PROJECT INFORMATION DOCUMENT (PID)
APPRAISAL STAGE

Report No.: PIDA14215

Project Name	Serbia Competitiveness and Jobs (P152104)
Region	EUROPE AND CENTRAL ASIA
Country	Serbia
Sector(s)	Other social services (30%), General industry and trade sector (70%)
Theme(s)	Managing for development results (5%), Micro, Small and Medium Enterprise support (15%), Export development and competitiveness (30%), Technology diffusion (20%), Improving labor markets (30%)
Lending Instrument	Investment Project Financing
Project ID	P152104
Borrower(s)	Ministry of Finance
Implementing Agency	Public Policy Secretariat, Ministry of Economy, Ministry of Education Science and Technological Development, Ministry of Labor, Employment, Veteran and Social Affairs
Environmental Category	B-Partial Assessment
Date PID Prepared/Updated	22-Jun-2015
Date PID Approved/Disclosed	23-Jun-2015
Estimated Date of Appraisal Completion	22-May-2015
Estimated Date of Board Approval	29-Jul-2015
Appraisal Review Decision (from Decision Note)	The review authorized the team to appraise and negotiate.

I. Project Context

Country Context

Serbia continues to face major economic challenges following the global financial crisis that began in 2008. Between 2001 and 2008, supported by a favorable global economy and implementation of reforms to open up the economy, Serbia made considerable progress in terms of both growth and poverty reduction. Real GDP growth averaged 5.0 percent annually, and the poverty headcount declined from 14.0 percent in 2002 to 6.6 percent in 2007. However as in many countries in emerging Europe, Serbia's growth was driven by high domestic demand fueled by significant capital inflows, and came at the expense of accumulating internal and external imbalances. The 2008 international economic crisis and drying up of capital inflows impacted heavily on Serbia, resulting in a first recession in 2009. A slow and indecisive response to the crisis prolonged its impact, and the economy was further affected by droughts and flooding in 2012, leading to a second recession. Capture by vested interests led to a negative cycle in which state funds and state owned banks were used to prop up insolvent enterprises. The disastrous floods of May 2014 triggered a further recession. As a result of these three successive recessions, Serbia's GDP is still below the pre-crisis level, most of the earlier gains in poverty reduction were reversed and the public debt to GDP ratio sharply increased from 36 percent in 2009 to over 70 percent in 2014.

Serbia has a window of opportunity to accelerate structural reforms and rebalance its economy. Two successive elections in 2012 and 2014 created a new coalition with a strong majority in Parliament. Following the achievement of some of its political objectives, mostly related to the dialogue with Kosovo and opening EU accession talks, the government in 2014 turned its focus toward the unfinished economic reform agenda. While reform efforts suffered initially due to the above-mentioned floods, the Government has since made tangible efforts to initiate reforms in critical areas, including reducing the role of the state, improving the business environment, and restoring macro-fiscal stability.

During the second half of 2014 the Government initiated critical reform legislation and framed a comprehensive medium term fiscal strategy, which was approved in February 2015. In this context, public sector wage and pension cuts were legislated to address a rapidly deteriorating fiscal situation, and decisive steps to dismantle commercial State Owned Enterprises were initiated. Structural reforms in the energy and transport sectors along with state owned banking reform followed. The government has also, for the first time in over a decade, initiated a fundamental reorganization of the state administration, recognizing that weak planning and implementation deficits are among the most significant risks to the reform program. To minimize macroeconomic risks, reforms are underpinned by a three year Precautionary Stand-By Agreement with the IMF, approved by the IMF Board in February 2015.

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Sectoral and institutional Context

For higher and sustainable growth in the future, Serbia will need to rely more on increased capital accumulation, enhanced productivity, improved competitiveness and deeper integration with global markets. By investing more, becoming more export-oriented, and raising economy-wide productivity, Serbia could achieve more balanced and sustainable growth. At 3.4 percent of GDP, FDI is 2 percentage points lower than before the crisis. Total investment at 18–19 percent of GDP is below the 21–22 percent pre-crisis level and the 25 percent recommended by the Growth Commission as the threshold that countries should strive to meet to attain robust growth.

While relatively low compared to regional peers, exports have much potential to continue growing. In a small middle-income economy, exports should drive economic activity, a strategy which successful emerging markets have embraced. Proximity to and the prospect of full integration into the EU offer Serbia a solid opportunity to expand exports. Serbia has a revealed comparative advantage (RCA) in several important sectors and other sectors are improving rapidly. The most rapidly growing categories of exports from 2007-2012 were primary agriculture and machinery/ electronics/ transportation equipment. Information and communications technology (ICT) comprise 51 percent of services exports, a higher share than in comparator countries in South East Europe; however, as measured by unit values, Serbian exports are typically of lower quality with less value-added. They are also more volatile, suggesting problems with the capacity and consistency of export production.

The contribution of total factor productivity (TFP) has perceptibly deteriorated since 2008. Growth accounting reveals that the contribution of TFP to Serbian growth since 2008 has only been one-fourth of what it was before the crisis. The contribution of capital to growth has been mildly positive, but the contribution of human capital has been highly negative, especially in recent years. With Serbia's aging population, maintaining a positive contribution to growth requires boosting labor productivity and innovation, increasing labor market participation, and keeping workers in the labor force until retirement age and beyond.

