

EXECUTIVE SUMMARY

1. **Background.** Serbia has made significant progress on a wide ranging reform program since 2000. Macro-economic stability has been restored, and incomes have risen strongly. GDP per capita, estimated at \$2,200 in 2002, is now approaching \$5,400. Poverty has fallen from 14.6 percent of the population to about 8.8 percent. Growth has been underpinned by structural reforms to improve the business environment and the functioning of the enterprise sector. Public debt has almost halved as a proportion of GDP and reserves stand at over 30 percent of GDP. At the time of Serbia's accession to Bank membership in 2001, analysis was focused on the importance of breaking with the past. Now, however, the theme of this partnership strategy might more appropriately be to build on the success of recent economic gains and seize the future.

2. **Completing the Transition Agenda and Moving Toward Europe.** Due to the turmoil of the 1990s Serbia was one of the last countries in the Western Balkans to embark on the transition agenda. Strong progress has been made, particularly in expanding private sector participation in the financial and real sectors. The reform program has helped to underpin the country's strong economic performance and reductions in poverty. Nevertheless, risks remain. Serbia faces a challenging agenda if it is to fulfill its potential and participate in a wider Europe. Further reforms to spur private sector led growth, while protecting and better managing the environment, will be critical to ensure living standards and quality of life continue to converge with those in Europe. Particular efforts will be required to ensure that all people in Serbia have the opportunity to participate in and benefit from growth. Further strengthening of democratic institutions and overcoming remaining political legacy issues will also be required in the European stabilization and association process. Serbia concluded technical negotiations with the European Union on a *Stabilization and Association Agreement (SAA)* in September 2007. However the political situation and the EU accession process in Serbia remains influenced by recent history.

3. **The World Bank Group has actively supported Serbia's transition since re-engagement in 2001.** The Bank has had a discrete program of lending and analytical work for Serbia. Total IDA credits and grants committed to Serbia since 2001 amount to almost \$740 million, with \$145 million in IBRD commitments. As well as IDA/IBRD support, the Bank Group provided technical assistance from both IFC and MIGA to improve the business environment. IFC has invested over \$325 million in Serbia, and MIGA has provided guarantees of over \$425 million, in both cases predominantly in the financial sector. The objectives of the last CAS's three pillars to: (i) create a smaller, more sustainable, more efficient public sector, (ii) create a larger, more dynamic private sector, and (iii) reduce poverty levels and improve social protection and access to public services, were largely met. The economy has grown at an average of 5.5 percent per annum, driven by the private sector. The proportion of the population living in poverty has fallen by 5 percent, and the Government is already close to meeting their 2010 target of reducing poverty to 6.5 percent. Consistent fiscal deficits in the early part of the decade were reduced as a result of significant consolidation of public expenditures in 2004 and 2005, although spending increased in 2006 as a proportion of GDP in the run-up to the election. Current projections for 2007 suggest that spending has stabilized. This was accompanied by significant structural public sector reform, and the effectiveness of public spending has improved, with the share of public investments rising as a proportion of total government spending. Despite recent progress, there is the need to continue improving the effectiveness of public spending by strengthening the Government's Public Expenditure Management system. The World Bank Group support is widely recognized by the authorities as having strengthened the business environment while maintaining and improving service sustainability and quality in key sectors such as health, transport and energy. The CAS FY05 was noticeable for the country's graduation from IDA to IBRD financing due to Serbia's relatively strong economic performance since 2000.

4. **The new Country Partnership Strategy (CPS).** This CPS reflects the coordinated support able to be provided to Serbia from all parts of the Bank Group. Interventions from IBRD, IFC, MIGA, and WBI, will

be coordinated closely and are expected to have strong synergies. Over time, all parts of the Bank Group, including IFC, MIGA, and WBI are likely to play an increasingly central role in the Bank Group's program. Given Serbia's relatively strong economic progress to date and the country's graduation to IBRD this CPS envisages the Bank working even more closely with the Authorities to ensure that the Bank program is demand driven and focused on supporting the Government's own reform program. The four year CPS is designed to ensure that the World Bank programming cycle is consistent with the anticipated political cycle in Serbia. Following Parliamentary elections in January 2007, the normal Parliamentary term in Serbia would run until the end of 2010. The CPS consequently coincides with the current Parliamentary mandate. Within the overarching framework of European integration and poverty reduction, the CPS supports three Government identified priorities.

- i. encouraging dynamic private sector led growth to ensure incomes continue to converge with European levels;
- ii. providing opportunities and broadening participation in growth; and
- iii. managing emerging environmental and disaster risks.

5. A focused program of investment operations, support for reform efforts, deployment of a range of financial instruments beyond traditional lending and technical assistance is planned. The CPS envisages an indicative base-case lending envelope of \$600 million over four years. Within the strategic framework outlined in the CPS, mechanisms have been introduced to ensure that support is able to be tailored and adjusted to meet emerging needs and the rapidly changing circumstances of a middle-income country situated in a region still on the road to political stability. This CPS outlines a set of agreed investments and analytical support for FY08 and FY09. Indicative areas for potential engagement in the second half of the CPS period are also set out. Nevertheless, decisions on interventions in the latter half of the CPS period will be made as part of a mid-term review process anticipated for late calendar 2009. Scope is also available to calibrate lending to reflect changes in Serbia's overall creditworthiness compared to current projections, and lending volumes will be considered again in the mid-term review. The Government recognizes the value added and comparative advantages that can be brought by the Bank Group. The Bank will, however, need to continue to adjust its business model to remain responsive to Serbian requirements and a rapidly changing environment. This is likely to require the deployment of a range of financial instruments beyond traditional lending, including possibly deferred drawdown financing and catastrophic risk insurance. Greater involvement by all parts of the Bank Group to work with the Authorities to encourage public-private partnerships, including at the sub-national level, offers particular scope to encourage further investment in the delivery of important infrastructure and social services.

6. Partnerships. The Bank Group will work in partnership with the authorities and other members of the international community. Given the over-arching role of the EU, Bank interventions will be aligned with EU programs to help Serbia reach European standards. Specific rural and regional development investments will also be undertaken in close coordination with the EC. The Bank continues to work closely with the IMF, although Serbia does not currently have a program. The Bank will cooperate closely with the range of multilateral and bilateral partners active in Serbia. In light of Serbia's prevailing strong resource position the Bank will increasingly seek to leverage local resources in support of investment activities.

7. Risks. Risks remain, particularly given the increasingly uncertain situation in the region arising from unresolved Kosovo status issues. Serbia also remains vulnerable to exogenous shocks. Managing risks will require that the Bank Group work cooperatively with the Serbian Authorities in a highly flexible manner in order to encourage Serbia's continued international engagement and integration at a particularly sensitive time. At the same time, Bank Group support is necessarily dependent on Serbia meeting international responsibilities. The Bank will need to be agile in responding to changing circumstance and the demands of a sophisticated middle income client with a range of options for both financial products and advisory services.