA	EUROPEAN STANDARDS
Key Areas and WBG Instruments From Current Portfolio and Proposed in FY12-FY15 CPS	**Public Administration** PEDPL3	**Macro Stability and Quality of Public Spending** PEDPL, PFDPL (Reform of Non-Private Enterprises)	**Cross-Border Cooperation** Corridor X
	Judicial Strengthening Analytical Work, PFM and Public Procurement	**Sector and Enterprise Structure** IFC financing and advisory work on privatization and corporate governance	**Transport Policy** Road and Safety Project,
		Business Environment PFDPL (Reform of Non-Private Enterprises) IFC Investment Climate advisory work	**Agriculture policy** Irrigation and Drainage
		Upgrading Infrastructure Corridor X, Energy Efficiency Irrigation and Drainage, Roads, IFC PPP advisory work and financing	**Energy Policy** ECSEE APL II
		Competitiveness and Productive Capacity Innovation/Skills, Land PFDPL, Irrigation/Drainage, IFC financing	**Social policies/Health** PEDPL; Health Projects Gender Monitoring Poverty Monitoring
		Structural Rigidities PEDPL3; (health, insurance); PFDPL (Reform of Non-Private Enterprises);	**Monitoring and Evaluation** EC Trust Fund
			Environment Bor Project

Consultations

90. **This CPS is the product of intensive dialogue with Serbian authorities, civil society, and donor partners.** The co-chairing (with the EU Delegation) of regular Informal Donor Coordination meetings provided the World Bank office with a platform to exchange views with donor partners on country priorities, strategies for assistance and discuss complementarity of efforts. Meetings were also organized with civil society representatives, members of think-tanks and opinion-leaders and shapers to hear their views regarding country challenges, the role of the World Bank Group and its areas of greatest "competitive advantage". In particular, knowledge acquisition and dissemination as well as "advocacy" for overall economic as well as sectoral reforms were identified as critically important roles expected from the Bank Group, going forward. Finally, it is planned to engage with members of relevant Committees from Parliament, as soon as the parliamentary agenda permits to exchange views on the proposed strategy, its rationale and objectives.

B. Planned Lending and AAA

91. **With the overall objective of supporting Serbia's European integration, it is expected that this CPS will: (i) support economic growth by tackling some of the bottlenecks to improved productivity and competitiveness; and (ii) strengthen the efficiency and outcomes of Serbia's social sector spending.** The CPS recognizes that the goals of competitiveness and improved social sector spending and outcomes are often fundamentally interrelated.

92. **Planned lending during the CPS period is underpinned by AAA activities carried out over the past 2-3 years and new AAA activities (both country-specific and regional).** Design of each of the major lending activities foreseen for the CPS builds on recently-completed or ongoing AAA activities. In particular, the entire CPS has been shaped by a comprehensive Country Economic Memorandum, *Productivity and Exports: the Path to Prosperity* prepared with the Government and in collaboration with the EC. Further, Public Expenditure DPL series has been shaped fundamentally by the Public Expenditure Review carried out during the previous CPS.

Table 6: Portfolio and New Lending FY12–FY15 and CPS AAAs

Ongoing Operations FY12-15			
Competitiveness		***Social Spending: Efficiency and Outcomes***	
Ongoing investment projects (closing date)*			
ECSEE APL2	FY12	Health Project	FY12
Transport Rehabilitation	FY12	Consolidated Collection	
Real Estate and Cadastre	FY12	Pension Project	FY13
Energy Efficiency	FY13	DILS	FY13
SEEC CRIF	FY13		
Irrigation and Drainage	FY13		
Bor Regional Development	FY15		
Corridor X	FY16		
New Operations FY12-13 (delivery date)			
PFDPL1	FY13	PEDPL3	FY12
Roads	FY13	Health	FY13
Country Specific Non-lending (AAA) and Trust Funds FY12-15 (delivery date)			
Country Economic Memorandum	FY12	Education TA	FY12
Innovation (TF)	FY12-15	Survey on Income and Living Conditions (TF)	FY12-13
Justice Sector Support (MDTF)	FY12-16	Poverty and Social Impact Analysis	FY13-15
Municipal PER	FY13		
Energy Strategy	FY14		
Regional Non-lending (AAA) and Trust Funds FY12-15 (delivery date)			
Western Balkans REPARIS (TF)	FY12-14	Regional Monitoring & Evaluations (TF)	FY12-13
Western Balkans TA Science, R&D/Innov. (TF)	FY12-14	Regional Smart Safety Nets	FY13
Western Balkans Program. Financial Sector Dev	FY12-14	Western Balkans Gender Monitoring	FY13-15
Promoting Employment Thro' Skills Dev (TF)	FY13	Western Balkans Programmatic Poverty	FY13-15
Western Balkans Public Fin Mgt/PEFA (TF)	FY13-15	Regional Health Finance AAA	FY14

*Agriculture project closes on December 31, 2011

Expected Outcomes

I: Competitiveness

93. **Serbia confronts a large competitiveness agenda.** As noted at the outset, the focus of this CPS on improving Serbia's competitiveness through investments in productivity is consistent with the Bank Group's broader strategy for the entire Europe and Central Asia region, as well as that of the European Commission, as detailed in *Europe 2020.* In this context, it reflects the continuation of the previous CPS, which was developed and later refined with these principles central to the dialogue between the Bank and the Serbian authorities. It is also the very specific product of the 2012 CEM, *Productivity and Export: the Path to Prosperity*. This comprehensive analysis of the Serbian economy has been prepared in close coordination with the Government and with important contributions from the EC, through the Directorate General for Economic and Financial Affairs (ECFIN).

94. **IFC plans to expand its activities further during the CPS period.** The corporate sector continues to face difficult economic environment due to weak demand in the international markets and limited growth opportunities in the domestic market, which are being exacerbated by scarcity of long-term borrowing. Companies have not yet started investing in new capacity as the demand outlook remains uncertain and long-term capital has become more expensive, reflecting higher risk premiums. To mitigate the negative effects of the economic slowdown, IFC will continue to establish long-term relationships with competitive local and regional private sector companies that have strong fundamentals, and are well-positioned to grow as the economic recovery gains momentum. IFC will look for opportunities to increase its investments in agribusiness, one of Serbia's traditionally strong economic sector. IFC will support cost competitive companies with export potential and strong business fundamentals, especially those which have the capacity to become regional leaders. Through its financing and advisory services, IFC will target the under-served segments of the economy such as the MSMEs, energy efficiency and renewable energy, municipalities and rural regions in the country.

95. **In the financial sector, IFC has a substantial investment portfolio in Serbia's financial markets which represents a strong base for playing an important developmental role.** IFC can support privatization of its two portfolio banks (the second largest bank in the country and a small regional bank). In addition, IFC will explore the opportunities to help Serbia develop local currency financing to reduce exchange rate risks connected with increasing euroization of the economy. IFC will also consider expanding its financing for regional insurance companies and supporting government efforts to complete privatization in the insurance sector. IFC can play a critical role in WBG crisis response by supporting Serbia's systemic banks in achieving growth and sustaining liquidity. IFC would be able to provide rapid and coordinated response that is demand driven and can be rolled out with active coordination with other partners. IFC's support could include: (i) short-term and trade finance to address immediate liquidity concerns and maintain trade flows; (ii) mezzanine and equity investments to shore-up capital, and (iii) SME funding through financial intermediaries.

96. ***CPS Outcome: Improved Infrastructure:*** The 2011 EC Progress Report notes Serbia's strategic geographic location in South-East Europe and the important role it has to play in building trans-European networks in the region. Other areas identified as requiring investment and policy reform included agriculture and energy. While noting progress in these areas, the Report finds that Serbia will have to make additional efforts to align the sectors with the EU *acquis*.

- The ongoing **Corridor X Road Transport project** will increase transport efficiency and improve traffic safety on a major road corridor connecting Serbia with key markets to the north and south. It will reduce the cost of transport for all goods, thereby reducing the cost of imports

and will also contribute to making exports more competitive. The project will facilitate increased traffic, which itself will bring additional benefits to Serbia in the form of additional toll revenue to maintain the roads. Expected outcomes during the CPS period include reduced user costs and crash related deaths and serious injuries. The proposed **Road Maintenance & Safety project** will be designed to improve connectivity and thus encourage economic development in regions not directly linked to the new highways and improve road safety.

- The **Irrigation and Drainage Rehabilitation project**, which is expected to close by end FY13, is building capacity for increased agricultural yields through support to high priority rehabilitation of drainage and irrigation infrastructure, and improving water resource management. Outcomes expected during the CPS period include adoption of the Water Law, legislative establishment of Water Users Associations (WUA); and developing irrigation schemes.

- The Bank is supporting Serbia's participation in the South East Europe Energy Market, and eventual integration into the EU energy market, through the on-going **ECSEE APL3 project**. The operation is improving electricity market access for consumers and suppliers through an increase in the quantity, quality, reliability, safety, and efficiency of the bulk power transmission system. Discussions are also underway for support later in the CPS for an **Energy Strategy.**

97. **IFC expects that infrastructure reforms will advance in Serbia.** Such reforms would allow IFC to play an important role by facilitating private sector participation in the infrastructure sector. Due to the country's limited borrowing capacity, the introduction of PPPs on a wider scale could finance infrastructure development without jeopardizing macroeconomic stability. IFC would support PPPs with its Belgrade-based Infrastructure Advisory Team. In the municipal sector IFC will build on its experience with an earlier Integrated Solid Waste Management advisory program which helped a selected group of municipalities to prepare proper project documentation for the construction of a new waste management center and financing of two regional landfills. IFC will seek other opportunities in the areas of landfills and waste management, water and waste water management, road infrastructure, district heating and urban transport.

CPS Outcome: Improved Investment Climate: The Government is committed to developing a better understanding of policy actions that would be most effective in improving Serbia's export performance. The Bank is working closely with the authorities on a **Country Economic Memorandum entitled *Productivity and Export: the Path to Prosperity*.** The comprehensive and highly detailed report (i) provides a review of Serbia's macroeconomic situation and its progress on structural reforms including the political economy around it; (ii) presents the current status of Serbia's exports, including a discussion of its various regional trade arrangements and an analysis of which sectors Serbia has a revealed or potential comparative advantage; and (iii) identifies obstacles to improved productivity in key sectors, including power supply and efficiency, use of land, transport and logistics. Additional analysis and TA will complement the CEM, providing a regional perspective on key issues of competitiveness. This includes the ECA **Region's Regular Economic Reports** and the **Western Balkans Public Financial Management TF.**

- One of the clear areas identified by the EC as requiring strengthening for faster growth and more rapid EU accession was the justice sector. **The Multi Donor Trust Fund for Justice Sector Support project** is addressing these and other key issues which are compromising the efficiency and perceived integrity of the courts. Key elements of the project include facilitating Serbia's EU integration process and establishing justice sector performance benchmarks. The MDTF—JSS is, among other things, supporting the introduction of an automated case management system and mobilizing resources for a comprehensive information technology strategy.

- South East Europe is increasingly vulnerable to climate related catastrophes, and would benefit significantly from better insurance coverage for Serbian businesses and households in the event of a natural or climatic disaster. Serbia's participation in the Regional **Southeastern Europe and Caucasus Catastrophe Risk Insurance Facility (SEEC CRIF)** was approved in March 2011 by the Bank's Board of Executive Directors and is expected to become effective in January 2012. The objective of the SEEC CRIF is to increase access to financial protection for the Government as well as homeowners, farmers and small and medium enterprises (SMEs) from losses due to weather extremes caused by climate change and relevant geo-hazards, such as earthquakes, landslides, droughts, and floods.

- Also, Serbia is a participant in the **Road to Europe – Program of Accounting Reform and Institutional Strengthening (REPARIS)[22].** This program is helping to adapt laws and regulations governing financial reporting and develop institutions, and to bring the financial reporting framework into line with EU requirements.

- The 2011 EC Progress report notes the substantial influence Serbia's large State presence in the economy has on competitiveness, including state-controlled monopolistic structures in place in energy, telecommunication, agriculture and tourism. **The proposed Private and Financial Sector DPL programmatic series proposed** in this CPS, to begin in FY13, would focus on identifying an irreversible time-bound process to resolve and/or improve the efficiency of non-private enterprises. It would help establish a governance model of state-owned enterprises and large conglomerates to create transparency on the support provided by the state and investment decisions in a unified and coordinated manner, moving towards the corporatization of the enterprises; and it would help ensure that companies remaining in public hands—including ones for which government intervention is dictated by the nature of the industry (natural monopolies)—deliver positive economic results for both shareholders and consumers.

- The DPL will include a social pillar to address the potential effects reform of non-private enterprises could have on employees and other stakeholders. This pillar will be informed by a number of past and ongoing analytical efforts. Recent studies showed that the "regular" unemployment benefit program will not be sufficient to meet the needs of workers in areas likely to be hit the hardest (e.g. mining towns). And despite recent reforms, social assistance of last resort reaches only a fraction of the poor and is not very generous, so it would not be able to meet the needs of a large majority of dismissed workers. Active labor market policies will be needed. A 2006 Labor Markets Study looked at the challenge of compensating and redeploying redundant workers, following large number of privatizations and reforms undertaken earlier in the decade. The study reviewed the Government's efforts in 2002 and later in 2005 to strengthen a Social Program which offered affected workers a choice of different severance options, including one whose primary focus was labor market programs. The study showed that few affected workers opted for these programs, and instead chose one of two remuneration options. Additional work is ongoing, including **ESW on Smart Safety Nets** which is helping to identify how to link safety nets and activation policies. Finally, Serbia has had some successful initiatives to build on. One such program provides subsidies to employers for newly created jobs, as well as self-employment grants. A rigorous impact evaluation found that this program has had a significant impact on employability, with many beneficiaries still employed after two years.

[22] REPARIS is a Bank executed (hybrid) multi donor trust fund currently financed by the governments of Austria, Switzerland and Luxembourg, and managed by the World Bank Centre for Financial Reporting.

- Together with the introduction of a social pillar, the Bank will conduct a **Poverty and Social Impact Assessment (PSIA)** which will inform the preparation of the DPL over the coming months. This will include *ex-ante* simulations of the reforms supported by the DPL; a qualitative and quantitative analysis of the characteristics of the workers likely to be affected; their skills and experiences; and their prospects for future employment. This analysis will be fundamental to the design of the compensatory measures to be supported under this DPL. Moreover, to ensure continuity throughout the programmatic series, a baseline analysis and follow up tracer studies are planned to monitor the impact of the reforms and the compensatory measures. This consistent monitoring should be very helpful, as it will help inform and adjust the design of successive tranches of the DPL.

Box 7: The State as a better manager of its own public enterprises - New DPL Series

Serbia and the Bank have had a long and complex experience in restructuring thousands of SOEs. In the early 2000s the Government took steps to reform its enterprise sector, primarily through the privatization of the majority of socially owned enterprises**.** The Government successfully privatized nearly 2,500 companies, raising approximately €2.6 billion. Further, to date the bankruptcy process has been completed for nearly 400 qualifying companies.

Despite the scale of the privatization efforts to date, the role of the state in the corporate sector remains pervasive: there are some 250,000 employees still working in approximately 1,300 socially-owned, state-owned, and municipal enterprises, representing nearly 14 percent of the formal workforce. The large presence of the state in the enterprise sector has direct fiscal implications for state and municipal budgets. While direct subsidies from the National Budget are circumscribed to only two large state-owned enterprises (the railways and a coal mine), indirect subsidization in the form of tax, social contribution and pension arrears are significant, and government guarantees are a source of potentially costly contingent liabilities. Based on a preliminary analysis, the Bank estimates that close to €290 million is allocated to direct subsidies, or close to 4 percent of government budget, while indirect subsidies could represent double that figure. Additionally, in 2010, government-issued guarantees to state owned enterprises were in the vicinity of €700 million.

The privatization efforts so far were primarily focused on resolution of socially owned enterprises, while large state owned enterprises, including natural monopolies, as well as municipal utilities have largely remained in government control, raising issues of accountability, performance management and quality of service provision. Although some limited reform actions were taken in the past few years through restructuring, corporatization, and privatization of state-owned enterprises on a case by case basis, there is a need to develop a comprehensive approach to target the entire non-private enterprise sector.

The numerous fiscal, operational and competitive challenges of a large enterprise sector remaining in public hands have prompted the Government to request World Bank assistance. The Bank proposes to help the authorities through the reform of the remaining non-private enterprises to ensure that the role of the state is optimized and that the performance of the assets in public hands is maximized, reducing fiscal burden and maximizing revenues. The new DPL series proposed in this CPS would focus on:

- improving the performances and accountability of the management of large state state-owned enterprises by enhancing corporate governance, improving transparency in performance setting and monitoring and separating management appointment from the political cycle. This would include introducing a transparent mechanism for allocating government subsidies compatible with the new Law on State Aid;

- developing a systematic, irreversible time-bound process to complete the resolution of socially-owned enterprises and of the key non-core state-owned enterprises (i.e. pharmaceutical producers, mining, etc.);

- introducing performance monitoring tools for local utilities and enhancing the role of the private sector to co-invest in infrastructure via an appropriate legal framework PPP;

- addressing with social safety net and active labor market programs the social issues potentially arising from labor redundancies associated with performance improvements and privatization of state enterprises.

This programmatic DPL series would pick up on the DPLs and Policy Based Guarantee carried out under the FY08-FY11 CPS, which focused on enhancing the business environment, strengthening financial discipline, and building a more efficient and stable financial sector.

- Through its regional **Investment Climate advisory program**, IFC will support the country's efforts in two areas: (i) reducing time and cost of international trade, and (ii) tax simplification and decreasing costs of compliance and alignment with EU and OECD guidelines and regulations. Reforms in tax and trade will decrease compliance costs and increase alignment with EU and OECD guidelines and regulations. IFC will explore options to deepen its advisory work in the agribusiness sector and increase competitiveness and investment.
- In addition, IFC will support corporate governance improvement through implementing company-level interventions and raising awareness of the importance of corporate governance.
- Further, IFC will aim to contribute to improved governance through its work on public-private partnerships (PPP) and setting industry standards in environmental and social practices.

Box 8: Building a Platform for Sustainable Investment Climate Reforms

IFC assisted the national and 10 local governments in establishing a regulatory governance platform, which is based on tools following EU and OECD models. By linking the reform efforts of the national and local governments, IFC contributed to the streamlining of 1,992 legal acts at the national level and 1,143 administrative procedures at the local level. IFC contributed to the reduction of administrative burdens on the private sector by US$136 million per year (direct and indirect costs). Following a series of reforms, the governments and other major stakeholders have committed to implement sustainable regulatory governance tools. At the national level, most significant is the creation of the Office for Regulatory Reform and Regulatory Impact Assessment within the Government. To scale up and sustain sub-national regulatory reform, a partnership was established between IFC and the Standing Conference of Towns and Municipalities of Serbia under which the organization will train and provide regulatory reform services to more municipalities.

The Alternative Dispute Resolution (the "ADR") Construction Project in Serbia was a pilot project for IFC, designed to assess dispute resolution in one sector, following the overall success of establishment and implementation of commercial mediation system during the first phase (2005-2009). A group of engineers was trained as mediators to mediate construction disputes. In cooperation with International Federation of Consulting Engineers (the "FIDIC") IFC also facilitated the official translation of the FIDIC's harmonized Red Book (MDB) and the FIDIC Guide to Practice, encouraging inclusion of FIDIC mediation clauses in new construction contracts. IFC also supported the Ministry of Justice in drafting the new Law on Mediation that will provide for implementing a better mediation system. The IFC ADR Construction project established the national legal framework and the contractual basis for commercial mediation, while establishing sector-specific mediation capacity in Serbia.

- ***CPS Outcome: Improved innovation capacity.*** The Bank and Serbia's development partners are providing complementary and well coordinated support in this area, including with a regional perspective.

  (i) **Serbian Innovation Fund:** The Innovation TF financed by the EC supports the capacity building of the newly established Innovation Fund of Serbia, matching grant programs for the earliest stages of development in technology-intensive start ups, and will pilot a technical assistance program tailored to the needs of select research and development institutes in Serbia to promote technology transfer and commercialization.

  (ii) **Western Balkans TA on Science and Innovation:** The Bank and the EU signed an agreement to implement a technical assistance program for the development of a Regional Research and Development Strategy for Innovation in the Western Balkans. The strategy will identify priorities in legal requirements, infrastructure, education and training to be implemented by the beneficiary entities. The TA is financed by the EC (DG-Enlargement) through a Multi-Country IPA Assistance Project in the amount of US$2 million. The TA is focusing on (i) how to increase the economic impact of R&D in the Western Balkans; and (ii) how to integrate education, research and innovation. This

analysis will form the basis of a report designed to inform research policies and promote integration of the region into the European Research Area (ERA).

(iii) **Regional Study on Employment and Innovation:** The Employment Through Skills Trust Fund, financed by the Government of Austria, will support survey analysis of the existing skills mix in selected countries, including Serbia, and compare this inventory to similar benchmark analysis in selected OECD countries. The results of this project will be disseminated at an international conference.