Low private investment, combined with labor supply and structural issues have led to a lack of formal sector jobs. As of 2014, the employment rate was only 40 percent, and unemployment stood at 17 percent (relative to 20 percent the year before, as 80,000 more jobs have been created, though mostly in the informal sector and agriculture). Public employment still accounts for more than two fifths of formal employment. At 42 percent youth unemployment is more than twice that of the working age population and many young people are leaving the country in search of employment opportunities. Not surprisingly, the bottom 40 percent of the population constitute the bulk of the jobless, where the lack of labor income is a major deterrent to escaping poverty. Special measures are necessary to help this group, since they do not necessarily have the skills to benefit from the types of jobs that export-led growth can create.

To restart growth, reduce poverty, and increase shared prosperity, it will be necessary to boost private sector investment, exports, productivity, and jobs. Since this is a complex agenda, it needs to be broken down to better understand the constraints and possible government interventions. This can be done through the lens of jobs by considering both labor supply and labor demand issues. Labor demand issues are related to firm investment (or lack thereof), exports, and productivity. It is hard to have job creation when firms are not investing and/or innovating. In Serbia, investment, exports, and productivity growth are relatively low, suggesting that firms are not investing enough to lead to strong job creation. Possible reasons for low investment include: (i) uncertainty about returns to investment, (ii) lack of appropriability of returns to investment (innovative and first-mover firms incur higher initial costs and can be copied), (iii) firms, entrepreneurs, and investors do not know where to invest, (iv) access to finance (credit-constraints because financial markets do not function well and/or investment payback periods do not coincide with loan maturities offered by private lenders), (v) lack of competition does not induce firms to invest and innovate, (vi) investment climate constraints raise costs and lower returns on investment, and (vii) infrastructure and trade logistics bottlenecks decrease returns on investment.

On the labor supply side, problems include: (i) job search constraints (this implies addressing informational gaps, e.g. educating workers or helping firms advertise), (ii) limited participation in the labor force and high informality, especially among older workers, low-educated women, members of ethnic minorities, and social assistance beneficiaries, and (iii) lack of job-relevant skills (this appears to be a problem in Serbia, but less so than in many other countries).

Project support is organized across 3 main themes: private sector investment and export promotion; firm-led innovation and research sector reforms; and labor market intermediation. In addition, there is a horizontal theme that focuses on policy planning, monitoring, and coordination.

II. Proposed Development Objectives

The PDO is to improve the effectiveness and coordination of selected public programs to alleviate constraints to competitiveness and job creation, including investment and export promotion, innovation, active labor market programs, labor intermediation, and activation of social assistance beneficiaries.

III. Project Description

Component Name

Policy planning, monitoring, and coordination

Comments (optional)

This component supports the Government's program for policy planning, monitoring, and coordination through developing and piloting an inter-ministerial policy planning, monitoring, and coordination system (PPMC) in support of competitiveness and jobs reforms.

Component Name

Investment and export promotion

Comments (optional)

This component promotes investment and exports:
(a) developing and adopting a strategic framework and overall action plan for investment and export promotion, including restructuring the Ministry of Economy investment and export promotion agencies; and
(b) improving investment and export promotion programs and services.

Component Name

Innovation

Comments (optional)

The component promotes innovation by:
(a) supporting the operation of the Innovation Fund and it's Matching Grants Program;
(b) supporting technology transfer; and
(c) undertaking strategic planning for institutional reform of the public research and development sector.

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Component Name

Labor

Comments (optional)

The component will: a) enhance the capacity of the National Employment Service; b) improve the effectiveness of active labor market policies; and c) increase social assistance beneficiaries' incentives to work.

Component Name

Project management and technical assistance

Comments (optional)

IV. Financing *(in USD Million)*

Total Project Cost:	381.00	Total Bank Financing:	100.00
Financing Gap:	0.00		

For Loans/Credits/Others	Amount
Borrower	281.00
International Bank for Reconstruction and Development	100.00

Total	381.00

V. Implementation

The key coordinating agency will be the recently-created Public Policy Secretariat (PPS). The PPS will coordinate all of the results monitoring, reporting, fiduciary functions, and safeguards, in close collaboration with the line ministries.

The line ministries involved in the project include: Ministry of Economy (MoE); Ministry of Education, Science and Technological Development (MoESTD); and Ministry of Labor, Employment, Veteran and Social Affairs (MoLESVA, in coordination with the National Employment Service).

VI. Safeguard Policies (including public consultation)

Safeguard Policies Triggered by the Project	**Yes**	**No**
Environmental Assessment OP/BP 4.01	✗	
Natural Habitats OP/BP 4.04		✗
Forests OP/BP 4.36		✗
Pest Management OP 4.09		✗
Physical Cultural Resources OP/BP 4.11		✗
Indigenous Peoples OP/BP 4.10		✗
Involuntary Resettlement OP/BP 4.12		✗
Safety of Dams OP/BP 4.37		✗
Projects on International Waterways OP/BP 7.50		✗
Projects in Disputed Areas OP/BP 7.60		✗

Comments (optional)

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