

## *Serbia Country Partnership Strategy for FY08-FY11*

103. **The measurement of results is an essential component to improve accountability and effectiveness of the Bank involvement in Serbia.** Box 1 aggregates the major results and outcomes expected to be achieved by the Government, with the World Bank support, during the CPS period. A more detailed results framework setting out the expected outcomes of individual interventions under each Pillar is included in Annex 1. The Bank will rigorously monitor the progress made under each pillar throughout the CPS period.

104. **The Bank and the Government will engage in annual consultation process to assess progress of the CPS and make possible adjustments to the Bank program.** The authorities have indicated their wish to hold annual round table discussions with the World Bank on outstanding sectoral reform issues and the overall status of the Bank portfolio in Serbia. These discussions provide an opportunity to review the status and assess progress of the CPS, make possible adjustments to both the Government and the Bank program and reflect new information and developments that might affect the Bank's portfolio. Consultations will also provide input for updating the CPS results framework to reflect possible adjustments to the individual sectoral objectives and milestones.

105. **The Bank will monitor results in the framework of its own monitoring mechanisms.** With regard to lending volumes, the Bank will undertake an annual creditworthiness review and adjustments to the base case lending scenario will be made on the basis of the review outcomes, within the lending parameters established above. A CPS mid-term review is foreseen to take place in mid-FY09. This will provide an opportunity to assess CPS progress and, as appropriate, move to high case lending, or reallocate resources and fine-tune the directions and objectives for the outer years of the program. In addition, the Bank will carry out results based portfolio reviews on an annual basis to assess the status of the various projects in the portfolio. The results and monitoring frameworks for individual Bank interventions will be aligned with the CPS results framework to facilitate portfolio monitoring.

106. **The Bank will primarily depend on Government systems and agencies for obtaining statistical data for the compilation and verification of CPS results and milestones.** Serbia has strong statistical capacities and the Statistical Office of the Republic of Serbia is a well organized unit that provides reliable and accurate statistical data. The EU and Eurostat are supporting the Statistical Office to adopt European standards in data gathering and processing. A British trust fund administrated by the World Bank is assisting the Statistical Office to strengthen its capacities in carrying out poverty measurements with the aim to produce better quality data on poverty in Serbia. However, mainly IMF figures will be used when assessing the macroeconomic developments in Serbia.

## **VI. POTENTIAL RISKS AND MITIGATION MEASURES**

107. **Regional stability.** The potential for regional instability and political uncertainty in Serbia arising from unresolved Kosovo status issues is the key risk to the CPS. Efforts to reach a long-term negotiated solution to Kosovo's status are currently being conducted, but the scope for agreement appears extremely limited. At this stage, the Serbian and Kosovo sides have fundamental differences of views on the basic question of autonomy or independence. Divisions are also apparent within the international community. The possibility exists of a unilateral declaration of independence by Kosovo. The status of Kosovo has become an increasingly prominent issue in Serbia, to the extent that this may override the Government's other stated reform priorities. Regional uncertainty could potentially deter investment, leading to a deterioration in Serbia's overall economic position. A potential reduction in regional cooperation, including in sectors such as energy where Serbia has considerable potential, could have an adverse economic effect. At the extreme, isolated violence associated with continued uncertainty remains a possibility. Kosovo is likely to be an issue in forthcoming Presidential elections, and have the potential to lead to an increasing radicalization of Serbian society.

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108. **Serbia remains vulnerable to exogenous economic shocks.** Economic performance over the past few years has been very strong. Nevertheless, rapidly growing credit and associated private external debt and a stubborn current account deficit illustrate Serbia's continuing vulnerability to external shocks. A sudden increase in lending spreads or a decrease in liquidity could limit continued growth in Serbia and projected improvements in overall creditworthiness.

109. **Continued policy reform will be required to strengthen macro-economic stability and further improve Serbia's creditworthiness.** In particular, the government will need to recalibrate macroeconomic policy in order to reduce the imbalances that have emerged over the last two years, primarily due to fiscal stimulus. Greater fiscal restraint, consistent with the Government's stated intentions, will be important to reduce risks, as will continued structural reform. In addition further efforts to ensure rapid domestic credit growth and increases in private external borrowing are put on a more sustainable footing, and that credit increasingly finances productive investment rather than consumption. If these issues are not tackled, real vulnerabilities remain from the widening current account deficit and rapidly growing private external debt.

110. **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, particularly in relation to debt servicing, or an agreement being reached that allows an orderly resolution of this issue. Given the very high level of uncertainty in the region, this CPS is perhaps best seen as setting out broad "rules of engagement" rather than as a detailed blueprint for Bank Group support.

## VII. CONCLUSION

111. **Serbia is well poised to continue its strong economic performance and make progress toward the goal of full European integration.** While the transition program began relatively recently, significant economic reform has underpinned strong economic growth and real reductions in poverty in Serbia over the past few years. The Government has demonstrated a degree of commitment to undertake difficult but necessary "second generation" reforms that should help to ensure a sustainable growth path for the economy led by a dynamic private sector. Efforts are also evident to ensure that the benefits of growth are distributed widely, and that opportunities for disadvantaged households to participate in the economy are increased. Nevertheless, Serbia and the region have not yet fully moved beyond the difficult legacies resulting from the turmoil of the 1990s. A key challenge will be to ensure that this reform momentum is able to be continued, and that international confidence and regional stability is maintained, at a particularly sensitive time for Serbia. The World Bank Group has the potential to continue to be a strong partner for Serbia as it faces these challenges. This will, however, require the Bank Group to be even more responsive to the demands of a sophisticated middle income client. Further strengthened cooperation with other multilateral and bilateral partners, particularly but not only the EC, will also be critical to strengthen the overall effectiveness of the support that can be provided. Most critically, the World Bank Group will need to be able to respond flexibly in order to calibrate engagement with Serbia in an environment of high uncertainty.