II: Improved Efficiency and Outcomes in Social Spending

CPS Outcome: Strengthened fiscal performance with sustained improvement in human development outcomes through more efficient, effective social spending. Serbia faces twin challenges of meeting the growing social needs resulting from the economic and financial crisis within tight fiscal constraints. The Government recognizes the need to get more social impact per *dinar* invested in its social programs. Moreover, the EC is increasingly concerned with its ability to monitor the impact of its support to Serbia, particularly in the social sectors. In this context (as noted above) it is working with the Bank to develop an IPA funded regional Trust Fund to strengthen national level capacity for **Monitoring and Evaluation (M&E) of Strategy Implementation**. The Bank expects to work closely with Serbia, based on the recently completed Public Expenditure Review and planned PSIAs, to identify areas for efficiency gains while improving the reach and effectiveness of social spending.

- The proposed third operation in the **Public Expenditure DPL** programmatic series will build on the previous two operations which have supported the Government's efforts to restrain growth in public sector wages and pension obligations, while improving public expenditure management. The objective of the PEDPL 3 is to reduce the size of Serbia's large public sector and support reforms that will improve the efficiency of public spending while mitigating the persistent social impact of the economic crisis. It is designed to (i) increase the efficiency of expenditure in the health and education spending; (ii) strengthen public expenditure and debt management; and (iii) strengthen social assistance to cushion the impact of the economic crisis and expand coverage of social assistance programs. As part of the operation, the Bank would carry out a PSIA Review to look at the results of reforms to student financing and school and class rationalization, to assess the effects on geographic coverage (in particular with respect to cuts in areas where more marginalized groups live) and the impact of those who stand to lose their jobs.

- The Bank will continue to support increased access, efficiency, and quality of local health, education, and social protection services through the **Delivery of Improved Local Services (DILS) project.** Expected outcomes in the education sector include testing central and local per capita funding formulas; in social protection the project will improve the framework in the Ministry of Labor for utilization of State disability funds in addressing disabled people's needs and the social assistance registry; and in health increase the number of Roma children vaccinated through Roma health mediators supported by the Ministry of Health, as well as the number of accredited Primary health clinics. The Public Expenditure DPL series also supports policy reforms in the health sector, specifically the introduction of performance-based payments.

- Key to both CPS pillars is a more cost efficient and effective education system: The EC notes in its 2011 Progress Report that the "ongoing skills mismatch continues to act as a drag on the development of new segments of the economy and requires further reforms of the education and training system that would respond better to labor market demand". Ongoing **Education TA** will contribute to increased capacity in planning and monitoring of education spending, as well as an improved institutional framework for monitoring of outcomes in pre-university education.

- The Government has taken steps to reign in pension spending, but its pension reform agenda remains unfinished, leaving unsustainable pension deficits. The challenge will grow more acute given Serbia's aging population. **The Consolidated Collection and Pension project** will reduce the administrative costs associated with the pensions system, reduce the reporting burden of employers, and help bring down the total cost of the pension system as a percentage of GDP.

CPS Outcome: More informed and effective policymaking to reduce poverty and increase social inclusion. Serbia's recovery—and its efforts to reduce poverty to at least pre-crisis levels—will be held back unless it addresses some key challenges.

- The Bank is looking carefully at who has been hurt by the crisis and its continuing aftermath, and what obstacles they face in finding employment. **The Western Balkans Poverty Assessment** will support evidence based policy making through the timely provision of poverty analysis, collaboration with local stakeholders to strengthen analytical and statistical capacity, and the in-depth analysis of topical issues, particularly the distributional consequences of policy reforms. This programmatic ESW will seek to monitor poverty, inequality and labor market trends; continue providing analytical and statistical support to government counterparts; and provide analytical work on emerging policy issues. An important task under this project during the new CPS period will be to support the Statistical Office through the **Social Inclusion and Living Conditions (SILC)** survey using National IPA funds. As the survey is the main tool adopted in EU Member States to monitor progress towards the poverty and inclusion targets in the *Europe 2020* strategy, this activity is an important element of the coordination of efforts in strengthening the analytical capacity of local stakeholders for evidence based policy making in the field of inclusion that we are developing with DG EMPL. **The Western Balkans regional AAA on Smart Safety Nets and Activation** will advise on how to make the social assistance system incentive-compatible, flexible and pro-active, and how to coordinate social cash transfers with the provision of employment and social care services**.**

- IFC will continue its efforts to address poverty and lack of access in the frontier regions in Serbia through its direct financing to companies operating in these regions, including in the agribusiness sector, as well as through providing credit lines to the banks.

- Women face particular challenges in the labor market. Designing projects and reforms that support gender equality requires identifying the barriers that prevent women's participation. The Bank has invested significantly in the Western Balkans in both gender and poverty analysis. The recent dissemination of a report on the gender impact of the crisis[23] has been an opportunity to open a new forum for dialogue on gender issues with UNWomen[24] and other donors as well as academic and independent researchers on the analytical agenda on gender in the country. In addition, an initial portfolio gender review has been conducted, and during the CPS period, thematic reviews of how to mainstream gender in existing and future projects, to be conducted under the **Western Balkans Programmatic Gender Monitoring**, will identify how to increase the gender inclusiveness of the existing portfolio and inform the design of future lending operations. One example is the DILS project, which will introduce incentives for cervical screening in primary health care. This has led to a broader discussion with the authorities about a future health project which would include monitorable targets for improving women's health. IFC will also explore ways to improve financial intermediation to SMEs, especially to women-owned businesses as a vital part of Serbia's economy.

[23] *The Financial Crisis, Labor Market Transitions and Earnings: a gendered analysis*, forthcoming

[24] The event was an opportunity for launching a new closer collaboration with UNWomen, whose experience and practical involvement on the ground in policy dialogue and projects on gender empowerment can help us increase the relevance of the new Western Balkans Programmatic Gender Monitoring activity.

Box 9: Western Balkans Programmatic Gender Monitoring

As background for the CPS preparation, the country team has undertaken a Gender Portfolio Review for Serbia based on a methodology developed by the LAC region. The objective of the review is to identify how to mainstream gender into the existing Bank portfolio. This activity is a pilot in the region and was designed as a learning experience whose lessons will be shared more broadly across the Region. The emerging findings for Serbia will be addressed more systematically under the new **Western Balkans Programmatic Gender Monitoring** activity, which is just starting. Out of the existing portfolio, six projects were selected for the portfolio review. Three were selected as their closing dates in FY13 offer the greatest opportunity to mainstream gender. Three of the projects in the portfolio due to close in FY12 were chosen to capture the spectrum of challenges and existing experiences in streamlining gender. They include the health project to capture a more "mature" and relatively self evident sector to mainstream gender; the land administration project to identify one sector in which the Bank has significant knowledge on how to mainstream gender; and the energy project where the potential for mainstreaming gender is much more difficult to assess and best practices are harder to come by.

The portfolio review is based on project-related information from PADs and supplemental project documents if available. The information is analyzed along three dimensions[25] to assess:

(i) Whether the project was informed by gender analysis and consultations as part of the social assessment. This also includes discussing whether addressing gender disparities should have been included in the project objective.

(ii) Whether the project included gender-responsive design and targeting. Gender-responsive design indicates that infrastructure, services, institutions, or policies accounted for different needs of men and women. This may lead to identify the need for new institutional arrangements or partnerships to mainstream gender in the sector. The issue of targeting of beneficiaries is also explored in detail looking for example at whether, if women were part of the social assessment, there was any follow-up on targeting women as beneficiaries, whether there are social norms to be considered in the targeting process, whether there particular concerns for female headed households due to conflict, displacement, migration that require special consideration etc.

(iii) Whether the project included gender-responsive Monitoring and Evaluation. This part of the analysis is based on a review of project indicators. The potential for including gender sensitive indicators is also explored.

Results from this Review are coming in and will be reviewed to identify whether follow up analysis and data collection (e.g. through focus groups of beneficiaries) might be required.

Initial findings confirm there is scope for significant improvement in mainstreaming gender into projects. While three of the 6 projects appear to have focused on gender in the social assessment, most projects did not specifically have components targeting women and their needs and result frameworks were also not designed with gender disaggregated indicators in mind

Environmental Sustainability

98. **As noted above, while not a pillar of the CPS, Bank supported projects are also helping to advance Serbia's environmental agenda.**

- The **Bor Regional Development Project** is supporting the Government's efforts to assist this large but underserved population in what was once a thriving industrial center with creating employment opportunities and economic diversification. The majority of funding has been allocated for the cleanup and remediation of large areas with mining waste disposal sites remaining from historic mining operations. The Bor region's economy is based primarily on a large state owned copper mine, which, now at far lower levels of production, has left behind a challenging ecological legacy.

[25] Targets for Monitoring Progress in Gender Integration in Operations: Approach for the Sustainable Development Network, May 6, 2010

- The ongoing **Energy Efficiency project** will result in significant energy savings of retrofitted schools and hospitals, including carbon emissions reductions of 42 percent on average for hospitals. Other outcomes will be improvement in air quality through the reduction of emissions at the Clinical Center; and financial savings for the Ministry of Health. IFC's efforts in the area of climate change are important in its strategy in Western Balkans. In Serbia, IFC will continue to focus on climate change using its regional energy efficiency and renewable energy programs.

C. The CPS Financing Program

99. **A significant share of IBRD financing during FY12-FY15 will come from ongoing operations approved during the previous CPS.** Total remaining disbursements of the active portfolio are expected to amount to some US$550 million.

100. **IBRD financing during the first two years of the CPS is expected to amount to US$340 million.** The Government has asked for lending during the entire CPS period of US$800 million. The Bank is sensitive to the challenging external environment for Serbia (and the rest of the Western Balkans), as well as the importance of supporting the country during this critical period as it prepares for EU accession. Management has indicated the Bank will be as responsive as possible to meet the Government's borrowing needs. Final lending amounts will depend on IBRDs lending capacity and demand from other borrowers as well as performance during the course of CPS implementation. The lending program for the last two years of the CPS will be discussed at the time of an early CPS Progress Report.

101. **IFC expects to provide financing of US$600-800 million to the private sector during the CPS period.** The program will depend on the government's support for private sector participation in the infrastructure sector at national and municipal levels, further improvements in the business environment, and the growth outlook in Europe**.** IFC's activities will focus on creating opportunities for growth through supporting competitive sectors, deepening investment climate work, strengthening domestic financial markets, and facilitating private sector participation in infrastructure.

Table 7: Proposed IBRD Lending Program by Fiscal Year (in US$m)

		IBRD	TOTAL
FY12			
Public Expenditure DPL 3		100	
	FY12 Total	**100**	**100**
FY 13			
PFDPL1		100	
Roads Project		100	
Health Project		40	
	FY13 Total	**240**	**240**
FY14			
PFDPL2			
Energy Efficiency			
Investment Operations tbd*			
	FY14 Total	**TBD**	
FY15			
PFDPL3			
Investment Operations tbd*			
	FY15 Total	**TBD**	

Annex 3 describes the on-going and planned Trust Fund program that will complement above Bank financing
* Possible projects include Cadastre, Skills project and Agriculture project.

VI. RISKS

102. **The chief risk to successful completion of this CPS would result from Serbia failing to consolidate hard won progress toward macroeconomic stability.** This would be particularly damaging given what is likely to remain serious volatility in Serbia's main export markets in the eurozone, as it would likely undermine Serbia's economic recovery and lead to increased levels of poverty and unemployment. To help mitigate this risk, the CPS program includes a DPL operation designed to reduce the size of Serbia's large public sector while maintaining the quality of core public services and a new DPL series aimed at reducing the role of the State in the market by resolving the status of non-private enterprises. The CPS' emphasis on removing some of the bottlenecks to competitiveness and productivity can also help mitigate the risk of a sharp slowdown. The Stand-by Arrangement with the IMF will also be central in this regard. Finally, the current Government's track record of successful implementation of Fund Programs and Bank supported DPLs provides important context in which to consider this risk. As noted above, the recognition by all major parties that difficult steps toward EU accession and continued fiscal discipline will be required going forward also help reduce vulnerability.

103. **The second and related risk is a weakening of commitment to policy reform as a result of the elections.** This would slow progress toward EU accession and disrupt advancement of the Bank's programmatic DPL series. Again, the consensus behind, and the overwhelming economic and financial incentives to remain on track for, EU accession will help sustain the country's focus on policy reform. The emphasis of the CPS on supporting this progress will also help in key sectors.

104. **Third, implementation risks are significant.** The public institutions responsible for the reforms central to the DPL series and to executing Bank financed investment operations need strengthening. Failure to accelerate implementation of investment lending could lead the Bank to cancel or postpone projected operations in key areas. The Bank is working closely with the authorities on new approaches to portfolio management, and will continue to consolidate the portfolio, including through cancellation and restructuring of slow disbursing projects, to ensure more efficient and timely implementation.

Annex 1: Results Matrix for the Country Partnership Strategy

Country Devt. Goals	Issues and Obstacles	Outcomes the WBG Program is Expected to Influence	Milestones	WBG Program
		Pillar I: Competitiveness		
Improve Infrastructure	Missing links on the Serbian portion of Corridor X (one of the Pan-European Corridors of which Serbia is a key transit country) undermine the country's ability to capitalize on its geographic position and to facilitate social and economic development of the country. Road safety remains a major concern. While fatalities caused by traffic accidents have been decreasing, the number of injury accidents has been increasing.	Increased transport efficiency and improved traffic safety on the project sections of Corridor X, between Nis and Dimitrovgrad, and Grabovnica and Donji Neradovac. Indicated by: (i) Reduction in road user costs for road section Nis-Dimitrovgrad: Baseline (2009) – 1.31; Target (2015) – 1.00; and road section Grabovnica to Donji Neradovac: Baseline (2009)- 1.07; target (2015) – 1.00 (ii) Reduction in the rate of road crash- related deaths and serious injury on road section Nis Dimitrovgrad: Baseline (2009) – 44.10%; Target (2015) – 39.70%. Action plan for reform of PEPS adopted by 2015. National Road Safety Strategy developed and launched by 2015.	Construction of motorway: (i) A total of 31.9 km of motorway constructed (E-75 Corridor to FYR Macedonia) on a section of the corridor between Grabovnica, and Gradelica, and between Vladicin Han and Donji Neradovac; (ii)A total of 8.67 km of motorway constructed (E-80 Corridor to Bulgaria) on a section of the corridor between Dimitrovgrad and the border with Bulgaria. Lead Agency for road safety established and operational. Two road safety pilot projects implemented.	Current portfolio: FY10 Corridor X project (P108005) New financing: FY13 Roads Project
Improve irrigation systems and institutional framework to support increased agricultural production	Dilapidated water sector impairs functionality of essential drainage and flood control infrastructure in Serbia. A precondition for development of new and rehabilitation of the existing irrigation schemes was the adoption of a new Water Law, and enactment of sub-legislation establishing Water Users Associations (WUAs). Water Law adoption was delayed from 2005 to 2010. Sub-legislation for WUAs has not been enacted yet, due to conflicting interests of various stakeholders. Flood defense and drainage infrastructure is in need of significant investments to bring it back into basic operating condition. Besides insufficient financial resources, challenges remain in improving cooperation between various stakeholders, streamlining the permitting procedures for civil works and establishing a robust pipeline of investment schemes.	Creation of new and/or rehabilitation of existing irrigation schemes: Baseline (2006) – 0; Target (2013) – 10. Improved capacity for increased agricultural yields Baseline (2006) – 0; Target (2013) – 20%. Improved water resources management and strengthened water resource management institutions and policies. Improved agriculture sectors resilience to droughts indicated by: flood protection schemes strengthened for 550,000 ha and 1.8 million people along Danube, Sava, Tisa and Tamis rivers.	Water Law adopted (2010). Enacted sub-legislation for organization, management and financing of WUAs. Water Users Associations established. Establishment of strong pipeline of investment schemes.	Current portfolio: FY06 Irrigation and Drainage Project (P087964) IFC investments in the under-served segments of the economy: SME, agribusiness, energy efficiency and renewable energy, municipalities, and rural areas.

Country Devt. Goals	Issues and Obstacles	Outcomes the WBG Program is Expected to Influence	Milestones	WBG Program
Improve Investment Climate	The role of the state in the corporate sector remains pervasive, with fiscal implications in the form of direct and indirect subsidies and consequences for growth and competitiveness: (i) Large state owned enterprises (SOEs) have largely remained under government control, with poor governance and performance. (ii) Socially owned enterprises, employing a significant share of the workforce, also remain unresolved. (iii) Municipal utilities present heterogeneous performance and are affected by lack of investments. (iv) Despite restructuring, corporatization, and privatization of SOEs on a case by case basis, there is a need to develop a comprehensive approach targeting the entire non-private enterprise sector to improve its governance and efficiency.	Resolution of the majority of the Privatization Agency Portfolio. Privatization/resolution of select large SOEs operating in contestable markets Improvement of corporate governance model for SOEs, by introducing rules for management appointments, increasing accountability and transparency of their performance, to be implemented by a dedicated and resourced unit within the government in charge of the state enterprise portfolio Improvement in efficiency of non private enterprises via benchmarking, PPPs, management contracts, better regulations, etc. Managing the potential social impact via social protection measures and active labor market measures to support transactions	Comprehensive database of non-private enterprises and their performance developed and possibly, published. Comprehensive triage of non private enterprises, including separation of natural monopolies and competitive companies, with three principal outcomes deciding: i) which companies will continue to operate in public sector; ii) which companies need to be privatized; and iii) which companies will be subject to closure/liquidation Establishment of centralized and sufficiently resourced SOE Oversight Unit for non-private enterprises Development of a time-bound action plan for resolution of Privatization Agency portfolio Corporatization of all remaining socially owned enterprises Selected asset resolution transactions	New financing: FY13-15 PFDPLs; IFC: banking and insurance privatization; IFC: PPPs in infrastructure; Support infrastructure projects at municipal level; IFC investments: Improve competitiveness of private corporate sector; Explore local currency financing; Crisis response through: (i) short-term financing and trade products; (ii) mezzanine and equity investments; (iii) SME funding support through financial intermediaries. AAA: FY12 Country Economic Memorandum; AAA: FY11 Justice Sector Support IFC Advisory Services: investment climate; corporate governance. AAA: FY11-14 Western Balkans Public Financial Management & TF supported projects AAA: FY11-14 Programmatic Western Balkan Financial Sector TA AAA: FY12 Regional REPARIS AAA: Regular Economic Reports
	Inadequate infrastructure and weak institutional and enforcement capacity in the judiciary erodes public and business confidence The capacity for planning, budgeting, allocating, executing and controlling public funds needs strengthening. Banking supervision is generally strong, but supervision of non-bank financial institutions is weak, and oversight capacity varies across subsectors. Corporate financial reporting has improved but lags behind EU practices. Serbia has low levels of insurance against losses from natural disasters due to high cost of	Government accepts and adopts finalized legal aid law and Parliament passes the new law on legal aid. Improved efficiency and services of the judiciary through supporting the Government's justice sector reform agenda and Serbia's EU accession process Improved public financial management as measured by the PEFA framework through increased ratings in PEFA indicators, associated advice and technical support. Strengthened supervision of the financial sector focusing on non-bank financial institutions. Strengthened transparency of corporate financial reporting in line with EU standards.	EC notes progress in the pace and scope of judicial reforms. Strategic framework for the second phase of justice sector reform prepared. Action Plan for Justice Sector reform produced and funding secured by Ministry of Justice. Response to PEFA findings, development of a PFM reform strategy and action plan, implementation of priority PFM reform actions with coordinated support from development partners. Supervisory Committee established to harmonize regulation and practices in financial sector supervision. Improvement noted in Annual Progress Report of EC, Chamber of Auditors becomes admitted to International Federation of Accountants (IFAC).	

Country Devt. Goals	Issues and Obstacles	Outcomes the WBG Program is Expected to Influence	Milestones	WBG Program
	developing such insurance, lack of precise and updated information on risks (including from climate change), and lack of risk-based supervision of the insurance market	Reduced risk of damage from flooding to land, crops, property, infrastructure, and life loss from flooding	Regional CRIF established (December, 2011); Insurance Modeling completed (December, 2012); risk-based supervision legislation drafted (September 2012).	Current portfolio: FY11 CRIF (P110910)
Improved innovation capacity	The current system and composition of R&D funding does not support Serbia's agenda to modernize and enhance its competitiveness. R&D is dominated by the public sector, largely inefficient, and most importantly de-linked from industry needs, particularly those of SMEs. Serbian industry's capacity, both in terms of human capital and financial resources for R&D and innovation, is low. Serbia faces low demand for R&D, brain drain, weak business R&D investments and limitations in ICT services.	Established institutional capacity to stimulate innovative activities in the enterprise sector, indicated by: Serbia Innovation Fund made operational Piloted financial instruments for technological development and innovation in enterprises; and Research and development institutes engaged in technology transfer and commercialization, and assisted in formulation of RDI reform policy. Strengthened research and innovation capacity through consensus building and stimulated research cooperation at the regional level. Developed cooperation between R&D, higher education and business sectors.	Amount of financing mobilized by IFIs in addition to EU IPA funds (Baseline 2011: 0; Target 2014: €20million). Number of active technology start-ups (Baseline 2011: 0; Target 2014: 10). Number of new products and processes launched by beneficiary enterprises (Baseline 2011: 0; Target 2014: 8). Number of technologies transferred by RDIs (Baseline 2011: 0; Target 2014: 3); Disseminated policy recommendations for RDI sector reform. Prepared regional research and development strategy for innovation, including national action plans for implementation of the strategy.	New Financing: FY12 Serbia Innovation Fund (P126229); AAA: FY11-14 Western Balkans TA on Science, R&/Innovation (TF); AAA: FY13Western Balkans Study on Employment and Innovation (TF);
Pillar II: Improved Efficiency and Outcomes in Social Spending				
Strengthened fiscal performance with sustained improvement in human development outcomes through more efficient, effective, social spending	Health outcomes in Serbia still lag behind those of the EU-15. Public health spending is relatively high, so health reforms focus on improving efficiency through new financing mechanisms at the primary and secondary levels. Efficiency must be accompanied with increased quality (such as through the newly established National Agency for Quality and Accreditation) and improved access to care (particularly among vulnerable groups). Disability Fund's procedures need to be reformed to allow competition, secure transparency and equal access to funding for the Disabled People's Organizations. Pension reform agenda remains unfinished. Aside from unsustainable pension deficits, the pension system is excessively diversified and the administrative costs associated with pension administration system are high.	Number of accredited PHCs (Ministry of Health). Number of Roma children vaccinated through Roma health mediators supported by the project (Ministry of Health). Improved framework established in the Ministry of Labor and Social Protection allowing equal access to and transparent utilization of State disability funds in addressing disabled people's needs. Effectiveness of administration improved and indicated by administrative costs/pension expenditures. Baseline (2005): 4%; Target (2012)-2.5%. Progress in administrative consolidation of the 3 PIOs: Baseline (2005) – 0%; Target (2012) – 100 .	30 accredited PHCs. 3,600 Roma children vaccinated. Disability Fund framework established and functioning. Feasibility study completed and the institutional framework for the new system identified. (Central Registry established as of March 2011). The PIOs fully administratively and financially consolidated	Current portfolio: FY08 DILS Project (P096823); AAA: Education TA, Phase 2 (P118286) New financing: FY13 Health project IFC: Investments and advisory in health PPPs. Current portfolio: FY05 Consolidated Collection and Pension Administration Reform Project (P090418)

Country Devt. Goals	Issues and Obstacles	Outcomes the WBG Program is Expected to Influence	Milestones	WBG Program
	The contribution collection responsibility is centralized in the Tax Department. This requires a consolidated, more accurate and frequent stream of data for efficient control and enforcement of pension contributions payments.	Reduce employers' reporting burden, measured by fewer reporting forms required: Baseline (2005) – 28 types of forms submitted; Target (2012) – 20 types of forms submitted. Further pension reform measures to improve long-term sustainability, adequacy and transparency of the pension system: Baseline (2005) – total pension expenditure to GDP ratio 13.4 %; Target (2012) – total pension expenditure to GDP ratio 12 %. Improve client service in the pension system, measured by the average time required for resolution of one cases: Baseline (2005) – 2 hours; Target (2012) – 1 hour.		
	Serbia needs to reduce the size of its large public sector while maintaining the quality of core public services. Rationalization of public expenditure is critical to Serbia's fiscal sustainability. Wages and pensions account for much of the increase in public spending over the last decade. They now account for over 10% of GDP. There is a need to balance delivery of services associated with public expenditure and sustainability of public finances. Current input-based financing will need to be reformed and per student capita financing introduced in order to increase efficiency of use of education public spending.	Gradual decline in the level of spending on pensions and public sector wages (as percentage of GDP) as indexation formulas are implemented. Gradual decline in spending on teachers' salaries (as percent of GDP) as capitation formula for school financing is implemented. Fiscal policy improves as Fiscal Council reviews budget preparation. External auditing and debt management improve. Central and local per capita funding formulas in the education sector tested (Ministry of Education and Science).	Indexation formulas for pensions and public sector wages implemented. Capitation financing for schools piloted. Fiscal Council established and operational. State Audit Institution completes external audit of final accounts for the Republic of Serbia and at least 10 other external audits. MOF prepares borrowing plan for 2012 and updates debt management strategy. Central and local per capita funding formulas tested.	New financing: FY12 Public Expenditure Development Policy Loan 3 (P123065)
More informed and effective policymaking to reduce poverty and increase social inclusion	Despite regular poverty monitoring by the Statistical Office, there is a need for a deeper analysis of the data and identification of issues to be addressed. In addition, the Statistical Office requires on demand assistance to address issues related to survey quality, comparability, development of new modules and introduction of new techniques, particularly as new tools such as the SILC survey and possibly poverty mapping are introduced and developed. Poverty and social assessment is critical to PFDPL preparation and implementation of its	Topical policy notes based on micro-economic data are produced. The SILC survey is collected for the first time and an analytical report is produced. PSIA section of PFDPL document addresses concerns about distributional impact of its actions.	New and emerging issues with respect to data quality or new analytical tools are addressed. PSIA conducted.	AAA: Western Balkans Programmatic Poverty Assessment AAA: Western Balkans Smart Safety Nets and Activation AAA: FY12-13 Survey on Income and Living Conditions (TF) AAA: FY13-15 Poverty and Social Impact Analysis

Country Devt. Goals	Issues and Obstacles	Outcomes the WBG Program is Expected to Influence	Milestones	WBG Program
and equality	social pillar. Knowledge on gender is not integrated into the WB program and requires mainstreaming across the WB portfolio.	New projects prepared under this CPS mainstream gender in their design and monitoring.	Gender implications are taken into account in project design and on the ongoing policy discussions.	AAA: FY12-13 Regional Monitoring and Evaluation (TF) AAA: Western Balkans Programmatic Gender Monitoring
		Environmental Sustainability		
Improve environmental condition in the Bor region	The Bor region is among the poorest in Serbia, with high unemployment rates. The region's economy has been historically dominated by a copper mining and processing complex known as RTB Bor. This complex is operating with obsolete technology and high production costs, and continued operations with the existing circumstances are extremely harmful to the environment.	Address urgent environmental and social legacy issues arising from mining sector restructuring and promote new sources of economic growth and job creation in the region. Indicated by: (i) Improved environmental conditions in the areas associated with past and present mining operations; (ii) Improved capacity to monitor environmental conditions	Finalization of designs for the collector and remediation works. Procurement and implementation of works contracts – collector and remediation works. Remediation of the tailings pond and construction of the new collector. Operationalization of environmental monitoring plan. Commissioning the upgraded smelter[26]. Full utilization of remaining budget under labor redeployment component. Establishment of business incubator in Majdanpek. Continued increase in disbursements under the microfinance program, in line with challenging market conditions.	Current portfolio: FY08 Bor Regional Development project (P092999)
Improve Energy Efficiency	Serbia is one of the most energy inefficient countries in ECA. It has enormous potential to realize fiscal savings, improve competitiveness, and move toward EU standards.	Improve energy efficiency in public buildings to lower the heating bill and improve health and environment for users.	Realize energy savings in schools, reaching 207kWh/Sq.meter; and in hospitals, with target of 231kWh/Sq. meter. Reduce CO2 emissions by 42% on average for hospitals and schools. Improve air quality through reductions of emissions at Clinical Center.	Current Portfolio: FY04 Energy Efficiency (P075343) IFC advisory and financing energy efficiency and renewable energy projects

[26] In order to meet an implementation covenant from the Financiang Agreement, the GOS has decided to facilitate investment in the RTB Bor's Smelter and bring it in line with Serbian environmental standards. While this is not a project funded activity it is important for improving environmental conditions in Bor.

Annex 2: Completion Report

SERBIA: COUNTRY PARTNERSHIP STRATEGY FY08 – FY11

COMPLETION REPORT

1. This report is a self-evaluation by the World Bank of the experience in implementing the Republic of Serbia Country Partnership Strategy (CPS) covering the period from FY08 to FY11. The main objectives of the report are threefold:

i) examine the performance of the CPS program and progress towards achieving country goals;
ii) assess the performance of the World Bank in delivering the CPS program; and
iii) derive lessons from the implementation of the CPS program that will be taken into consideration for the design and implementation of the new CPS for the period FY12 - FY15.

I. SUMMARY OF FINDINGS

2. ***Overall, CPS program performance is assessed as moderately satisfactory: the CPS was well aligned with Serbian national development goals and addressed key developmental priorities, but implementation was affected by unforeseeable internal and external factors.*** The CPS was – appropriately -- designed within the framework of Serbia's strategy for integration with the EU, a widely-shared goal among Serbian political parties as well as the general public. CPS interventions were focused on areas where the Bank could add value by virtue of its international and regional knowledge or past experience in Serbia itself. However, while some aspects of the CPS program were extremely successful (inter alia, the DPL program, real estate cadastre and energy efficiency interventions), it was affected in a number of cases by a set of ***challenging internal political developments*** which arose at the beginning of the CPS period, in turn, leading to implementation delays. In the first instance, new presidential elections, the declaration of independence by Kosovo (formerly a part of Serbia), and parliamentary elections led to widespread political uncertainty for an extended period and contributed to an 18-month delay in the ratification by parliament of five Bank operations approved at the end of the previous CPS period, which were key to the achievement of some CPS outcomes. The same political factors also distracted decision-makers' attention from the implementation of projects already in the portfolio, thereby delaying the achievement of results in some instances. Moreover, the formation of the government by a complex coalition comprised of 13 political parties frequently affected project implementation, most prominently in cases (such as the Corridor X project) where it was necessary to reach agreements among government institutions headed by officials representing different coalition partners with divergent philosophies.

3. ***The impact of the global crisis in 2008-2009 also led to some setbacks and caused the Government to turn its attention to emerging challenges and reorder some priorities, although the overall goals and direction of reforms remained unchanged.*** Serbia suffered a deep recession characterized by a 3.1 percent decline in GDP in 2009 and sharp drops in private investment, consumption and public revenues. Policy-makers' attention thus understandably shifted to stabilization of the economy, principally through negotiating a Stand-by Arrangement with the IMF. It also turned to the Bank for assistance with related structural reforms including public expenditure management, further business climate enhancements and financial sector strengthening (including crisis management). The Bank responded through a combination of new DPL lending and analytical work for fiscal management-- undertaken in close partnerships with the EC, EBRD, EIB and the IMF -- which was additional to the original CPS program.

4. ***Despite the unforeseen developments affecting CPS outcomes in some instances and the CPS program itself in others, the overall program is judged to have achieved moderate success across each of the three pillars identified in the CPS and CPS Progress Report.*** While most expected outcomes were only partially achieved, there was good progress with regard to several key reform areas – notably, restructuring and privatization of socially-owned enterprises, energy efficiency, cadastre/property registration, financial sector strengthening, capital markets development and debt management, budget administration, pension system sustainability, and the reduction of pollution flows to the Danube. On the other hand, the reform process faced significant obstacles over the CPS period in some important areas such as energy sector reform, remediation of environmental hazards in the Bor region, and the development of irrigation and drainage schemes (due to a four year delay in the adoption of the underlying framework Water Law). Additionally, although works began on the economically important Corridor X highway there have been some implementation delays. Nonetheless, given that end-results were only planned to be achieved in the next CPS cycle, and most implementation problems have been resolved, it is likely that project outcomes will materialize with only a relatively short delay.

5. ***The World Bank's performance in delivering the CPS program is assessed as satisfactory***. Especially noteworthy was the Bank's quick response to Serbian requests in the face of the global crisis and the flexibility that it demonstrated in adjusting lending, including increasing the original CPS allocation of US$600 million by US$300 million in November 2009. About half of the total (revised) CPS allocation of US$900 million was directed towards budget support through two series of development policy operations (DPOs) in order to support reforms in privatization and the financial sector, as well as to strengthen public expenditure management. The sizeable Policy Based Guarantee operation ($400 million) undertaken within the Privatization and Financial DPL series also helped boost market confidence in Serbia during a critical period. During FYs09 and10 the Bank approved three investment operations in social services, health and roads, totaling about US$448 million – all important priorities in Serbia's development agenda. More recently, the Board approved a $5 million loan to support Serbia's participation in the regional Catastrophe Risk Insurance Facility, which should help protect individuals and businesses as well as reduce fiscal pressures arising from natural disasters.

6. ***IFC first focused its support in two major areas: (i) facilitating restructuring and ownership change in the enterprise sector; and (ii) helping Serbia to improve its competitiveness.*** In the CPS Progress Report, IFC has reprioritized its short-term objectives. The global financial crisis led to a shift to the banking sector with a focus on supporting the systemic banks to survive the crisis. Also, through its investments and advisory services to selected Serbian banks, IFC assisted critical and most vulnerable segments of the economy such as micro, small and medium size enterprises and agriculture sector. In the real sector, IFC focused on supporting its existing portfolio clients, low-cost producers and regional market leaders helping them survive through the crisis and when possible expand their operations. IFC supported 11 projects investing US$455 million (US$351 million its own account and US$104 million through mobilization) including about US$209 million in the financial sector and over US$246 million in the real sector.

7. ***Key lessons and recommendations for the new CPS*** can be summarized as follows**:**

- The emphasis on reform areas associated with EU Integration should be maintained, given the wide political and popular consensus on the EU perspective for Serbia
- DPLs underpinned by high quality analytical work are an important tool in effecting change in the Serbian context, including by helping to define a comprehensive reform program and to maintain the commitment of diverse actors
- Investment operations are most successful when relatively narrowly focused on a few related objectives and when primary responsibility for implementation rests with a single agency
- Institutional arrangements and implementing agencies' commitment to project activities should be carefully considered during preparation; additionally, attention should be paid to the availability of adequate dedicated staff resources on both the Government's and Bank's sides to carry out implementation activities in a timely way
- Steady consolidation of the portfolio with a focus on fewer, larger projects is likely to help maintain focus and ensure attention from high-level officials; strengthening the Ministry of Finance's coordination role and support function vis-à-vis the implementing agencies could also improve portfolio performance
- Close coordination with the EC, other International Financial Institutions (IMF, EBRD, EIB), and bilateral partners is vital to maintaining the momentum of the reform agenda and reducing strain on limited capacity
- The Results Framework, and monitoring and evaluation should be strengthened in the next CPS and careful attention should be paid to the availability of appropriate instruments to support the achievement of stated outcomes

II. PROGRESS TOWARDS ACHIEVING COUNTRY GOALS

8. ***The strategic setting for reforms in Serbia is defined in large measure by the country's goal of achieving integration with the EU.*** The 2008 National Plan for Integration (NPI) is the core strategic document that defines Serbia's agenda for achievement of integration with the EU – the country's overarching development objective -- and clearly lays out the key priorities for the harmonization of Serbia's institutional and legal framework with EU requirements. In December 2010, the Government also adopted an action plan aimed at gaining EU candidate status by end-2011. Some progress towards the goal of EU integration was apparent during the CPS period. In late 2010 the EU Council decided to forward Serbia's application for EU candidacy to the EC for an opinion and provided the Serbian Government with its questionnaire -- responses to which will form the basis for an assessment by the EU on Serbia's readiness for integration into the EU. Shortly thereafter, in January 2011, the European Parliament ratified the SAA (Stabilization and Association Agreement) with Serbia.

9. ***The Bank Group's strategy for this CPS period was fully consistent with the Serbian Government's development strategy as set out in the Poverty Reduction Strategy (PRS), EU integration strategy, and the 2008 Budget***. The Government's strategy laid out the key aims of: (i) maintaining macro-economic stability, (ii) promoting dynamic private sector led growth through accelerated economic reform, and (iii) increasing employment and living standards and encouraging more balanced regional development. The CPS program seeks to further each of these goals directly through Pillars I and II, aimed at promoting private sector-led growth and broadening opportunities on both an individual and household basis. Its third pillar, aimed at better management of environmental and disaster risks, is also recognized as a key component of sustainably accelerating growth and reducing risks to in households and businesses.

10. ***Despite the financial crisis, the government maintained macro-economic stability, thanks to the adoption of appropriate fiscal and monetary policy and structural reforms in the financial and public sectors.*** As in other Central and Eastern European countries, Serbia's public revenues suffered a sharp blow as a result of the global crisis. General government revenues in 2009 declined by 9 percent in real terms compared to 2008, causing the fiscal deficit to jump from 2.6 percent of GDP in 2008 to 4.3 and 4.5 percent of GDP in 2009 and 2010 respectively, despite severe spending cuts. The authorities responded with a fiscal adjustment package, supported by the IMF through a new Stand-By Arrangement (SBA) and the Bank through its ongoing macro dialogue in the context of the PE and PF DPL series and new analytical work aimed at containing expenditures (Doing More With Less FY09). A large and balanced fiscal adjustment package formed the core of the reform program and aimed to contain the deficit to sustainable levels through a number of bold measures, including, notably, a freeze on wages and pensions in nominal terms and outright cuts in subsidies and capital expenditures. In addition, Fiscal Responsibility Legislation (FRL) enacted in December 2010, set the medium-term deficit target at 1 percent of GDP, and outlined wage and pension indexation formulae up to 2015. The FRL also set numerical targets for the deficit for the medium term, and placed a cap on public debt (currently 45% of GDP). To stabilize the financial system, the

Government and the National Bank of Serbia (NBS) -- in close cooperation with the banking community, the Bank, other IFIs, and the EU -- mounted a coordinated response, which resulted in strengthened deposits. Deposits now stand at over €6.2 billion, exceeding their pre-crisis levels.

11. ***There were also notable improvements, albeit slow, in public financial management during the CPS period.*** In 2009, the Treasury instituted a modern, integrated information system incorporating a single chart of accounts used by all cost centers and now controls payments through a single account in the National Bank of Serbia. The organic Budget Systems Law was refined in 2009 and 2010 to incorporate improvements in budgeting, accounting, financial control, internal auditing, debt management and fiscal responsibility and many of these changes are now under implementation. The Public Procurement Law has also been updated but considerable work is still needed on by-laws +and administration as well as on strengthening of institutional capacity for procurement. The State Audit Institution performed its first audit of the final accounts for the Republic of Serbia for 2008 with only limited success but has since improved its performance as evidenced by the completion of a more comprehensive and thorough audit of 2009 final accounts. Work on 2010 accounts is now ongoing. A step forward was made towards the use of country systems in the area of financial management, since an assessment conducted in 2010 concluded that the Treasury system and the National Bank as the agent are sufficiently effective and reliable to be used for flow of funds on the World Bank supported project. The practical move towards this shift is envisaged in the short term.

12. ***Although growth was negatively affected by the global financial crisis, the government achieved satisfactory progress with respect to improving the business environment and reforming the enterprise sector.*** The rapid pre-crisis growth of the Serbian economy (5% per year during 2001-2008) was followed by a sharp recession in 2009 (GDP decreased by 3.5%) in the wake of the global financial and economic crisis. However, 2010 data indicate that GDP growth rebounded to 1.8 percent, suggesting that a private sector-led economic recovery is gaining momentum. This relatively quick rebound is at least partially related to the actions taken by the Government over 2008-2010 to improve the business environment. Key measures adopted include the following: (i) establishment of a one-stop shop for business registration to simplify business entry; (ii) adoption of a new Law on Business Entities to strengthen corporate governance; (iii) improvement of the legal and institutional framework for competition through adoption in 2009 of a new Competition law; and (iv) passage of a new Enforcement Law, thereby significantly improving the effectiveness of contract enforcement. Further, a comprehensive regulatory review was completed on the basis of which the government adopted 304 recommendations to amend laws and regulations and eliminate 192 unnecessary regulations with the aim of reducing the regulatory burden on business. Implementation is underway. Finally, the government is conducting regulatory impact analysis of new laws affecting business.

13. ***Government also remained committed to improving transport and trade logistics, despite the severe fiscal pressures deriving from the impact of the global crisis***. For example, in order to complete the missing links on a crucial highway, Corridor 10, the Government sought and obtained financing of €1.58 billion, including US$388 million from the Bank. Finally, it should be noted that there was considerable progress on the privatization agenda during the CPS period. A controlling

stake in one of the largest state-owned enterprises, the Naftna Industrija Srbije (NIS - state oil company) was sold, and two other large enterprises, the state telecoms company and Galenika, a state-owned pharmaceutical company, were offered for sale. The government also moved forward rapidly on its commitment to restructuring and privatize the entire portfolio of socially-owned enterprises, leading to the privatization or other resolution of about 600 enterprises, despite setbacks resulting from the 2009 drop in economic activity.

14. ***Significant improvements were achieved with regard to building a more stable, efficient and resilient financial sector.*** The Parliament enacted amendments to the Law on Banks, the Law on Bankruptcy and Liquidation of Banks and Insurance Companies, the Law on Deposit Insurance, and the Law on Deposit Insurance Agency. Additionally, the Government approved new amendments to the Law on Insurance with provisions which will result in converting the ownership of Dunav – a very large insurance company with market share of 28 percent -- from social to state, and mandate the commencement of Dunav's privatization by 2013.

15. ***Although neither employment nor living standards increased over the CPS period, there was a strong push for fundamental reform of social assistance and pensions, as well as important changes in the health and education sectors.*** The deceleration of economic growth that resulted from the global crisis and recession led to an upsurge in poverty. Poverty increased from 6.1 in 2008 to 6.9 percent in 2009, and further, to 9.2 percent in 2010, equivalent to a total of 220 thousand people sliding into poverty during the two crisis years, according to the Household Budget Survey (HBS). Growing unemployment (from already high levels) has been an important transmission channel; unemployment reached 20.0 percent in October 2010. However, the government ensured that social safety nets programs for the poor and vulnerable were protected from the fiscal spending cuts necessitated by the crisis. Furthermore, the newly- adopted Social Assistance Law contributed to scaling up of the MOP (Material Support for Low Income Households program) and laid the ground for improving the effectiveness and impact of social assistance by linking 'passive' cash transfers with social care, employment and activation services, and putting employment integration at the very heart of social policy. Some tough decisions were also taken to ensure the fiscal sustainability of the pension system. These included a freeze on pensions in 2009 and 2010, and the enactment of amendments to the Pension Law, which, on the one hand, decreased the number of benefits per pensioner, and, on the other, increased the minimum pension to better protect the most vulnerable elderly groups. Reforms in the health and education sectors had the impact of increasing health and education coverage at the local level, rationalizing the schools network, and laying the groundwork for implementation of capitation-based financing for health.

III. CPS PROGRAM PERFORMANCE

16. ***The CPS was designed in a flexible way to maintain targeted, timely, and responsive assistance to support Serbia's transition to the EU and allowed for course adjustments to respond to emerging needs (e.g. the global crisis).*** The main objectives of the CPS were three-fold, all fully

aligned with government priorities: (i) encouraging private sector led growth and EU convergence; (ii) providing opportunities and broadening participation in growth; and (iii) managing environmental and disaster risks.

17. ***Serbia's rapidly changing political environment affected CPS implementation***. On January 20, 2008, two months after the World Bank Executive Board discussed the CPS, Serbia held first round presidential elections. In February 2008, President Boris Tadic from the pro-European Union (EU) Democratic Party won a majority. Two weeks after the presidential elections, Kosovo declared independence, leading to the dissolution of Parliament and the scheduling of new parliamentary elections for May 2008. On May 11, buoyed by broad domestic support for EU membership, President Tadic's Democratic Party scored a significant victory but fell short of an outright majority, in turn. The President subsequently reached out to smaller parties (including the Socialist Party), and assembled a pro-reform governing coalition by June. This resulted in substantial delays in the ratification by Parliament of Bank projects, particularly five operations that had been approved by the Board towards the end of the previous CPS period. As already explained, as a result of widespread political uncertainty, these operations--Bor Regional Development Project, Transitional Agriculture Reform Project, Additional Financing for Transport Rehabilitation Project, Additional Financing Energy Efficiency, and Additional Financing Irrigation and Drainage Rehabilitation Project -- required nearly 18 months to be ratified by Parliament after their signature in July 2007.

18. ***Overall, the CPS achieved moderately satisfactory progress as summarized at the outset of this report (para 1).*** Figure 1 below provides a summary of the extent of achievement with respect to each indicator included in the matrix.

Figure 1: **CPS Program Performance**

CPS Pillars	CPS outcome areas	CPS implementation progress		
		Not achieved	*Partially achieved*	*Achieved*
Pillar I: Encouraging private sector led growth and EU convergence	Privatization and restructuring of socially-owned enterprises		✓	
	Restructuring and privatization of large state-owned enterprises.			✓
	Research and development			✓
	Business registration		✓	
	Independent and efficient judiciary		✓	
	Property registration			✓
	Divestment of remaining financial sector holdings		✓	
	Crisis management framework			✓
	Capital markets development and debt management			✓
	Corridor X Highway	Not observable		
	Road network and road safety		✓	
	Financial sustainability of the energy sector	✓		
	Electricity market access		✓	
Pillar II: Providing opportunities and broadening participation in growth	Government spending		✓	
	Economic opportunities in Bor and Resavica	✓		
	Strengthen MAFWE's budget administration			✓
	Irrigation and drainage	✓		
	EU compliant agricultural systems		✓	
	Sustainable pension system			✓
	Social service quality and access		✓	
Pillar III: Managing environmental and disaster risks	Remediation of urgent environmental hazards	✓		
	Energy efficiency		✓	
	Reduction of pollution flows to Danube			✓
	Reduction of risk of damage and loss of life from flooding		✓	

Priority I: Encouraging private sector led growth and EU convergence

<u>Rationalizing SOEs</u>

19. ***Despite the impact of the economic slowdown which caused some setbacks, positive results were achieved with respect to the liquidation, restructuring and privatization of Socially-Owned Enterprises (ScOEs) and (generally larger) State Owned Enterprises (SOEs) over the CPS period.*** Government, supported by the Bank's PFDPL program and related analytical work, placed high

priority on the divestiture of its extensive portfolio of some 1,000 ScOEs. Specifically, legislation was passed requiring completion of the ScOE privatization process before end-2008, by mandating that companies for which privatization had not started would automatically be closed. Consequently, over 2008-2009, 430 were sold for about €362 million, and 162 ScOEs were sent to bankruptcy in 2010. As a result, by the end of 2008, virtually all of the country's ScOEs had been readied for privatization or publicly offered. Unfortunately, however, the timing of the latter stages of this process coincided with the onset of the global financial crisis, depressing the uptake by the private sector of the tenders. Moreover, throughout 2009, many previously-awarded privatization contracts (about 91) had to be cancelled since private investors, hurt by the global recession, failed to fulfill their contractual obligations. Most of these ScOEs were returned to the Privatization Agency's portfolio – and converted to SOEs in accordance with the law -- in order to undergo a new resolution process. Nonetheless, the privatization/resolution of ScOEs continued since 2007 leaving the Privatization Agency with a substantially reduced portfolio of about 450 ScOEs and SOEs in early 2011 (excluding 193 for which privatization contracts had to be cancelled). The Government also began the process of corporatizing SOEs with aim of eventually privatizing selected enterprises (e.g., the national airline, the state telecoms company and several others) during the CPS period. Thus far, a 51 percent stake in the state oil company has been sold to a foreign investor and steps have been taken to ready the telecoms company and a state-owned pharmaceutical company for eventual sale. In addition, the Government is moving forward with a plan to carve out the good assets of the national airline and transfer them to a new company that it will offer for sale.

20. ***Partly as a result of the steps taken to liquidate or privatize ScOEs and SOEs, the government was able to make some headway in its effort to reduce the level of state budget subsidies to SOEs and ScOEs.*** Subsidies from the Ministry of Economy and Regional Development to state- and socially-owned enterprises, which stood at 1.9 percent of GDP in 2007, had declined to 0.8 percent of GDP by 2010, freeing up resources for other priority expenses. Subsidies to ScOE's amount to only about 15 percent of the total subsidies provided, reflecting the superior progress made in the resolution and privatization of these businesses vis a vis SOE restructuring/privatization.

21. ***The CPS program also helped introduce a new model of funding for Research and Development (R&D), aimed at strengthening the role of demand in the choice of R&D priorities.*** The main change is a shift away from direct financing of R&D Institutes to providing the funding to companies, which, in turn, can then purchase R&D services from the institutes or other sources. In addition, improvements were made to a number of laws and other framework documents – e.g., the Law on Innovation, the Law on Science, and the Innovation Strategy -- in order to promote greater innovation in Serbia. Moreover, with support from the Bank, the government is designing a program of institutional capacity building for the Serbia Innovation Fund (SIF), piloting financial instruments to stimulate innovative activity in enterprises, and piloting reforms in the research and development institute (RDI) sector. The program is funded via the EU Instrument for Pre-Accession (IPA).

22. ***Overall, Serbia has made substantial progress in reducing red tape for businesses and creating a business friendly environment, although some areas continue to lag.*** With the establishment of a one-stop shop for business registration within the Serbian Business Registration Agency, the process of registering a business was significantly simplified, resulting in a reduction of the time required to register a company to a maximum of 5 days by 2010. Furthermore, significant progress was recorded with respect to reducing the overall regulatory compliance burden. For example, the number of procedures needed to start a business was reduced from 11 to 7 procedures, and the time needed dropped from 23 to 13 days (DBRs 2008 and 2011). Similarly, the cost of registering property halved from 5.4 percent of the property value to 2.7 percent. The Bank supported Government's efforts to create a more business friendly environment, in part through the conduct of a Regulatory Impact Analysis (RIA), of new regulations affecting businesses. In parallel, the Government embarked on an ambitious comprehensive regulatory review exercise and has already started implementing key recommendations. By end-2010 some 79 (of 304) recommendations to amend regulations and procedures had been implemented and 192 unnecessary regulations eliminated which are estimated to result in annual cost savings to businesses of around €50.8 million. Finally, it is worth noting that Government has recently taken a decision to create a permanent institutional framework for RIA. The Bank has played a significant role in supporting the Government's efforts to reduce the overall regulatory burden compliance and to improve the business environment through a SIDA TF and the PFDPL2, and continues to support further improvements through an IDF grant. However, some processes, e.g., obtaining a construction permit, still need improvement. According to DBR 2011 it still requires 20 procedures and 279 days to obtain a construction permit, although the cost decreased.

23. ***IFC supported this agenda through completion of the first phase of the regulatory guillotine review at sub-national level to improve the business environment and sub-national competitiveness in four municipalities.*** In addition, IFC has provided advisory services to 30 companies through its Supplier Development Program, as part of the Serbia Investment Promotion Program. At sub-national level, IFC assisted 10 localities (with 0.7 million people, or 10% of the total population) to improve, simplify, or eliminate some administrative procedures. As a result, more than 98% of business related administrative procedures were abrogated or improved. More specifically, in the construction sector, as a result of the adoption of Planning and Construction law (September 2009), 60 local administrative procedures were improved or eliminated with an estimated annual savings of US$ 100 million to the private companies.

24. **IF*C enhanced corporate governance practices through implementing company-level interventions and strengthening knowledge and awareness on the importance of corporate governance at the corporate and institutional levels.*** IFC advised 18 local companies on how to improve their corporate governance practices. In parallel, IFC assisted with the introduction of the Corporate Governance Code for listed companies and provided institutional support to the Serbian Chamber of Commerce and Belgrade Stock Exchange to promote corporate governance among listed and unlisted companies throughout Serbia. IFC promoted assessment of corporate governance

practices among banking institutions. As a result of improved corporate governance practices, local companies were able to raise US$ 72 million in financing.

Strengthening financial sector intermediation

25. ***An area of notable progress during the CPS period relates to creation of a more efficient property market through improvements in both registration and financing.*** With support from the Bank-financed Real Estate Cadastre Project (FY04), the Government has designated cadastre municipalities covering 88 percent of the country's total physical space. The Real Estate Cadastre (REC) is currently fully operational in 92 percent of cadastre municipalities (CM), and the remaining 8 percent will be covered by Dec 31, 2011. The process is already well underway in these remaining municipalities since REC public display has already been initiated, implying that outdated land books are no longer in use, and only REC can register transaction and issue ownership certificates. The availability of secure land titles has already had a substantial effect on the use of mortgage backed financing. In 2007, mortgage financing was provided for only about 5 percent of all property transactions and that figure had increased more than six fold to 31 percent of all transactions by the third quarter of 2010. The Bank was instrumental in achieving these positive outcomes through its support for the Real Estate Cadastre project that was under implementation throughout the CPS period and is expected to close in October 2011.

26. ***The Government also made clear headway in restructuring the financial sector and strengthening the regulatory regime underlying the banking, insurance, and securities sectors.*** Partial success was realized in Government's effort to fully privatize public financial sector holdings, although the advent of the global financial crisis in late 2008 caused some setbacks to the original plans. With support from the FY11 PFSPBG, the Government moved forward with consolidating the majority state-owned banking sector. Of the four majority state owned banks, Credy Banka was sold to a private foreign group, Postanska and Privredna Pancevo were merged, and Srpska Banka remains as is. As a result, the number of majority state-owned banks is currently 2 (versus 4 at the start of the CPS period). By Q3 of 2010 majority state-owned banks' share had decreased to 1.9 percent. In addition, the state continues to have minority stakes (20-30 percent) in 5 banks. Efforts to sell these stakes through the stock market proved unsuccessful in the wake of the economic slowdown generated by the global financial crisis.

27. ***The performance of the insurance sector has improved since 2008 thanks to improved supervision that led to the exit from the market of loss making insurance companies and the entry of foreign players.*** One large state-owned company, DDOR Novi Sad, was sold to the Italian Fondiaria, which substantially improved the performance of the company. In addition, Dunav, a state-owned insurance company accounting for 28 percent of the market, has initiated restructuring measures to improve its performance. However, Dunav's underwriting performance is still lagging and some of its policies (e.g., substantial reductions in premium rates in the motor third party liability business) continue to distort the market. In light of the possible market distortion, the Government has committed to future privatization of Dunav, which will, inter alia, require transformation of the company from a social-owned to a state-owned entity. To reduce the potential for systemic risk in the

sector, the Law on Insurance has already been amended to require the separation of life and non-life insurance businesses by the end of 2011. Moreover, additional legal amendments to the Law are underway, that will define the process by which this transformation (from social to state ownership) can be achieved and commence the privatization of at least 20 percent of state-owned capital in insurance companies by the end of 2013.

28. ***The onset of the global financial crisis in late 2008 prompted the Government to request the Bank's assistance in developing and implementing an appropriate crisis management framework***. In response to this request, the Bank undertook both an FY10 FSAP update and FY10 Crisis Preparedness Assessment to ensure an adequate analytical basis for reforms. As a result of the Crisis Preparedness Assessment and related TA, and supported by the Private and Financial Sector Policy Based Guarantee (PFPBG) the NBS has supported a stress testing exercise for banks, strengthened the deposit insurance, and enhanced the bank resolution framework. The Deposit Insurance Agency now has: (i) access to adequate information to ensure a fast payout; (ii) up-to-date payout procedures and tested software; and, (iii) swift access to emergency funding sources. Moreover, a diagnostic methodology was developed through the FSAP update TA, and is being applied regularly. Based on this methodology, the banking sector as a whole has a capital adequacy ratio of over 20 percent (September 2010). Serbia, with Bank support, has also successfully put in place all the legal amendments required to institute an effective, new bank resolution framework. These measures, and particularly implementation of the activities related to Deposit Insurance and bank assessment early in the crisis, clearly contributed to halting an incipient run on banks in the wake of the global crisis, and subsequently, to the actual reversal of deposit outflows.

29. ***The Bank also supported capital markets development and debt management over the period of this CPS***. The government established a Public Debt Management Administration and initiated preparation of a debt management strategy to improve rates and maturities, increase the proportion of debt denominated in local currency and smooth future repayments. Although progress in developing the municipal bond market was hampered by the financial crisis, steps were taken to strengthen the coordination mechanism between the MoF and NBS, resulting in improving the issuance of government securities. Further, the maturity of T bills has been extended gradually from 3 months to 6, 12, 18 and 24 months in 2010. Finally, the CPS period saw improvements in the procedures established by the Public Debt Management Administration and the IT system, risk assessment methodology, and overall debt management strategy and borrowing plan were substantially strengthened.

30. ***The World Bank Group also responded in a coordinated fashion. With the EBRD and EIB, it launched a joint action plan in February 2009 to support the banking and real sectors of each of the European countries in which these international financial institutions operate.*** A subsequent conference was held in March 2009 in Vienna among the Serbian authorities, the IMF, IFIs, including IFC, and key European banking groups with the objective of developing a 'holistic' joint-IFI strategic approach to tackle the financial crisis in Serbia. Within this context, IFC focused on supporting existing clients both with capital investments and term funding and developing and

implementing capital support programs for the major banks in the country to promote systemic stability. Also, through investments and advisory services to selected Serbian banks, IFC assisted critical segments of the economy such as micro, small and medium size enterprises and agribusiness sector.

31. ***IFC invested US$69 million in equity to support bank capitalization, including:*** (i) US$21 million in capital increase to a bank supporting small and medium enterprises (SMEs) and mortgage financing; (ii) US$11.7 million to strengthen the capital of another bank and support its lending activities to the MSME segment; and (iii) US$36.4 million equivalent preferred share investment in the largest state-owned bank to help capitalize the bank and extend support to the SME sector. Also, IFC provided US$140 million loans to four other banks strengthening their financial capacity to extend much needed term funding to the agribusiness and SME sector during the global financial crisis. In addition, right after the financial shock in September 2008, IFC injected liquidity in the banking sector by disbursing US$30 million to two financial institutions.

Infrastructure development

32. ***Investments in the transport sector led to improvements in the condition of the road network and better road safety over the CPS period.*** The Bank-financed Transport Rehabilitation Project (FY04) made solid progress *vis a vis* its targets**.** Under the project**,** over three hundred kilometers of priority sections of the primary and secondary road network were rehabilitated with the impact of (i) lowering roughness to an average on the rehabilitated sections of 3.7 on the IRI scale from the baseline of 5, (ii) achieving an average reduction in vehicle operating costs of 14 percent to date, and (iii) addressing 15 accident black spots. Additionally, as a result of the introduction of performance-based contracting in two pilot regions, there was a cumulative reduction of 40 percent in the unit costs for maintenance activities. With respect to road safety, data are also encouraging: road crash-related injuries dropped by about one-third in the two pilot regions. Measured results with respect to road crash related fatalities are inconsistent across the two pilot regions. While a reduction of 22 percent in road crash related fatalities was recorded in Kolubara region in 2010 compared to 2009, there was an increase of 10 percent in Macva. Given the relatively small numbers of accidents and fatalities, however, it is difficult to assess the impact of the road safety improvements over such a short period. Data will have to be monitored over at least a 3-5 year period to better understand the outcomes achieved as a result of recent road improvements. In addition to physical improvements to the roads, the Bank also undertook a comprehensive Road Safety Management Capacity Review (FY08) to help Government identify the key elements of regulatory and institutional reforms needed to support better road safety. Key recommendations of this Review were fully incorporated into a new law on road safety, which was adopted by the Serbian Parliament in December 2009, and a new lead agency established to better coordinate and deliver road safety improvements. Technical assistance is now being provided through the Corridor X Highway Project (FY10) to assist in the establishment of a Lead Agency and develop a results focused road safety strategy.

33. ***Construction of Corridor X, a crucial highway connecting Serbia with Bulgaria and Macedonia, faced some start-up delays but is now back on track; the project is likely to achieve its results in the next CPS cycle, as planned***. Although the highway is an extremely high priority for the Government from the standpoints both of creating employment as well as lowering the costs of, and promoting, economic activity, substantial delays were encountered in implementation, reflecting initial uncertainty within Government about institutional responsibility for the project and whether the establishment of a free-standing unit was warranted. Moreover, delays were encountered in finalizing technical aspects and related procurement documents, reflecting the delay in the operational establishment of the new unit, a lack of institutional coordination in Serbia, and inadequate resources (both within the Bank and in Serbia) in dealing with the volume of work involved. At this point, all detailed designs for the highway have been finalized, procurement of major contracts has been processed, and Government has addressed most expropriation issues In light of these developments, works are expected to begin shortly and last for about two years.

34. ***Progress in the energy sector was very limited over the CPS period, and further structural reforms of the sector and investments in generation capacity are needed.*** Although the electricity markets in Serbia are liberalized in accordance with the ECSEE treaty, and the quality and efficiency of the bulk power transmission system were improved (three new 110 kV substations and interconnecting transmission lines have been constructed and are in full operation through the Bank-financed ECSEE APL2 project), there was little progress on restructuring of the electricity supply company (EPS) and on efforts to attract private investments in new generation capacity. Though collection rates (around 94%) are reasonably robust, tariffs in Serbia remain well below full cost recovery and investment needs and about one-third of EU27 average prices. It is worth noting however, that although the CPS sought results with respect to EPS restructuring and private generation capacity that were important for Serbia's development, no appropriate instrument was included in the program to support the achievement of these outcomes. The Bank's role in electricity was relatively narrowly limited to the construction of power lines to facilitate the development of a regional electricity market, thereby limiting its influence on broader sectoral reforms.

Priority II: Providing opportunities and broadening participation in growth

<u>Improving efficiency and accountability in public spending</u>

35. ***In parallel with its efforts to control expenditure to respond to fiscal pressure, the Government also made some progress in improving the quality of budget planning/management and rationalization of social sector spending during the CPS period.*** One outcome foreseen in the CPS – which has not yet materialized -- was a move from an annual to a three-year budget. Nonetheless, a number of steps were taken to improve public fiscal management including: (i) reform of the Budget Systems Law; (ii) improvements in financial control, accounting and reporting; (iii) strengthened debt management; and (iv) institution of a medium term focus for fiscal planning and budget preparation. Moreover, building on recommendations of AAA on pensions undertaken by the Bank as part of the Public Expenditure Review, Doing More with Less (FY09), a new Pension Law was enacted to introduce parametric changes to the public pension system, which will put pension

expenditures on a more sustainable path. As a result of the reforms, transfers to the pension fund are projected to decrease gradually, falling below 5% of GDP by 2015 (from 7.3% in 2010). A new Social Assistance Law was also adopted by the parliament in March 2011. The new law would improve the access of vulnerable groups to social assistance by applying equivalence scales for MOP (Material Support for Low Income Households Program) in accordance with prevalent EU and OECD practices. Budget allocations for the MOP have been adjusted accordingly. To increase efficiency in health, Government has approved, and submitted to parliament, an amendment to the public sector wage law that would allow health care staff to be paid, in part, on the basis of the number of patients they serve. PER recommendations with regard to the education sector focused on rationalizing school size in line with the students served. Following on the recommendations of the analysis, Government closed 658 classrooms (1.4% of the total) for school year 2009/10. A further 533 classes have been closed thus far in 2011

36. ***Virtually no headway was made on the CPS goal of increasing economic opportunities in the depressed areas of Bor and Resavica.*** Due to significant delays in gaining parliamentary approval of Bor Regional Development Project and a subsequent suspension of the project due to Government's inability to upgrade an outdated smelter, implementation activities began only towards the end of the CPS period, so that results will only materialize in 2-3 years. The planned Resavica Restructuring Project was dropped as Government was unable to proceed with restructuring and privatization/resolution of the Resavica Coal Mining Enterprise, particularly given the 2009 recession. More generally, however, IFC supported more balanced regional development through an Investment Climate Advisory Project on Sub-National Competitiveness, which addressed the business enabling environment in four municipalities. Regulatory reform yielded savings in cost and time of more than US$95 million in all localities. Cities were included in each region, and three of the ten partner localities were in frontier regions.

Agriculture sector strengthening

37. ***Substantial results were achieved in reducing and rationalizing agricultural subsidies.*** Spending on agriculture market support – including for milk, exports and warehousing -- fell sharply over the CPS period, declining from 30 percent of the MAFWM budget in 2007 to just 10.6 percent by 2011. Currently the largest form of agricultural subsidies (33.7% of the MAFWM budget) consists of the so-called "de-coupled area payment" which mirrors EU practice under the EU's Common Agricultural Policy (CAP). The decoupled area subsidy consists of a standard payment (equal to €120 per hectare) to every registered farmer, up to a maximum of 100 hectares. As of 2008, full time farmers are eligible to receive the subsidy only if they contribute to the pension system.

38. ***Delays in adopting a new Water Law hampered progress on planned irrigation construction and rehabilitation interventions.*** A key precondition for development of irrigation schemes under the Bank-supported Irrigation and Drainage Rehabilitation Project (FY06), was the adoption of the new Water Law to provide a legal basis for the creation Water Users Associations (WUAs) and the designs for rehabilitation and construction of new irrigation schemes. Adoption of the Law was, however, subject to a delay of nearly 4.5 years due to the lack of political consensus.

As a result, work on the development of irrigation schemes could start only after approval of the law in May 2010 and is expected to continue up to early 2013 – implying that the results associated with this activity will only materialize in the next CPS period.

39. ***The slow pace of the EU integration process for Serbia affected efforts to improve agricultural systems as well as Serbia's ability to meet EU standards and tap into EU export opportunities.*** A Rural Development Strategy was developed and a supporting law approved. Within this framework, the Ministry of Agriculture Forestry and Water Management (MAFWM) has developed an IPARD-oriented National Rural Development Program (NRDP). A Rural Payment Agency (RPA) was established in late 2009 and manages a Government of Serbia (GoS) agriculture and rural development incentives programme. Payments are initiated through the treasury administration system from about 140 offices nationwide. The MAFWM Sector for Rural Development (SRD) is managing the rural development process which, prior to Serbia gaining EU candidate status, aims to establish an IPARD-like management structure including a Managing Authority (MA) and Monitoring Committee (MC). Although the MA has not yet been legally established, its prototype is operational. The establishment of a Monitoring Committee (MC) is in a very early stage. There is an ongoing process of setting up an Inter-ministerial Council an Expert Group and a Council for Farmer's Association.

40. ***IFC focused on supporting its existing clients, low-cost producers and market leaders helping them weather the crisis and expand their operations.*** IFC invested in one of the leading food companies in the region to provide working capital and help finance its urgent capital expenditure investments. Also, IFC invested in another leading company in the region to complete its investment in a new particle board production plant. Through its investment in a Serbian private sector group, with interests in manufacturing, agribusiness, and mining sectors, IFC helped the company restructure its balance sheet, improve the risk profile, and continue its export oriented growth. In addition to its own financing, IFC successfully mobilized long-term loans from other financial institutions that sent a strong positive signal at the time when the global economy outlook remained uncertain.

Protecting the vulnerable and improving social services

41. ***The pension system has become more effective and efficient.*** With the merging of the three public pension funds into a single institutional structure, administrative costs relative to pension expenditure decreased from 2.2% in 2005 to 1.5% in 2010. Perhaps more importantly, a significant improvement in the rate of collection of pension contributions was recorded between the years 2005 and 2010, as the Tax Administration collected 70 percent more funds in 2010 than it had in 2005. After an extraordinary pension increase in late 2008, which resulted in pension payments as a share of GDP jumping to 13.8 percent of GDP in 2009, pension payments were contained at 13 percent in 2010 (estimated) and are projected to continue decreasing gradually as a share of GDP. This reduction is related to reforms that Government implemented to limit pension spending growth, including a change in indexation and a freeze in pension increases. In the absence of the freeze, pension spending would have risen to 15.8% of GDP in 2010 (rather than 13.0%)

42. ***Social service quality and access were improved as was the legal framework for increasing efficiency in the education and health sectors.*** The total number of beneficiaries of the MOP or Material Support for Low Income Households (targeted last resort cash benefit program for the poor) increased 6.5 percent between 2008 and 2009 and 20 percent between 2009 and 2010, reflecting both improvements in targeting and program management and the impact of the recession on poverty. Spending on the MOP increased 22 percent and 38 percent respectively between those years. Coverage among the poorest quintile also increased, albeit slowly, going up from 7.9 percent of the poorest quintile in 2008 to 8.7 percent in 2010 (measured in the first two quarters of 2010). Moreover, the access of the poor to education has improved. Coverage of pre-school education increased from 32 percent in 2002 to 45 percent in school year 2007/08, and the percentage of (disadvantaged) Roma children attending primary school increased by 9.9 percent between 2009 and 2010. As a result of the health mediators program, family visits by Roma Health mediators increased 148 percent between 2008 and 2010, and the vaccination of Roma children increased 66 percent. Further, the PEDPL series contributed to improving the efficiency of the education sector through support for legislation that encouraged consolidation of an oversized system in line with demographic changes and the projected reduction in number of school age children. In the two years since its inception, school rationalization program has closed more than 1,100 classes throughout the Serbian education system. The PEDPL also supported the adoption of legislation to introduce a performance related payment for primary health care professionals, aimed at increasing the efficiency with which primary health services are delivered. Other health indicators also show increased system efficiency at the secondary and tertiary levels, largely due to the effective implementation of the Serbia Health Project: between 2005 and 2009 acute care hospital beds were reduced by 12 percent; discharges increased by 9.7 percent; average stay reduced by 10.6 percent, from 8 to 7.2 days; and bed occupancy rates rose from 61.6 percent to 69 percent.

Priority III: Managing environmental and disaster risks

43. ***Remediation of urgent environmental hazards, including tailing ponds and wastewater discharge in the Bor region hasn't been completed.*** The environmental management and remediation related activities were under partial suspension until December 2010 due to government's failure to raise the resources needed to bring the RTB Bor's core assets, and particularly the smelter, in line with Serbian environmental standards. However, technical designs for construction of the collector and remediation of tailings and waste sites have been ongoing during this period and works are expected to be implemented in 2012 and 2013 since financing for upgrading of the smelter has now been secured.

44. ***Significant improvements in energy efficiency were achieved in the schools and hospitals where works have been completed.*** Savings arising from the energy system conversion and modernization of the Clinical Center of Serbia in Belgrade (switch from crude oil to gas) alone has saved the budget of the Ministry of Health around 75 million Serbian dinars (about US$1 million), and allowed the Clinical Center to earn around 53 million Serbia dinars (aboutUS$600,000) through

delivery of energy to third parties. Moreover about 40 additional public buildings have been retrofitted, dropping energy consumption 40% on average.

45. ***Substantial results were achieved in reducing nitrogen and phosphorus pollution flows to the Danube and tributaries from farms and slaughterhouses.*** With the Bank's assistance through the Danube River Enterprise Pollution Reduction Project more than 100 farms and 6 agricultural high schools have adopted EU Nitrates Directive-compliant farm manure and nutrient management practices that will reduce nutrient leakage into water bodies connected with the Danube River. Three slaughterhouses and meat processing industries invested in proper waste management practices. Additionally three rendering plants were provided with specialized trucks and equipment, which will speed up the collection and processing of high-risk animal waste from slaughterhouses and farms, thus reducing environmental pollution. The annual decrease in the amount of nutrients, which are not taken up by plants and eventually flow into water courses from Project beneficiary farms, is conservatively estimated at 44 percent for nitrogen and 100 percent for phosphorus compared to the 2006 baseline levels.

46. ***IFC has supported sustainability across the region through investments and advisory.*** Through its equity investment in a regional facility (Porr), IFC financed two regional landfills in Serbia. Also, through its investment in a regional fund (GGF), IFC supported development of renewable energy and energy efficiency projects. In parallel, IFC was also active in advisory services. IFC assisted the Ministry for Environment and Spatial Planning to finalize the National Strategy for Solid Waste Management (NSSWM) and prepare the Decree on Fees for Packaging Waste Collection and Recycling. Also, IFC assisted in the preparation of a future Regional Waste Management Centre for the inter-municipal enterprise in the region of Subotica. This is a model of successful inter-municipal cooperation in the waste management sector.

47. ***Moderate results were achieved in reducing the risk of damage from flooding to land, crops, property, infrastructure, as well as reducing risk of loss of life from flooding***. As of January 2011, 16 flood protection schemes were completed covering over 60,000 ha, while work on another 9 schemes protecting over 150,000 ha with over 300,000 people is ongoing. Major works are now being tendered for these latter 9 schemes and work is expected to commence this summer/fall. Furthermore, the regional Catastrophic Risk Insurance Facility Project, which increases homeowners', farmers' and SMEs' access to financial protection from losses associated with natural disasters, recently approved by the Bank's Board, provides further protection in disaster-prone areas.

IV. WORLD BANK PERFORMANCE

48. ***Overall, the World Bank performance in designing and implementing the CPS program was satisfactory.*** The program originally identified investments in each of the three CPS priorities for FY08 and FY09, including loans for transport infrastructure, regional development, energy generation, improved social services and participation in a regional disaster preparedness initiative. A programmatic DPL series to strengthen the private and financial sector was also planned. The CPS

intended to provide substantial flexibility, with lending in FY10 and FY11 to be identified in the CPSPR based on evolving country needs. Given domestic and external developments in late 2008 and 2009, the in-built flexibility of the CPS program was very helpful in responding quickly to Government requests for program adjustments to respond to the crisis. The Government asked that an additional US$300 million be allocated for new development policy lending, which would help meet Serbia's short to medium term financing needs and complement a coordinated assistance package comprising EU and IMF assistance under the SBA. The Bank acted responsively in providing additional funds and mobilizing the technical support needed to ensure a good quality fiscal adjustment. In addition, the Government and Bank agreed to reprogram the bulk of investment lending to support a major road corridor infrastructure project (Corridor X) because of its vital economic importance and the potential of the project to provide new jobs at a time of recession.

49. ***As referred to above, the original allocation of USD 600 million included in the CPS was increased by an additional USD 300 million in November 2009.*** Half of the current Bank financing for Serbia is directed at budget support through a series of development policy operations (DPOs) and one Policy Based Guarantee (PBG). Three investment operations: Delivery of Improved Local Services Project (US$ 46.3 million); Health Additional Financing Project (US$13.5 million); and Corridor X Highway Project (US$ 388 million) were approved by the World Bank Board of Executive Directors in March 2008, March 2009, and July 2009, respectively. Finally, the Board approved US$5 million the regional Catastrophic Rick Insurance Facility Project Of the series of development policy lending operations, the Private and Financial Sector DPL series (FY09 US$ 50 mil, and FY10 US$ 100 mil,) and the Private and Financial Sector PBG (US$ 400 million) focus on supporting the Government's reform program in the areas of: real sector privatization, business environment and financial sector strengthening. The Public Expenditure DPL series (FY10 USD 100 mil, FY11 USD 100 mil), originally focused on improved systems for public sector management, and was expanded to include measures to strengthen both public expenditure allocation and social assistance in light of the 2009 recession. Coordination with the IMF and the EU has been close.

50. ***Analytical and Advisory Activities provided timely policy advice to improve the quality and sustainability of Serbia's fiscal adjustment.*** The Public Expenditure Review (PER) "Doing More with Less", the Bank's flagship AAA report in FY09, which provided useful input to the PEDPL series and the IMF SBA on ongoing sector and subsidy reforms, was followed-up in FY10-11 by just-in-time assistance to identify potential structural savings in the public sector wage bill. The World Bank supported roundtable discussions with civil society stakeholders on second-generation reforms that could form a sustainable policy framework over the medium-term. To date, discussions have addressed pensions, a volatile political issue with major fiscal implications; modernization and efficiency of the education system; and the potential for private sector participation in critical infrastructure investments. Work on the Country Economic Memorandum commenced recently, in early 2011, so its impact cannot be identified at this time. The Ministry of Finance and the other stakeholders in corporate financial reporting have actively participated in the World Bank Centre for

Financial Reporting Reform's REPARIS[27] program, aimed at assisting Western Balkans countries to improve corporate financial reporting systems and gradually implement the relevant EU *acquis communautaire*. The World Bank has provided an IDF program in FY10 and FY11 to assist in development of a national strategy for financial reporting reforms. As of May 2011 the Ministry of Finance has prepared draft laws to introduce appropriate financial reporting and statutory audit requirements required for EU integration.

51. ***Apart from the multi-sectoral and cross-cutting activities mentioned above, a number of sector-specific AAA activities were undertaken to underpin lending and provide just-in-time policy guidance***. A Road Financing Study, prepared in FY08, reviewed the administration and institutional structure of the road sector and provided suggestions to improve the revenue flow for primary, secondary and local roads. Another study examined Options for the Improvement of the Toll Regime on the Motorway Network. An FY08 Environmental Compliance Policy Note took stock of the progress Serbia had made in protecting its environment since the 2003 Kiev Environment for Europe Conference and identified medium-term actions to promote further progress. The Note focused on waste management; biodiversity conservation and energy and environment linkages. A PIEM Review helped the government to improve the system of financing of infrastructure projects through the National Investment Plan. A baseline survey was undertaken on the cost and efficiency of Serbia's Primary Health Centers (PHCs) and the results helped determine PHC payments reforms and established baselines for tracking of health sector performance. Through a FY09 Policy Note on Growth, the Bank entered in the policy dialogue on regional development and spending on human development. An FY09 Capital Markets Development TA program identified obstacles to capital market development and provided assistance in addressing priority issues -- including development of the bond market, development of an EU-oriented capital markets strategy and selected legal and regulatory reforms. The Bank also delivered TA to identify obstacles and provide advice on the legislative framework and institutional set up needed to upgrade and commercialize Serbia's innovation and technological capacity. Other FY10 just-in-time assistance included analysis of pension system needs, strengthening of capital markets and domestic savings; research and innovation, and efficiency of municipal enterprises. The World Bank has also been providing technical assistance in FY10-11 for education reform (a long neglected sector in Serbia) and is coordinating support for justice sector strengthening through a multi-donor trust fund.

52. ***As of March 2011, the active portfolio consisted of 12 projects, with total commitments of US$845.8 million, of which about US$625.4 million remains available for disbursement.*** The proportion of commitments at risk, a measure of the likelihood that projects will not meet their stated development objectives on time, represented 11.3 percent of the portfolio, which is slightly better than the averages for the Western Balkans (16.8%) and for the ECA region as a whole (15.2%). Three projects are currently considered to be at risk. The consolidated project disbursement ratio of 26.5 percent, and the current FY11 disbursement ratio of 8 percent, which compared unfavorably with the Western Balkans (12.5%) and ECA averages (15.8%), are low. A number of strategic

[27] REPARIS: Road to Europe – Program for Accounting Reform and Institutional Strengthening

portfolio management issues behind this poor performance were identified, such as significant delays in making projects effective; deficiency in project preparation, where client preparation of designs, feasibility studies, and bid documents only began after effectiveness; and difficulties of inter-agency and inter-ministry coordination in complex operations.

53. ***At present, one of the eleven projects comprising the Bank's active portfolio is rated unsatisfactory – namely, the Transitional Agriculture Reform Project***. The Bor Regional Development Project was recently upgraded, following signing of a financing agreement with the Canadian Export Bank in December 2010 to bring the RTB Bor core assets, and particularly the smelter, in line with Serbian environmental standards. This was the key precondition for lifting the partial suspension of the project related to environmental management and remediation and enables the resumption of key project activities which should lead to an improvement in performance rating. The Transitional Agriculture Reform Project underwent restructuring and improvements are already apparent, although they need to be consolidated. Finally, a concrete action plan for improving the implementation of the Irrigation and Drainage Rehabilitation Project, that for months was rated Moderately Unsatisfactory, was completed in early fall 2010 and the project is now achieving the agreed targets. All other projects are rated moderately satisfactory to satisfactory (Table 2).

Table 2: Portfolio Indicators – As of October 15, 2011

Sector	Project Name	Board	Revised Closing	IDA/IBRD/ GEF US$m	Disbursement (%)	Age (yrs)	Latest IP	Latest DO
HD	HEALTH PROJECT	May 2003	Dec 2011	33.5	81.6	8.3	MS	S
	CNSLTD COLLECT	May 2005	Sep 2012	25.0	75.6	6.3	MS	MS
	LOCAL SERV	March	Dec 2012	46.4	32	3.3	MS	S
SD	TRNSPT REHAB *	May 2004	March 2012	105.0	73	7.3	S	S
	ENERGY EFFICIENCY*	March	June 2013	49.0	68	7.5	MS	MS
	REAL ESTATE CAD	May 2004	Feb 2012	30.0	91	7.1	MS	S
	IRRIG/DRAINAGE*	July 2005	May 2013	74.4	40	6.2	S	MS
	ECSEE APL #2	June 2005	June 2011	21.0	69	6.2	S	S
	TRANS AG REFORM	June 2007	Dec 2011	4.5	26	4.3	MU	MU
	TRANS AG REFORM	June 2007	Dec 2011	17.0	41	4.3	MU	MU
	CORRIDOR X HIGH	July 2009	Dec 2015	388.0	7	2.2	MS	S
	SEEC CRIF	March	Dec 2012	5.0	0	0.5	S	S
ECSP	BOR REGIONAL DEV	June 2007	Sep 2014	43.0	8	4.3	MS	MS
				841.8	**33.2**	**5.2**		

*Includes Additional Financing

54. ***The Bank is also administering a number of grants in Serbia***. In addition to IDA/IBRD portfolio there is one US$ 7.5 mill Multi Donor Trust Fund for Judicial Reform as well as a portfolio of five grants (four IDF grants and one SIDA grant) in the amount of US$3.02 million.

V. LESSONS AND SUGGESTIONS FOR THE NEW CPS

55. ***The emphasis on alignment of CPS activities with the EU integration agenda should be maintained for the new CPS.*** There is a wide political and popular consensus on the EU perspective for Serbia, which can help surmount differences of philosophy and approach among key actors in Serbian politics and civil society. Maintaining a close link between CPS objectives and Serbia's own strategy for EU integration thus played an important role in maintaining a forward trajectory on CPS activities, albeit sometimes with significant delays. For example, difficult and politically sensitive reforms in the pensions sector were helped by benchmarking to EU practices and expectations with respect to fiscal management. Similarly, efforts in the privatization and private sector development and in financial sector reform areas were helped by the experience of the EU10 countries which became EU members relatively recently after addressing problems similar to those faced by Serbia.

56. ***The use of programmatic DPL series underpinned by high quality AAA was a successful means of supporting and sustaining a difficult policy and institutional reform effort, which should be employed again for the new CPS***. The two programmatic DPL lending series (PFDPLs I-IV and PEDPL I-II) and associated analytical work played an important role in helping to concretize and

keep on track the main elements of the Serbian Government's macroeconomic and growth agendas. Solid analytical work, which underpinned each of the series, was an important vehicle for building consensus on key reform areas with Serbian domestic actors a necessary step in the country's relatively polarized political environment. The DPL series and analytical work also helped coalesce cooperation with key external partners such as the IMF and European institutions, who partnered with the Government and Bank in supporting the DPL reform agenda. Finally, the flexibility afforded by programmatic DPL lending (to adjust sequencing and emphases within a set of broad policy goals) was particularly useful when the global crisis affected Serbia – the in-built flexibility allowed the Bank to quickly support the government in its efforts to respond to emerging priorities.

57. ***Design of investment operations should take care to maintain a clear focus on a relatively narrow set of objectives and avoid (to the extent feasible) involvement of multiple agencies in project management***. Given the diverse coalition that comprises the present Government – and the likelihood that a coalition Government will also emerge from the next electoral round – there can be differences in approach when multiple agencies involved in a project are headed by different coalition partners. This, in turn, can sometimes politicize project issues or lead to lengthy disagreements which stall implementation for extended periods. Limiting operations to a narrow set of closely related objectives within the purview of a single agency could help avoid some of these issues. Moreover, implementation agencies' commitment to project activities and implementation capacity should be carefully considered during project preparation. When projects are housed with strong institutions, it can take time to reach initial agreement, but prospects for successful implementation are high. Weak institutions are less likely to implement agreements even if there is a high level of formal "ownership." Finally, successful implementation requires that adequate staff resources on *both* the Bank's and the Government's sides are dedicated for project implementation, taking into account the actual volumes of work anticipated at different stages of a project. In the Corridor X project, for example, the lack of institutional clarity on project management coupled with difficulties in keeping up with the sheer volume of procurement activities led to significant delays in project start-up. These latter delays could certainly have been avoided if procurement needs had been more carefully anticipated and put in place early in the process.

58. ***Steady consolidation of the portfolio with a focus on fewer, larger operations is likely to improve portfolio performance by helping to maintain high-level attention on implementation within the government and in the Ban*k.** The Bank's current portfolio consists mainly of small projects in numerous sectors, which were mainly inherited form the previous CPS. The FY08-11 CPS already saw a trend towards consolidation (e.g., 2-3 planned operations were replaced by the large, high priority Corridor X project) and this should continue for the next CPS period, provided greater attention is paid to institutional requirements earlier in the project cycle and end-goals are set in a realistic way. A smaller portfolio of higher priority, visible projects is also more likely to receive concerted attention from senior decision-makers in Government. In this context, it should be noted that strengthening the Ministry of Finance's coordination role and support function vis-à-vis the implementing agencies could help improve portfolio performance**.** Recent efforts to engage the MoF in a regular dialogue on the portfolio has shown some promise in terms of reducing decision-

making time. The recently established quarterly joint MoF-Bank portfolio meetings should be continued in the next CPS as well.

59. ***Close coordination with the EC with other development partners, and International Financial Institutions (IMF, EBRD, EIB) should be maintained.*** The World Bank, the IMF, and EC closely coordinated in providing budget support to Serbia to respond to the financial crisis, by ensuring a stable macroeconomic environment and develop a viable crisis framework for the financial sector. There has also been close cooperation with the European Bank for Reconstruction and Development (EBRD), the European Investment Bank (EIB), and other development partners on infrastructure projects, including the large Corridor X project. Furthermore, the Bank has been working closely with the EC in setting up a new mechanism for financing research and development in Serbia. The positive momentum could be turned into greater use of the EC's Instrument for Pre-Accession (IPA) for leveraging bank's scarce resources over the next CPS period.

60. ***The results framework, and monitoring and evaluation, should be strengthened in the next CPS and attention should be paid to the availability of appropriate instruments to support the achievement of stated outcomes.*** The new CPS should explicitly set out the mechanisms for monitoring the results framework, the responsibilities for reporting on progress towards achievement of CAS outcomes, and the use of evaluation information for decision-making. Data collection and reporting on outcomes need to be improved across the portfolio. Project teams will also need to focus on helping sectors develop M&E systems which would in turn help project data collection and reporting. In a few cases, design of the outcome should have been calibrated better with the specific instruments included in the CPS. For example, outcomes included in the framework with respect to Electricity Company restructuring and promotion of private energy generation capacity were not necessarily well aligned with planned Bank-supported activities in the sector which focused narrowly on the construction of transmission lines to facilitate integration with the regional market.

Table 1. Summary of CAS Program Self-evaluation			
CAS Outcome Indicators (baselines and targets)	**Status and Evaluation Summary**	**Lending and Non-lending Activities that contributed to the outcome**	**Lessons and Suggestions for the new CAS**
PRIORITY 1: ENCOURAGING PRIVATE SECTOR LED GROWTH AND EU CONVERGENCE			
Country Development Goal 1.1 : Strengthen the competitiveness of the enterprise sector			
Outcome 1.1.1: ***Complete the privatization and restructuring program for socially-owned enterprises. Baseline: 1,800 socially owned enterprises sold, but 1,000 remaining in Privatization Agency database***			
Indicator: Complete the process of offering all socially-owned enterprises for sale by end-2008. **Baseline (2007)**: 1,000 companies **Indicator:** Greater use of flexibility available in *Bankruptcy Law* **Baseline (2007):** 450 SOEs in Bankruptcy	**Partially achieved.** 550 SOEs have been privatized. At end 2008 Government commenced resolution of all SOEs, but the process was affected by the global crisis which contributed to the suspension or cancellation of some (213) contracts due to non-fulfillment of obligations by investors. Today, the Privatization Agency's portfolio consists of 450 enterprises, for which the Government intends to retender once economic circumstances permit. **Achieved.** By November 2010, 673 companies from Privatization Agency's portfolio were filed for bankruptcy or were forcibly liquidated. Additionally, in line with the new Law on Bankruptcy, the bankruptcy process was completed for approximately 9,500 entities. Furthermore, 3,925entities with blocked accounts for over 3 years are expected to be resolved by mid 2011.	**Lending:** PFDPL 1 (FY09) PFDPL2 (FY10) PBG (FY11) **Non-Lending:** Privatization, Restructuring and Bankruptcy of State-Owned Enterprises (FY06-FY09); IDF: Enhancing Corporate Financial Reporting (FY08)	Development Policy Lending was extremely effective in helping Serbia to maintain (i) a coherent reform agenda of urgent and challenging structural reforms; and (ii) its timely implementation. DPL lending should remain one of the cornerstones of the next CPS, as it allows for sufficient leverage and incentives to spearhead further structural reforms.
Outcome 1.1.2: ***Continue restructuring and privatizating state-owned enterprises***.			

Indicator: Reduce direct financial subsidies provided by MoE to state and socially owned enterprises. **Baseline (2007):** 1.9% of GDP, target: 1.0%.	**Achieved**: In 2010 the direct subsidies provided by MoERD to state and socially owned enterprises came down to 0.8% of GDP. Further, under the ongoing enterprise sector reform process direct subsidies to socially owned enterprises administered by MOERD were reduced to 0.13% (EUR 43.9mn) in 2010.	**Lending:** PFDPL 1 (FY09); PFDPL2 (FY10); PBG (FY11) IFC invested in three corporations **Non-Lending:** IDF: Incorporation of SOEs (FY10); Note on Municipal Public Utility Companies (FY10) IFC corporate governance, international standards and technical regulations	
Country Development Goal 1.2 : Improve the business environment			
Outcome 1.2.1: ***Reduce regulatory compliance burden for businesses and enhance business entry***			
Indicator: Simplify procedures for obtaining construction permits and reduce compliance costs: **Baselines (2007):** 20 procedures; 204 days; Cost: 2,700% GNI/capita. **Indicator:** Reduce business registration time from 23 to 5 days.	**Not achieved.** According to Doing Business 2011 it still takes 20 procedures to obtain a construction permit and the time required has increased by 75 days to 279 days, but cost decreased from 2,700 % of per capita income to 1821.4%. However, significant progress was recorded with respect to reducing the overall regulatory compliance burden -- based on the standard cost model, the reforms implemented by end 2010 should result in annual cost savings to businesses of about EUR 50.8 million. **Achieved.** With the establishment of a one-stop shop for business registration within the Serbian Business Registers Agency, it now takes only up to 5 days to register a business.	**Lending:** PFDPL 1 (FY09) PFDPL2 (FY10) PBG (FY11) **Non-Lending:** Regulatory Impact Analysis (RIA) and RIA IDF (FY11); Capacity Building for an Improved Legal and Regulatory Environment TA; Doing Business Report; IFC Business Enabling Environment program, including Alternative	Sustained support for reducing the regulatory compliance for business began to have payoffs towards the end of the CPS period. There is now in Serbia a core group (across the public administration as well as those affiliated with the regulatory reform unit) that has experience with regulatory reform tools and approaches. RIA is now better understood but should be institutionalized and strengthened. In designing reforms it will be critical to ensure the inclusion of detailed transitional arrangements to avoid delays on pending cases. More emphasis should be given to clarifying institutional responsibilities particularly when different public sector agencies at central and local

		Dispute Resolution and Sub-national Competitiveness.	levels are involved.
Country Development Goal 1.3: Strengthen financial sector intermediation			
Outcome 1.3.1: ***Divestment of remaining financial sector holdings***.			
Indicator: Full divestment of majority stakes in 4 banks, minority stakes in 5 banks, and insurance sector holdings.	**Partially achieved.** Of the four majority state owned banks, one was sold to a foreign group, and the remaining two were merged, resulting in the decrease of number of majority state owned banks from 4 to 2. The Government retains minority stakes in 6 banks. A large state owned-owned insurer, DDOR Novi Sad, was also privatized.	**Lending:** PFDPL 1 (FY09) PFDPL2 (FY10) PBG (FY11) IFC support to largest state owned bank to help capitalize the bank	
Outcome 1.3.2*: Lower property market transaction costs, and increase availability of mortgage backed financing*			
Indicator: The Real Estate Cadastre is operational in the whole country **Baseline (2007):** 83% of cadastre municipalities **Indicator:** Mortgage financing provided for 15% of all land transactions. Baseline 5%	**Achieved**. The Real Estate Cadastre (REC) is currently fully operational in 92% cadastre municipalities (CM) and REC public display has been initiated in the remaining 8%. Initiation of REC public display implies that land books are no longer operational and only REC can register transactions and issue ownership certificates. **Achieved.** Mortgage financing provided for 31% of all buying-selling transactions. The financial crisis impacted the real estate market. A decrease in number of transactions as well as the share of mortgages in the total number of transactions was recorded in the period from Q1 2009 to Q3 2010, subsequently the real estate market started to recover as a result of a decrease in the real estate and mortgage prices.	**Lending:** Real Estate Cadastre Project (FY04) **Non-Lending:** IFC regulatory guillotine review at sub-national level including in the construction sector	Even in this challenging area, the clear commitment displayed by the client through policy leadership and sufficient budget allocations made for successful implementation. Effective coordination by the Government was achieved in part due to full integration of the project activities with the normal government structure. This suggests that the Bank should rely, whenever feasible, on existing institutions for project implementation (rather than creating new structures such as semi-autonomous PIUs).

Country Development Goal 1.4: Improved, well maintained and efficient infrastructure			
Outcome 1.4.1: ***Increased transport efficiency and improve traffic safety on the two sections of Corridor X, between Nis and Dimitrovgrad and Leskovac and Presevo, respectively.***			
Indicator: Reduce, by the end of the Project, road user costs from US$ 1.31/veh-km to 1/veh-km, and US$ 1.07/veh-km to 1/veh-km on project road sections	**Not observable.** The project is planned to end in December 2015 at which time the identified results will be measured. Currently, the project is on track to realize the objectives despite some start-up delays. Procurement and land appropriation have largely been completed. Construction is ongoing and rehabilitation of the highway is expected to be concluded in 2015 at which time cost targets are likely to be achieved.	**Lending:** Corridor X Project (FY10)	
Outcome 1.4.2: ***Strengthened road links, better condition of the road network and improved road safety, with greater efficiency in spending***.			
Indicator: Improve traffic safety along project road sections indicated by reductions of at least 10 percent (per veh-km) in: (a) road crash related fatalities; and (b) road crash related injuries.	**Partially Achieved.** Reductions of 22% in road crash-related fatalities in 2010 compared to 2009 were recorded in Kolubara region, but there was an increase of 10% in Macva in the same period. However, reductions of about 33% in road crash related injuries were recorded in both regions.	**Lending:** Transport Rehabilitation Project (FY04) **Non-Lending:** Road Management Study (FY09) Road Safety Mgmt. Capacity Study (FY08)	
Indicator: Performance based contracting used in all regions (baseline 2), with 20% reduction in winter maintenance unit costs (baseline Euro	**Partially achieved.** Performance based contracting hasn't been used in all regions due to issues related to unclear jurisdiction over the primary and secondary networks in Vojvodina. Once the issue is fully clarified, the Public Enterprise "Putevi Srbije" will extend the approach to the other twenty five regions of Serbia. In the meantime, there has been a 40 % cumulative reduction in unit costs for maintenance activities in two pilot regions		

570/ km). **Indicator:** 350km of roads rehabilitated, with road roughness declining on IRI scale **Baseline:** roughness 5	**Achieved.** Roughness has been lowered to an average of 3.7 on the IRI scale on rehabilitated sections of roads. Over 300 km of road have been rehabilitated, lowering vehicle operating costs by 14 % and eliminating 15 accident black spots. In addition, recommendations of Bank AAA were adopted in a new Law on Roads Safety and reform of the Public Enterprise 'Putevi Srbije".		
Outcome 1.4.3: ***Improved financial sustainability of the energy sector***			
Indicator: Energy prices move towards full cost recovery and investment needs of EPS	**Partially achieved.** Prior to the crisis, end-user tariffs increased steadily but no tariff increase was enacted in 2009 due to impact on consumers of the economic slowdown. A modest increase was implemented in 2010 and a more substantial 15.1 % increase was implemented in the first quarter of 2011. Nonetheless, these increases were insufficient to keep up with inflation and current tariffs are still below cost-recovery levels and thus much too low to support EPS investment needs.	**Lending:** ECSEE APL2 Project (FY05)	While an Investment Lending (IL) instrument enabled the Bank to engage in this sector, it did not prove sufficient to secure support from central ministries - - which was crucial to undertake the deep and difficult structural reforms which are central to sectoral development. Going forward, the Bank should ensure that the chosen instrument is well aligned with the main goals of the dialogue.
Outcome 1.4.4: ***Improved electricity market access for consumers and suppliers and strengthened capacity of the institutions to participate in the regional electricity marke***t.			
Indicator: Electricity markets in Serbia are liberalized in accordance with ECSEE treaty, and EPS restructuring continues, allowing private investment in new generation capacity.	**Not achieved. .** Although Serbia has signed the ECSEE treaty which puts in place the legal basis for market liberalization the market is not in fact liberalized and remains dominated by the EPS. Moreover, neither EPS restructuring nor the private investments in new generation capacity have occurred, despite large investment requirements in the 2010-2015 period. Power companies continue to under invest (especially in generation) and few official sources of finance are available to the sector.	**Lending:** ECSEE APL2 Project (FY05)	Further support for electricity in Serbia will require deeper engagement by the Bank on policy reforms in creating a hospitable framework for private financing of needed energy sector investments. If the Bank decides to engage on this agenda under the new CPS, consideration should be given to selection of an appropriate instrument such as a DPL or PBG.
PRIORITY 2: PROVIDING OPPORTUNITIES AND BROADENING PARTICIPATION IN GROWTH			

Country Development Goal 2.1: Maintaining a sustainable macroeconomic framework and improving overall composition of public spending			
Outcome 2.1.1: ***An improvement in the quality, efficiency and accountability of government spending. This will assist the Government in bringing about the necessary reduction in aggregate public spending levels and improving current levels of service delivery***			
Indicator: 1. Budget is prepared on three-years bases; 2. Transfers to pension fund to cover for their deficit is reduced; 3. Final accounts have been audited; 4. New system of social assistance has been introduced with improved coverage and targeting.	**Partially achieved.** 1**.** Serbia made steady progress towards a three year budget including (i) reform of the Budget Systems Law; (ii) improvements in risk management including financial control, accounting and reporting; (iii) strengthened debt management; (iv) fiscal planning and budget preparation on a medium term basis. Nonetheless the country has not yet implemented the three year budget. 2. Transfers to the pension fund have increased from 5.1% of GDP in 2008 to 7.3% in 2010. However, the deficit of the pension fund increased due to an extraordinary pension increased granted in late 2008 and a crisis-induced drop in pension contributions. In 2009 and 2010, with support from PEDPL2, pensions were frozen in nominal terms, and a new Pension Law and amendments to the Budget System Law were adopted. The two Laws will ensure that pension expenditures return to a more sustainable path, and transfers to pension fund will slowly decrease, to below 5% of GDP by 2015. 3. A full audit of 2009 Final Accounts was presented to the National Assembly in December 2010. Despite a slow start, the Serbia State Audit Institution has been more effective each year and audit coverage continues to increase. 4. A new Social Assistance Law was adopted in March 2011. The new law improves the access of vulnerable groups to benefits by applying equivalence scales for provision of social assistance (Material Support for Low	**Lending:** PEDPL1 (FY09) PEDPL2 (FY10) **Non-Lending:** PIEM Review (FY08) Public Expenditure Review (FY09) PER Follow up (FY10) Civil Service Reform (FY12) Policy Notes on Growth (FY10)	Targets must be relevant and achievable, taking account of political economy, capacity and reform building blocks. The focus on a three year budget was not a practical goal for the CPS, given Serbia's circumstances, although important reforms were achieved with Banks support. The next CPS could help build on those foundations by focusing on strengthening of the medium term fiscal and budgetary framework and the quality of financial and non-financial information for budget planning and implementation. In fact, continued Bank involvement could be desirable to help reinforce progress and ensure that there is no backtracking. In determining goals and their timing due regard should also be paid to the impact of the political cycle on the ability to undertake policy reforms.

	Income Households) in accordance with EU and OECD practices. Social assistance spending in the May 2009 supplementary budget was protected from the overall cuts that were introduced in other budget areas as part of the adjustments to the economic crisis. Further increases were approved (in line with the new law) for the 2011 budget.		
Country Development Goal 2.2: More balanced regional development			
Indicator: 2,500 people to be supported into employment through ALMPs in Bor region. **Indicator:** Support SMEs through 1,000 micro-credit loans in Bor region	**Partially achieved.** Due to a significant delay in project effectiveness, implementation activities were off to a very slow start. However, 1245 people received various employment support services (1212 received job search assistance, 22 off the job training, and 11were temporarily employed through public works. At this point it is to early to evidence an impact of employment support services. **Partially achieved.** Due to slow start up of the Bor project, the SME micro-credit program commenced in 2011. To date, 24 loans in the total amount of US$ 110,000 were provided through micro finance program. This pace is expected to pick up during the remainder of 2011.	**Lending:** Bor Project (FY07) Resavica Restructuring and Local Economic Development Project (Dropped)	
Outcome 2.2.2*: Strengthen MAFWE's budget administration*			
Indicator: Market support for agriculture falls from 30% of MAFWE budget to 10%.	**Achieved.** Market support in 2011 is equivalent to only 10.6% of the total MAFWM budget, and includes only limited price supports/subsidies for milk, exports and warehousing. Currently the largest subsidy consists of the so-called "de-coupled area payment'. This was introduced in 2007 to replace former input subsidies and reflects the structure of subsidies under the EU's Common Agricultural Policy (CAP). It consists of a standard payment (equal to € 120 per hectare) to every registered farmer, up to a maximum of 100 hectares. As of 2008, only full time farmers who contribute to the pension	**Lending:** Irrigation and Drainage Project (FY06)	Given the high priority placed by the Government on achievement of EU membership, alignment of project activities with EU requirements helps to ensure adequate attention to project goals and implementation. This suggests that projects included in the new CPS should focus on furthering Serbia's aspirations for convergence with the EU on policy and programs.

	system are eligible to receive the subsidy.		
Outcome 2.2.3 : ***Improve agriculture sectors resilience to droughts***			
Indicator: 5000 ha benefiting from irrigation development with 10% increase in corn and wheat production.	**Not Achieved**. A precondition for development of new and existing irrigation schemes was the adoption of a new Water Law, and creation of Water Users Associations (WUAs). Adoption of the law facilitating this was substantially delayed and it was finally approved only in May 2010. As a result, work on development of irrigation schemes could only start in 2010, and is expected to continue up to early 2013, by which time it should meet the original targets specified in the CPS.	**Lending:** Irrigation and Drainage Project (FY06); Serbia Transitional Agriculture Project (FY07)	Development/adoption of any new law as a precondition for undertaking Bunk-funded activities is increasing the risk of implementation failure and at best causes delay in implementation. In the event that a new legal framework is critical to effective implementation of project activities, the project should not be taken forward unless the required laws are already in place. In addition, careful planning and development of alternative scenarios is vital in case of conflicting stakeholder interest in proposed regulatory reforms.
Outcome 2.2.4: ***Improve agricultural systems, and Serbia's capacity to meet EU standards and tap into EU export opportunities***.			
Indicator: EU compliant rural development program operational, including management, monitoring and payment institutions and procedures (i.e., EU Rural Payment Agency).	**Achieved.** Serbia Rural Development Strategy has been developed and a supporting law approved. The Ministry of Agriculture Forestry and Water Management (MAFWM) has developed an IPARD-oriented national rural development program and had established the Rural Payment Agency by late 2009. A prototype Managing Authority is already operational and steps have been taken towards establishment of a Monitoring Committee with the support of an Inter-ministerial Council, an Expert Group and a Council for Farmer's Associations.	**Lending:** Serbia Transitional Agriculture Project (FY07)	Clear alignment of Bank-supported projects with the requirements of the EU accession agenda helps ensure strong Government commitment to the project objectives and implementation.
Country Development Goal 2.3: Strengthen social protection for the vulnerable			
Outcome 2.3.1: ***More effective, efficient and financially sustainable pension system***.			
Indicator: Pension contribution collections increase	**Achieved.** A 70%t improvement in the rate of collection of pension contributions was recorded between the years 2005 and 2010.	**Lending:** Consolidated Collection and Pension	

by 5%. **Indicator:** Pension payments fall as a share of GDP (Baseline: 2004-06 average: 13.5%)	**Achieved.** Pension payments as percent of GDP fell from 13.8 percent in 2008 to 13 percent in 2010 (estimated) and are projected to continue decreasing gradually as a share of GDP. Some significant reforms were implemented to limit pension spending growth in the latter years of the CPS. Namely a change in the indexation mechanism and a freeze on pension increases in 2009 (following extraordinary increases in 2008). Had the freeze not been implemented, pension spending would have risen to 15.8% rather than 13 % of GDP in 2010.	Administration Reform Project (FY05) **Non-Lending:** Pension TA (FY11) PER Follow up (FY10) PEDPL2 (FY10)	
Outcome 2.4.1: ***Efficient, sustainable and decentralized delivery of integrated health, education and social protection services at the local level in municipalities supported under DILS project***.			
Indicator: Increased take up of targeted cash benefits and social services among eligible households in municipalities benefiting from the DILS project **Indicator:** Among the poorest 25% of municipalities, improved access to primary and secondary education and primary healthcare in municipalities supported by the	**Partially achieved.** Total number of beneficiaries of the MOP increased 6.5 percent between 2008 and 2009 and 20 percent between 2009 and 2010. Spending on this program increased 22 percent and 38 percent respectively between those years. Coverage among the poorest quintile also increased modestly, going up from 7.9 percent of the poorest quintile in 2008 to 8.7 percent in 2010 (measured in the first two quarters of 2010). **Achieved:** Available municipal data indicate that access for the poor to education and health has improved: (i) coverage of pre-school education increased from 32 percent in 2002 to 45 percent in school year 2007/08; (ii) percentage of Roma children attending primary school increased by 9.9 % between 2009 and 2010.; and (iii) patients registered in the 11 most vulnerable municipalities increased by 56 % between 2009 and 2011 - - the increase was 72% in the 5 most vulnerable municipalities.	**Lending:** DILS Project (FY08) Health Additional Financing Project (FY09) **Non-Lending:** PER Follow up (FY10) Education TA (FY12) Roundtable on Education Baseline Survey (FY09)	

DILS project			
PRIORITY 3: MANAGING ENVIRONMENTAL AND DISASTER RISKS			
Country Development Goal 3.1: Strengthened environmental management			
Outcome 3.1.1: ***Remediation of urgent environmental hazards, including tailing ponds and wastewater discharge***			
Indicator: Environmental remediation works completed in all 4 sites in Bor region (and 2 tailings ponds closed).	**Not achieved.** The Environmental Management and Remediation related activities were under partial suspension until December 2010. However, technical designs for construction of the collector and remediation of tailings and waste sites have been ongoing during this period and works are expected to be implemented in 2012 and 2013.	**Lending:** Bor Project (FY07)	
Outcome 3.1.2: ***Improve energy efficiency in over 200 public buildings by 45% (and improve public energy efficiency by 0.5%).***			
Indicator: Replace heating supply at Clinical Center of Serbia and Nis Clinical Center. Energy efficiency retrofitting of 117 public buildings.	**Partially achieved.** Around 40 public buildings have been retrofitted to date and the achieved energy efficiency is around 44%. The heat supply system at the Clinical Center of Serbia was replaced, with the important benefits for patients and employees and significant cost savings for the Ministry. The heat supply system at the Clinical Center of Nis has not yet been replaced due to delays in tendering, in turn related to the delay in project effectiveness. Expected completion FY12.	**Lending:** Energy Efficiency Project (FY04)	Due attention to capacity for procurement under Bank rule will be important if further support in this sector is to be provided under the next CPS.
Outcome 3.1.3: ***Reduce nitrogen and phosphorus pollution flows to Danube and tributaries.***			
Indicator: 60 farms implementing nutrient management plans; 4 slaughterhouses have invested in animal waste management technology; 20% decrease in non-point source pollution flows from 2008	**Achieved.** More than 100 farms and 6 agricultural high schools have adopted EU Nitrates Directive-compliant farm manure and nutrient management practices. Three slaughterhouses and meat processing industries invested in proper waste management practices. In addition, three rendering plants were provided with specialized trucks and equipment, to speed up collection and processing of high-risk animal waste.	**Lending:** Danube River Enterprise Pollution Reduction Project (FY05-FY11) **Non-Lending:**	The successful implementation of this project yields a 3 key lessons: (i) flexibility during project implementation can enhance the impact of a project. In this case, the project expanded its pool of beneficiaries, adding rendering plants and 7 agricultural high schools at mid-term review, which increased the Project's contribution; and (ii) continuous support for implementation enables timely identification and remediation of critical issues. The institution of monthly video or

baseline.			audio conferences was crucial in helping this project to remain largely on schedule.
Country Development Goal3.2: Strengthened ability to prepare for, manage, and mitigate unexpected risks, including those arising for climate change			
Outcome 3.2.1: ***Reduced risk of damage from flooding to land, crops, property, infrastructure, as well as reduced risk of loss of life from flooding***			
Indicator: Flood protection schemes strengthened for 550,000 ha and 2 million people along Danube, Sava, Tisa and Tamis rivers.	**Partially Achieved**. As of January 2011, 16 flood protection schemes are completed covering over 60,000 ha, while work on another 9 schemes protecting over 150,000 ha with over 300,000 people are ongoing. Major works are now being tendered and work is expected to commence summer/fall 2011.Delays were caused by : (i) delays in project effectiveness; (ii) disagreements among stakeholders; (iii) absence of clear legal requirements; (iv) several changes of key counterparts; (v) local political events (elections);	**Lending:** Irrigation and Drainage Project (FY06) CRIF (FY11) **Non-Lending:**	For projects involving sub-projects successful implementation implies: (i) establishment of a strong pipeline of sub-projects (beyond first project year) is critical to ensuring robust implementation; (ii) permitting procedures and other local legal requirements may need to be well designed during project preparation to enable quick start; and, (iii) strong counterpart capable of resolving issues of intra-governmental coordination

Table 2: CPS Program FY08 - FY11 - Planned Lending Program and Actual Deliveries

CSP PLANS (November 13, 2007)			STATUS	
FY	**Project**	**IBRD Amounts (US$mil.)**	**Project**	**IBRD Amounts (US$mil.)**
FY08	PFDPL I	50	Forwarded to FY09	
	Health Improvement AF	15	Forwarded to FY09	
	Delivery of Integrated Local Services	40	Actual	46.4
	Railways	75	Dropped	
	Subtotal FY08	***180***	***Subtotal FY08***	***46.4***
FY09	PFDPL I	50	Actual	50
	Health Improvement AF	13.5	Actual	13.5
	PFDPL II	50	Forwarded to FY10	
	Regional Disaster Preparedness	25	Dropped	
	Energy Generation (Hydro Renewable)	55	Dropped	
	Resavica Restructuring and Local Development	40	Dropped	
	Subtotal FY09	***170***	***Subtotal FY09***	***63.5***
PROGRESS REPORT PLANS (October 20, 2009)			**STATUS**	
FY10	PFDPL II	100	Actual	100
	PEDPL I	100	Actual	100
	Corridor X	388	Actual	388
	PFDPL III	100	Forwarded to FY11	
	Subtotal FY10	**588**	***Subtotal FY10***	**588**
FY11	PFDPL III	100	PF PBG (US$400 million guarantee)	100
	PEDPL II and III	100	PEDPL II	100
			PEDPL III Forwarded to FY12	
			Additional Actual Projects:	
			CRIF	5
	Subtotal FY11	***200***	***Subtotal FY11***	***205***
Original CPS TOTAL US$600million, revised at CPS PR to US$900million			**TOTAL FY2008-FY2011**	**902.9**

Table 3. CPS Program FY08 - FY11 - Planned Non-lending Program and Actual Deliveries

CSP PLANS (November 13, 2007)		STATUS
FY08	Serbia Economic Memorandum Justice and Governance IDF Road Financing and Institutional Study	Forwarded to FY12 Dropped Completed in FY09 (*Title changed to* "Road Management and Financing Policy Note") *Additional Products:* Environmental Compliance Policy Note Public Investment and Expenditure Management Review (plan to be delivered in FY09) ROSC Follow-up TA Road Safety Management Capacity Review
FY09	Public Investment and Expenditure Management Review Employment Generation Options Private Sector Participation in Social Services (with IFC) PPP Analysis: Opportunities and Contingent Liabilities Capital Markets Development TA Public Financial Management TA Corporate Financial Reporting IDF Municipal Enterprise Restructuring/Privatization Innovation Promotion TA	Completed in FY08 Dropped Dropped Dropped Completed in FY10 Underway (the TF will be closed in FY14) Completed in FY11 Completed in FY10 (*Title changed to* "Note on Municipal Public Utilities") Actual *Additional Products:* Baseline Survey PHC Centers Public Expenditure Review Roundtables

PROGRESS REPORT PLANS (October 20, 2009)		STATUS
FY10	Roundtables Pension TA Education TA Serbia Justice System Innovation Promotion TA 2 Capital Markets Development TA	Actual Completed in FY11 Underway (to be completed in FY12) Underway (to be completed in FY12) Actual Actual *Additional Products:* Policy Notes on Growth Financial Sector Assessment Program Update Public Expenditure Review Follow-up Crisis Preparedness Assessment
FY11	Innovation Promotion TA 3 Capital Markets Development TA2	Underway (to be completed in FY12) Actual *Additional Products:* Regulatory Reform and Regulatory Impact Analysis Regulatory Impact Assessment IDF SOE Incorporation

Table 4: List of IFC's Advisory Services in Serbia, FY08-FY11

Project ID	Project Name	Start	End	Project status	Primary Business line	Total Funds, US$
Advisory services operations approved in the pre-CPS period, but active during the CPS period						
550050	Serbia National Level Regulatory Reform	FY07	FY11	Closed	Investment Climate	580,000.00
537423	ADR Serbia Phase I	FY06	FY09	Closed	Investment Climate	1,114,750.00
543064	PEPSE ISTR Serbia	FY06	FY09	Closed	Sustainable Business Advisory	559,900.00
540244	PEPSE Corporate Governance Phase I	FY06	FY09	Closed	Sustainable Business Advisory	941,740.00
Subtotal						**3,196,390.00**
Advisory services operations approved in the CPS period						
555366	Serbia Sub-National Competitiveness Project	FY08	FY12	Closed	Investment Climate	769,000.00
563707	ADR Serbia Phase II	FY09	FY11	Closed	Investment Climate	719,116.00
565469	ISTR Serbia Ext	FY09	FY12	Active	Sustainable Business Advisory	740,382.00
566967	Corporate Governance Phase II	FY09	FY12	Active	Sustainable Business Advisory	656,571.00
Subtotal						**2,885,069.00**
Grand Total						**6,081,459.00**

Annex 3: Active and Planned TFs

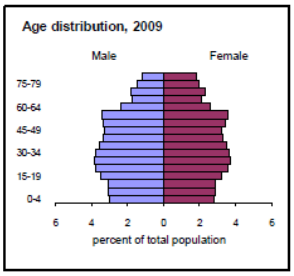
ACTIVE TRUST FUNDS					
TF NUMBER	**TRUST FUND**	**DONOR**	**CLOSING FY**	**US$ 000**	**BE/RE***
TF090454	GEF AGRICULTURE REFORM	MDTF	FY12	4,5000	RE
TF093849	IDF-SERBIA ASSET REGISTRY	US	FY13	300	RE
TF096222	IDF-Serbia - Creation of Permanent Institutional Framework for Regulatory Impact Assessment	US	FY14	350	RE
TF096223	IDF-Serbia - Incorporation of State Owned Enterprises Project	US	FY14	305	RE
TF096230	IDF Grant for Strengthening Institutional Capacity for e-Government Project	US	FY14	380	RE
TF097118	Justice Sector Support Project	MDTF	FY16	2,000	RE
TF097210	Bank Executed: Advisory Services for Justice Sector Reform in Serbia	MDTF	FY16	2,424	BE
TF098193	Carbon Energy Path	MDTF	FY12	100	BE

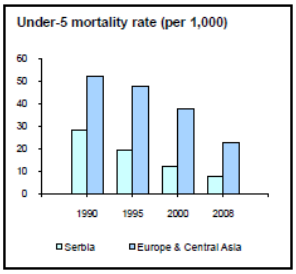
PLANNED TRUST FUNDS			
TRUST FUND	**DONOR**	**FY APPROVAL**	**US$ 000**
Innovation Serbia Project	EU-IPA	FY12	11,000
Survey on Income and Living Conditions	EU-IPA	FY12	1,100
Justice Sector Support	SECO	FY12	770
	EU-IPA	FY12	2,600

*BE: Bank Group Executed; RE: Recipient Executed

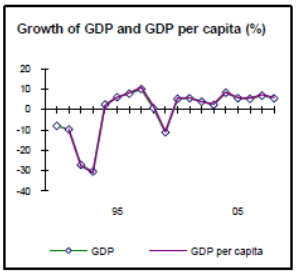
Annex 4: Serbia At-a-Glance

Key Development Indicators	Serbia	Europe & Central Asia	Upper middle income
(2009)			
Population, mid-year (millions)	7.3	403	993
Surface area (thousand sq. km)	*88*	23,549	48,659
Population growth (%)	-0.4	0.3	0.9
Urban population (% of total population)	52	64	75
GNI (Atlas method, US$ billions)	43.9	2,772	7,363
GNI per capita (Atlas method, US$)	6,000	6,880	7,415
GNI per capita (PPP, international $)	11,530	13,297	12,800
GDP growth (%)	-3.0	4.0	4.1
GDP per capita growth (%)	-2.6	3.6	3.2
(most recent estimate, 2003–2008)			
Poverty headcount ratio at $1.25 a day (PPP, %)	<2	4	..
Poverty headcount ratio at $2.00 a day (PPP, %)	<2	9	..
Life expectancy at birth (years)	74	69	71
Infant mortality (per 1,000 live births)	6	20	20
Child malnutrition (% of children under 5)	2	..	..
Adult literacy, male (% of ages 15 and older)	..	99	95
Adult literacy, female (% of ages 15 and older)	..	97	92
Gross primary enrollment, male (% of age group)	98	100	111
Gross primary enrollment, female (% of age group)	98	98	110
Access to an improved water source (% of population)	99	95	95
Access to improved sanitation facilities (% of population)	92	89	84





Net Aid Flows	1980	1990	2000	2009 [a]
(US$ millions)				
Net ODA and official aid	..	..	1,134	1,047
Top 3 donors (in 2007):				
European Commission	..	..	471	393
Germany	..	..	99	108
United States	..	..	108	94
Aid (% of GNI)	..	..	18.6	2.2
Aid per capita (US$)	..	..	151	142



Long-Term Economic Trends	1980	1990	2000	2009	1980–90	1990–2000	2000–09
					(average annual growth %)		
Consumer prices (annual % change)	..	..	70.0	8.1			
GDP implicit deflator (annual % change)	..	..	77.5	10.0			
Exchange rate (annual average, local per US$)	..	..	63.2	67.6			
Terms of trade index (2000 = 100)	..	..	100	142			
Population, mid-year (millions)	..	7.6	7.5	7.3	..	-0.1	-0.3
GDP (US$ millions)	..	..	6,083	42,984	..	-4.2	5.0
		(% of GDP)					
Agriculture	..	..	21.4	12.9	..	..	..
Industry	..	..	32.6	27.7	..	..	..
Manufacturing	..	..	..	..	..	..	..
Services	..	..	46.0	59.4	..	..	..
Household final consumption expenditure	..	..	88.3	73.7	..	..	3.3
General gov't final consumption expenditure	..	..	19.6	18.9	..	..	4.5
Gross capital formation	..	..	8.8	23.9	..	..	18.3
Exports of goods and services	..	..	23.9	27.5	..	..	10.5
Imports of goods and services	..	..	40.5	43.9	..	..	10.7
Gross savings	..	..	13.3	19.6			

Note: Figures in italics are for years other than those specified. 2009 data are preliminary. .. indicates data are not available.
a. Aid data are for 2008.

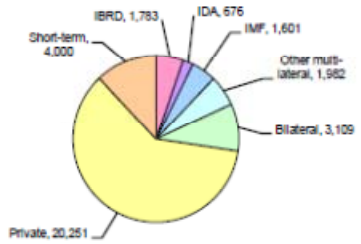
Development Economics, Development Data Group (DECDG).

Balance of Payments and Trade	2000	2009
(US$ millions)		
Total merchandise exports (fob)	1,645	8,372
Total merchandise imports (cif)	3,227	14,932
Net trade in goods and services	-1,441	-7,075
Current account balance	-153	-2,860
as a % of GDP	-2.5	-6.7
Workers' remittances and compensation of employees (receipts)	1,132	5,406
Reserves, including gold	524	17,173

Central Government Finance		
(% of GDP)		
Current revenue (including grants)	42.4	39.5
Tax revenue	*34.4*	34.4
Current expenditure	42.1	39.8
Overall surplus/deficit	-0.3	-4.1
Highest marginal tax rate (%)		
Individual	..	15
Corporate	*20*	10

External Debt and Resource Flows		
(US$ millions)		
Total debt outstanding and disbursed	11,499	33,402
Total debt service	120	4,650
Debt relief (HIPC, MDRI)	–	–
Total debt (% of GDP)	189.0	77.7
Total debt service (% of exports)	3.5	21.3
Foreign direct investment (net inflows)	52	1,921
Portfolio equity (net inflows)	0	23

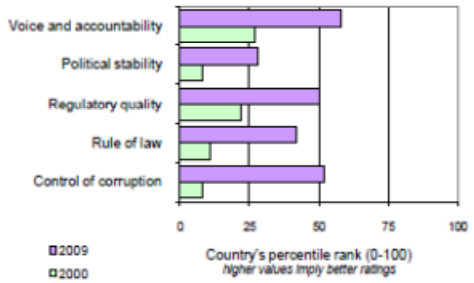
Composition of total external debt, 2009



US$ millions

Private Sector Development	2000	2009
Time required to start a business (days)	–	13
Cost to start a business (% of GNI per capita)	–	7.1
Time required to register property (days)	–	111
Ranked as a major constraint to business (% of managers surveyed who agreed)	2000	2009
n.a.	..	..
n.a.	..	..
Stock market capitalization (% of GDP)	*4.9*	26.8
Bank capital to asset ratio (%)	*18.3*	*20.5*

Governance indicators, 2000 and 2009



Source: Kaufmann-Kraay-Mastruzzi, World Bank

Technology and Infrastructure	2000	2008
Paved roads (% of total)	62.7	..
Fixed line and mobile phone subscribers (per 100 people)	..	173
High technology exports (% of manufactured exports)	..	..

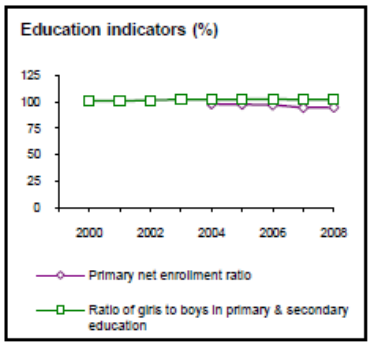
Environment		
Agricultural land (% of land area)	..	*57*
Forest area (% of land area)	..	*23.6*
Terrestrial protected areas (% of surface area)	..	2.7
Freshwater resources per capita (cu. meters)	..	..
Freshwater withdrawal (billion cubic meters)	..	..
CO2 emissions per capita (mt)	..	..
GDP per unit of energy use (2005 PPP $ per kg of oil equivalent)	3.7	*4.5*
Energy use per capita (kg of oil equivalent)	1,771	*2,141*

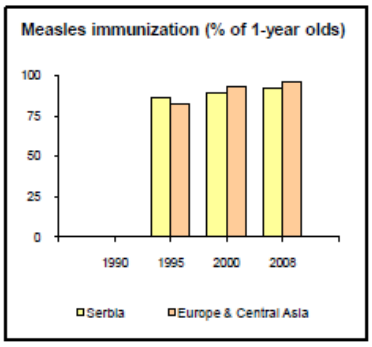
World Bank Group portfolio	2000	2009
(US$ millions)		
IBRD		
Total debt outstanding and disbursed	1,097	1,783
Disbursements	0	56
Principal repayments	0	0
Interest payments	0	98
IDA		
Total debt outstanding and disbursed	0	676
Disbursements	0	17
Total debt service	0	5
IFC *(fiscal year)*		
Total disbursed and outstanding portfolio	–	254
of which IFC own account	–	254
Disbursements for IFC own account	–	23
Portfolio sales, prepayments and repayments for IFC own account	–	29
MIGA		
Gross exposure	0	216
New guarantees	0	188

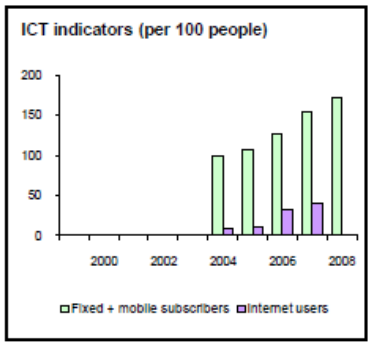
Millennium Development Goals

With selected targets to achieve between 1990 and 2015
(estimate closest to date shown, +/- 2 years)

	Serbia			
Goal 1: halve the rates for extreme poverty and malnutrition	1990	1995	2000	2008
Poverty headcount ratio at $1.25 a day (PPP, % of population)	..	..	..	<2
Poverty headcount ratio at national poverty line (% of population)	..	..	..	..
Share of income or consumption to the poorest qunitile (%)	..	..	..	9.1
Prevalence of malnutrition (% of children under 5)	..	..	..	*1.8*
Goal 2: ensure that children are able to complete primary schooling				
Primary school enrollment (net, %)	..	..	..	95
Primary completion rate (% of relevant age group)	..	..	..	100
Secondary school enrollment (gross, %)	..	..	89	89
Youth literacy rate (% of people ages 15-24)	..	..	..	99
Goal 3: eliminate gender disparity in education and empower women				
Ratio of girls to boys in primary and secondary education (%)	..	..	101	102
Women employed in the nonagricultural sector (% of nonagricultural employment)	..	..	..	*44*
Proportion of seats held by women in national parliament (%)	..	..	..	22
Goal 4: reduce under-5 mortality by two-thirds				
Under-5 mortality rate (per 1,000)	29	19	12	8
Infant mortality rate (per 1,000 live births)	25	17	11	7
Measles immunization (proportion of one-year olds immunized, %)	*82*	86	89	92
Goal 5: reduce maternal mortality by three-fourths				
Maternal mortality ratio (modeled estimate, per 100,000 live births)	13	15	9	8
Births attended by skilled health staff (% of total)	..	..	..	*99*
Contraceptive prevalence (% of women ages 15-49)	..	..	..	*41*
Goal 6: halt and begin to reverse the spread of HIV/AIDS and other major diseases				
Prevalence of HIV (% of population ages 15-49)	0.1	0.1	0.1	*0.1*
Incidence of tuberculosis (per 100,000 people)	..	..	..	18
Tuberculosis case detection rate (%, all forms)	..	..	..	95
Goal 7: halve the proportion of people without sustainable access to basic needs				
Access to an improved water source (% of population)	..	..	99	99
Access to improved sanitation facilities (% of population)	..	..	92	92
Forest area (% of total land area)	..	..	..	*23.6*
Terrestrial protected areas (% of surface area)	..	..	..	2.7
CO2 emissions (metric tons per capita)	..	..	..	..
GDP per unit of energy use (constant 2005 PPP $ per kg of oil equivalent)	4.6	3.2	3.7	*4.5*
Goal 8: develop a global partnership for development				
Telephone mainlines (per 100 people)	..	..	..	42.0
Mobile phone subscribers (per 100 people)	..	..	..	130.9
Internet users (per 100 people)	..	..	..	44.9
Personal computers (per 100 people)	..	..	..	25.8







Note: Figures in italics are for years other than those specified. .. indicates data are not available.

Development Economics, Development Data Group (DECDG).

Annex 5: Selected Indicators* of Bank Portfolio Performance and Management

As Of Date 10/19/2011

Indicator	2009	2010	2011	2012
Portfolio Assessment				
Number of Projects Under Implementation [a]	12	12	12	12
Average Implementation Period (years) [b]	3.8	4.8	5.4	6.2
Percent of Problem Projects by Number [a, c]	8.3	25.0	8.3	9.1
Percent of Problem Projects by Amount [a, c]	14.6	16.4	2.3	2.6
Percent of Projects at Risk by Number [a, d]	8.3	25.0	8.3	9.1
Percent of Projects at Risk by Amount [a, d]	14.6	16.4	2.3	2.6
Disbursement Ratio (%) [e]	11.0	9.0	10.4	7.8
Portfolio Management				
CPPR during the year (yes/no)				
Supervision Resources (total US$)				
Average Supervision (US$/project)				

Memorandum Item	Since FY 08	Last Five FYs
Proj Eval by OED by Number	17	0
Proj Eval by OED by Amt (US$ millions)	494.2	0.0
% of OED Projects Rated U or HU by Number	0.0	0.0
% of OED Projects Rated U or HU by Amt	0.0	0.0

a. As shown in the Annual Report on Portfolio Performance (except for current FY).
b. Average age of projects in the Bank's country portfolio.
c. Percent of projects rated U or HU on development objectives (DO) and/or implementation progress (IP).
d. As defined under the Portfolio Improvement Program.
e. Ratio of disbursements during the year to the undisbursed balance of the Bank's portfolio at the beginning of the year: Investment projects only.

* All indicators are for projects active in the Portfolio, with the exception of Disbursement Ratio, which includes all active projects as well as projects which exited during the fiscal year.

Annex 6: Social Indicators

	Latest single year			Same region/income group	
	1980-85	1990-95	2003-09	Europe & Central Asia	Upper-middle-income
POPULATION					
Total population, mid-year (millions)	7.5	7.7	7.3	404.2	1,001.7
Growth rate (% annual average for period)	0.4	0.4	-0.4	0.2	0.9
Urban population (% of population)	48.3	50.9	52.2	64.0	74.9
Total fertility rate (births per woman)	2.1	1.7	1.4	1.8	2.0
POVERTY					
(% of population)					
National headcount index	..	..	6.6	..	..
Urban headcount index	..	..	4.3	..	..
Rural headcount index	..	..	9.8	..	..
INCOME					
GNI per capita (US$)	..	..	6,000	6,793	7,502
Consumer price index (2000=100)	..	4	145	141	127
Food price index (2000=100)	..	..	..	..	..
INCOME/CONSUMPTION DISTRIBUTION					
Gini index	..	..	28.2	..	..
Lowest quintile (% of income or consumption)	..	..	9.1	..	..
Highest quintile (% of income or consumption)	..	..	37.4	..	..
SOCIAL INDICATORS					
Public expenditure					
Health (% of GDP)	..	5.2	6.3	3.9	3.8
Education (% of GDP)	..	..	4.7	4.1	4.3
Net primary school enrollment rate					
(% of age group)					
Total	..	..	94	92	93
Male	..	..	95	93	93
Female	..	..	94	92	92
Access to an improved water source					
(% of population)					
Total	..	..	99	95	95
Urban	..	..	99	98	98
Rural	..	..	98	89	86
Immunization rate					
(% of children ages 12-23 months)					
Measles	..	86	95	96	93
DPT	..	89	95	95	93
Child malnutrition (% under 5 years)	..	..	2	..	..
Life expectancy at birth					
(years)					
Total	..	72	74	70	72
Male	..	69	71	66	69
Female	..	74	76	75	75
Mortality					
Infant (per 1,000 live births)	34	17	6	19	19
Under 5 (per 1,000)	41	19	7	21	22
Adult (15-59)					
Male (per 1,000 population)	..	..	153	286	201
Female (per 1,000 population)	..	..	82	123	122
Maternal (modeled, per 100,000 live births)	..	15	8	32	82
Births attended by skilled health staff (%)	..	..	99	97	96

Note: 0 or 0.0 means zero or less than half the unit shown. Net enrollment rate: break in series between 1997 and 1998 due to change from ISCED76 to ISCED97. Immunization: refers to children ages 12-23 months who received vaccinations before one year of age or at any time before the survey.

World Development Indicators database, World Bank - 15 April 2011.

Annex 7: Key Economic Indicators

Indicator	Actual			Estimate		Projected			
	2005	2006	2007	2008	2009	2010	2011	2012	2013
National accounts (as % of GDP)									
Gross domestic product[a]	100	100	100	100	100	100	100	100	100
Agriculture	12	11	10	11	10	9	9	9	9
Industry	29	29	28	28	28	27	27	26	26
Services	59	60	61	61	62	64	64	65	65
Total Consumption	97	97	95	97	95	94	90	90	89
Gross domestic fixed investment	19	21	24	24	23	23	25	25	24
Government investment	3	4	5	4	3	3	3	3	4
Private investment	16	17	19	20	20	19	22	21	20
Exports (GNFS)[b]	26	30	31	31	29	35	36	38	40
Imports (GNFS)	47	51	55	58	47	51	51	52	53
Gross domestic savings	3	3	5	3	5	6	10	10	11
Gross national savings[c]	15	14	13	8	16	16	17	16	16
Memorandum items									
Gross domestic product (US$ million at current prices)	25234	29332	38956	47738	40142	38009	46457	48996	52475
GNI per capita (US$, Atlas method)	3430	3760	4370	5370	5710	5630	5700	6150	6960
Real annual growth rates (%, calculated from 02 prices)									
Gross domestic product at market prices	5.4	3.6	5.4	3.8	-3.5	1.0	2.0	3.0	4.5
Gross Domestic Income	2.4	5.4	6.1	2.8	-2.0	-0.8	3.2	3.3	4.6
Real annual per capita growth rates (%, calculated from 02 prices)									
Gross domestic product at market prices	5.7	4.0	5.8	4.2	-3.1	1.3	2.1	3.1	4.7
Total consumption	-1.2	4.9	4.9	4.8	-2.6	-3.1	1.2	3.7	3.9
Private consumption	-1.1	4.9	0.7	5.8	-1.9	-3.4	2.1	4.0	3.9
Balance of Payments (US$ millions)									
Exports (GNFS)[b]	6608	8763	11924	14991	11855	13339	16762	18448	20936
Merchandise FOB	4972	6442	8756	10957	8365	9808	12428	13833	15844
Imports (GNFS)[b]	11903	15086	22000	27820	18945	19665	23795	25576	27815
Merchandise FOB	10261	12713	18478	23503	15485	16143	19515	20950	22750
Resource balance	-5295	-6323	-10076	-12829	-7090	-6326	-7034	-7128	-6879
Net current transfers	3426	3752	3974	3746	4941	4421	4716	4320	4121
Current account balance	-2193	-2986	-6932	-10439	-2859	-2795	-3629	-4231	-4378
Net private foreign direct investment	1550	4264	2523	2718	1865	1157	1824	2541	2153
Long-term loans (net)	2198	2864	4275	3740	2245	1201	861	1667	3080
Official	263	128	91	111	812	851	1793	1212	759
Private	1935	2736	4185	3629	1433	350	-931	456	2321
Other capital (net, incl. errors & ommissions)	472	1280	1156	1631	2086	-751	1152	52	52
Change in reserves[d]	-2027	-5422	-1022	2350	-3337	1189	-208	-29	-907
Memorandum items									
Resource balance (% of GDP)	-21.0	-21.6	-25.9	-26.9	-17.7	-16.6	-15.1	-14.5	-13.1
Real annual growth rates (YR02 prices)									
Merchandise exports (FOB)	14.4	4.9	17.2	8.9	-14.9	19.1	13.9	13.4	13.5
Primary	..	..	..	..	..	..	..	..	..
Manufactures	..	..	..	..	..	..	..	..	..
Merchandise imports (CIF)	-13.6	7.8	26.0	9.3	-22.9	4.1	15.2	10.9	8.3

(Continued)

Indicator	Actual			Estimate		Projected			
	2005	2006	2007	2008	2009	2010	2011	2012	2013
Public finance (as % of GDP at market prices)[e]									
Current revenues	43.0	44.2	43.8	42.9	42.2	40.9	39.7	38.9	39.1
Current expenditures	38.8	41.1	40.4	40.9	42.5	41.0	40.1	39.1	37.9
Current account surplus (+) or deficit (-)	4.2	3.1	3.4	2.0	-0.3	-0.1	-0.5	-0.2	1.2
Capital expenditure	3.2	4.7	5.6	4.7	4.2	4.5	4.1	3.7	4.0
Foreign financing	0.4	-0.2	1.4	-1.5	2.2	1.1	3.5	2.3	1.3
Monetary indicators									
M2/GDP	27.3	32.3	39.7	37.3	44.4	45.6	50.0	62.5	66.7
Growth of M2 (%)	42.1	38.3	42.5	9.8	21.5	12.9	23.5	34.4	15.6
Private sector credit growth / total credit growth (%)	122.4	578.2	107.0	77.9	80.3	77.5	-12.9	77.1	79.1
Price indices(YR02 =100)									
Merchandise export price index	141.1	174.3	202.1	232.3	208.4	205.2	228.3	224.2	226.2
Merchandise import price index	157.8	181.4	209.2	243.4	207.9	208.2	218.4	211.5	212.1
Merchandise terms of trade index	89.4	96.1	96.6	95.4	100.2	98.5	104.5	106.0	106.7
Real exchange rate (US$/LCU)[f]	100.0	108.0	118.4	126.1	117.6	108.3	123.8	130.9	133.8
Real interest rates									
Consumer price index (% change)	17.3	12.7	6.5	12.4	8.1	6.3	7.1	3.4	3.4
GDP deflator (% change)	15.7	12.5	10.1	12.6	5.6	9.0	10.3	4.4	3.7

a. GDP at factor cost
b. "GNFS" denotes "goods and nonfactor services."
c. Includes net unrequited transfers excluding official capital grants.
d. Includes use of IMF resources.
e. Consolidated general government.
f. "LCU" denotes "local currency units." An increase in US$/LCU denotes appreciation.

Annex 8: Key Exposure Indicators

Indicator	Actual			Estimated			Projected		
	2005	2006	2007	2008	2009	2010	2011	2012	2013
Total debt outstanding and disbursed (TDO) (US$m)[a]	15467	19606	26236	30709	32886	31570	34951	34340	36536
Net disbursements (US$m)[a]	2698	3868	5363	4261	2981	36	861	1392	2220
Total debt service (TDS) (US$m)[a]	1232	2148	3232	4734	4644	5404	6073	6323	7275
Debt and debt service indicators (%)									
TDO/XGS[b]	162.8	160.6	168.3	167.4	201.7	184.5	170.4	153.0	145.2
TDO/GDP	61.3	66.8	67.3	66.7	79.4	82.2	75.2	70.1	69.6
TDS/XGS	13.0	17.6	20.7	25.8	28.5	31.6	29.6	28.2	28.9
Concessional/TDO	21.4	15.7	12.5	10.5	11.7	12.5	11.5	12.0	11.3
IBRD exposure indicators (%)									
IBRD DS/public DS	22.2	44.2	21.4	21.7	19.2	16.6	14.7	12.1	8.4
Preferred creditor DS/public DS (%)[c]	77.0	82.9	44.8	57.2	52.3	44.9	56.1	70.4	76.9
IBRD DS/XGS	1.2	2.9	0.8	0.6	0.6	0.7	0.6	0.7	0.7
IBRD TDO (US$m)[d]	2147	2127	2326	2276	1783	1818	2063	2264	2516
Of which present value of guarantees (US$m)									
Share of IBRD portfolio (%)	2	2	2	2	2	2	2	2	2
IDA TDO (US$m)d	486	553	625	655	676	681	708	709	689
IFC (US$m)									
Loans									
Equity and quasi-equity /c									
MIGA									
MIGA guarantees (US$m)									

a. Includes public and publicly guaranteed debt, private nonguaranteed, use of IMF credits and net short-term capital.

b. "XGS" denotes exports of goods and services, including workers' remittances.

c. Preferred creditors are defined as IBRD, IDA, the regional multilateral development banks, the IMF, and the Bank for International Settlements.

d. Includes present value of guarantees.

e. Includes equity and quasi-equity types of both loan and equity instruments.

Annex 9: IBRD Program Summary (in US million)

Fiscal year	*Proj ID*	*US$(M)*	*Strategic Rewards b (H/M/L)*	*Implementation b Risks (H/M/L)*
2012	PEDPL 3	100.0	H	M
	Result	100.0		
2013	ROADS PROJECT	100.0	H	M
	HEALTH PROJECT	40.0	H	M
	PFDPL1	100.0	H	M
	Result	240.0		
2014-2015				
	Investment Operations TBD	TBD		
	Result	TBD		
Overall Result		TBD		

Annex 10: Operations Portfolio (IBRD/IDA/GRANTS)

as of September 30, 2011

IBRD/IDA *

Total Disbursed (Active)	271.31
of which has been repaid	0.00
Total Disbursed (Closed)	676.22
of which has been repaid	0.00
Total Disbursed (Active + Closed)	947.53
of which has been repaid	0.00
Total Undisbursed (Active)	559.13
Total Undisbursed (Closed)	0.00
Total Undisbursed (Active + Closed)	559.13

Active Projects

		Last PSR Supervision Rating			Original Amount in US$ Millions		
Project ID	**Project Name**	**Development Objectives**	**Implementation Progress**	**Fiscal Year**	**IBRD**	**IDA**	**GRANT**
P090418	CNSLTD COLLECT & PENS	MS	MS	2005		25	
P108005	CORRIDOR X HIGHWAY PR	S	MS	2010	388		
P088867	ECSEE APL #2 (SERBIA)	S	S	2005		21	
P075343	ENERGY EFF	MS	MS	2004	18	31	
P077675	HEALTH (SERBIA)	S	MS	2003	13.5	20	
P087964	IRRIG/DRAINAGE REHAB (S	MS	S	2006	49.37	25	
P096823	LOCAL SERVICES DELIVEF	S	MS	2008	46.4		
P078311	REAL ESTATE CADASTRE	S	MS	2004		30	
P094212	TRANS AG REFORM	U	U	2007	17		
P093545	TRANS AG REFORM (GEF)	U	U	2007			4.5
P075207	TRNSPT REHAB (SERBIA)	S	S	2004	50	55	
P092999	YF BOR Reg Devt Proj	MS	MS	2007	33	10	
P110910	CRIF	S	S	FY10	5		
Overall Result					620.27	217	4.5

IFC Committed and Disbursed Outstanding Investment Portfolio
as of September 30, 2011
(In USD millions)

		Committed					Disbursed Outstanding				
FY Approval	Company	Loan	Equity	**Quasi Equity	*GT/RM	Partici pant	Loan	Equity	**Quasi Equity	*GT/RM	Partici pant
2006/08	Banca intesa spa	0	46.99	60.75	0	0	0	45.32	60.75	0	0
2011	Cacanska banka	6.75	13.65	0	0	0	6.75	8.91	0	0	0
2006	Continental bank	16.87	0	0	0	0	16.87	0	0	0	0
2011	Efgserbia	51.82	0	0	0	0	51.82	0	0	0	0
2011	Farmakom m.b.	54	0	0	0	40.5	0	0	0	0	0
2011	Frikom	29.53	0	0	0	0	29.53	0	0	0	0
1985	Jugobanka	0	0	0	0	0	0	0	0	0	0
2010	Kronospan srb	32.4	0	0	0	0	32.4	0	0	0	0
0	Porr jagodina	0	0	2.69	0	0	0	0	2.69	0	0
0	Porr leskovac	0	0	2.98	0	0	0	0	2.98	0	0
2008	Procredit lease	10.12	0	0	0	0	10.12	0	0	0	0
2010	Procredit serbia	27	0	0	0	0	27	0	0	0	0
2010	Socgen serbia	54	0	0	0	0	36.45	0	0	0	0
2005	Unicredit bank	28.91	0	0	0	0	28.91	0	0	0	0
1987	Vojvodjanska	0	0	0	0	0	0	0	0	0	0
Total Portfolio:		**311.4**	**60.64**	**66.42**	**0**	**40.5**	**239.85**	**54.23**	**66.42**	**0**	**0**

* Denotes Guarantee and Risk Management Products.
** Quasi Equity includes both loan and equity types.