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Report No: PAD1176

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

PROJECT APPRAISAL DOCUMENT

ON A

PROPOSED LOAN
IN THE AMOUNT OF EUR 89.5 MILLION (USD 100 MILLION EQUIVALENT)

TO THE

REPUBLIC OF SERBIA
FOR A

COMPETITIVENESS AND JOBS PROJECT

July 23, 2015

Trade and Competitiveness Global Practice
Europe and Central Asia Region

CURRENCY EQUIVALENTS

(Exchange Rate Effective: June 30, 2015)

Currency Unit	=	New Serbian Dinar
107.67	=	USD 1
Currency Unit	=	Euro
0.894	=	USD 1

FISCAL YEAR

January 1 – December 31

ABBREVIATIONS AND ACRONYMS

ALMPs	Active labor market programs
BEP	Business Enabling Project (USAID)
BTP	Belgrade Technopark
CPS	Country Partnership Strategy
DLI	Disbursement-linked indicators
DPM	Deputy Prime Minister
ECA	Europe and Central Asia
EEP	Eligible expenditure programs
EU	European Union
EUD	European Union Delegation
FDI	Foreign direct investment
FMC	Financial Management and Control
FSA	Financial social assistance
GDP	Gross domestic product
GoS	Government of Serbia
ICR	Implementation Completion and Results Report
ICT	Information and communication technologies
IF	Innovation Fund (Serbia)
IFC	International Finance Corporation
IFI	International financial institution
IFR	Interim Financial Report
IP	Intellectual property
IPA	EU Instrument for Pre-Accession
IPSAS	International Public Sector Accounting Standard
LSMS	Living Standards Measurement Survey
MIS	Management information system
MGs	Matching grants
MoE	Ministry of Economy
MoESTD	Ministry of Education, Science, and Technological Development
MoF	Ministry of Finance
MoLEVSA	Ministry of Labor, Employment, Veteran and Social Affairs
MoPALSG	Ministry of Public Administration and Local Self-Government

NALED	National Alliance for Economic Development
NES	National Employment Service
MOU	Memorandum of Understanding
NSF	National Science Foundation (of Serbia)
PCT	Patent Cooperation Treaty
PDO	Project development objective
PIFC	Public Internal Financial Control
PIU	Project implementation unit
POM	Project operations manual
PPS	Public Policy Secretariat
R&D	Research and development
R&I	Research and innovation (strategy)
RDI	Research and development institutes
SAI	State Audit Institution
SCD	Systematic Country Diagnostic
SEIO	Serbia European Integration Office
SOE	State-owned enterprise
SOE	Statement of expenditures
SIP	Serbia Innovation Project
STA	Single Treasury Account
TA	Technical assistance
TT	Technology transfer
TTF	Technology transfer facility
TTO	Technology transfer office
USAID	U.S. Agency for International Development
USD	United States Dollar
WB EDIF	Western Balkans Enterprise Development and Innovation Facility
WB	World Bank
WBG	World Bank Group

Regional Vice President:	Laura Tuck
Country Director:	Ellen A. Goldstein
Senior Global Practice Director:	Anabel Gonzalez
Practice Manager:	Paloma Anos Casero
Task Team Leader(s):	Thomas Haven and Dusko Vasiljevic

SERBIA
Competitiveness and Jobs

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PAD DATA SHEET

Serbia

Serbia Competitiveness and Jobs (P152104)

PROJECT APPRAISAL DOCUMENT

EUROPE AND CENTRAL ASIA

0000009096

Report No.: PAD1176

Basic Information

Project ID P152104	EA Category B - Partial Assessment	Team Leader(s) Thomas Edward Haven, Dusko Vasiljevic
Lending Instrument Investment Project Financing	Fragile and/or Capacity Constraints [ ]	
	Financial Intermediaries [ ]	
	Series of Projects [ ]	
Project Implementation Start Date 26-Aug-2015	Project Implementation End Date 31-Mar-2019	
Expected Effectiveness Date 15-Jan-2016	Expected Closing Date 30-Jun-2019	
Joint IFC No		

Practice Manager/Manager	Senior Global Practice Director	Country Director	Regional Vice President
Paloma Anos Casero	Anabel Gonzalez	Ellen A. Goldstein	Laura Tuck

Borrower: Ministry of Finance

Responsible Agency: Public Policy Secretariat

Contact:	Jasna Atanasijevic	Title:	Director
Telephone No.:	381-11-3349818	Email:	jasna.atanasijevic@rsjp.gov.rs

Responsible Agency: Ministry of Economy

Contact:	Vesna Kopanja	Title:	Advisor
Telephone No.:	381-11-3642701	Email:	vesna.kopanja@privreda.gov.rs

Responsible Agency: Ministry of Education Science and Technological Development

Contact:	Aleksandar Belic	Title:	State Secretary

Telephone No.:	381-11-3616584	Email:	aleksandar.belic@mpn.gov.rs
Responsible Agency: Ministry of Labor, Employment, Veteran and Social Affairs			
Contact:	Ljiljana Dzuver	Title:	Assistant Minister
Telephone No.:	381-11-2642139	Email:	ljiljana.dzuver@minrzs.gov.rs

Project Financing Data (in USD Million)

[X]	Loan	[ ]	IDA Grant	[ ]	Guarantee
[ ]	Credit	[ ]	Grant	[ ]	Other

Total Project Cost:	393.83 (EUR 352.48)	Total Bank Financing:	100.00 (EUR 89.5)
Financing Gap:	0.00		

Financing Source	**Amount**
Borrower	293.83 (EUR 262.98)
International Bank for Reconstruction and Development	100.00 (EUR 89.5)
Total	393.83 (EUR 352.48)

Expected Disbursements (in USD Million)

Fiscal Year	2016	2017	2018	2019	0000	0000	0000	0000	0000	0000
Annual	7.44	31.18	30.19	31.19	0.00	0.00	0.00	0.00	0.00	0.00
Cumulative	7.44	38.62	68.81	100.00	0.00	0.00	0.00	0.00	0.00	0.00

Institutional Data

Practice Area (Lead)

Trade & Competitiveness

Contributing Practice Areas

Governance, Social Protection & Labor

Cross Cutting Topics

[ ] Climate Change
[ ] Fragile, Conflict & Violence
[ ] Gender
[X] Jobs
[ ] Public Private Partnership

Sectors / Climate Change

Sector (Maximum 5 and total % must equal 100)

Major Sector	Sector	%	Adaptation Co-benefits %	Mitigation Co-benefits %

Health and other social services	Other social services	30		
Industry and trade	General industry and trade sector	70		
Total		100		

☑ I certify that there is no Adaptation and Mitigation Climate Change Co-benefits information applicable to this project.

Themes

Theme (Maximum 5 and total % must equal 100)

Major theme	Theme	%
Public sector governance	Managing for development results	5
Financial and private sector development	Micro, Small and Medium Enterprise support	15
Trade and integration	Export development and competitiveness	30
Trade and integration	Technology diffusion	20
Social protection and risk management	Improving labor markets	30
Total		100

Proposed Development Objective(s)

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.

Components

Component Name	Cost (USD Millions)*
Policy planning, monitoring, and coordination	4.00 (EUR 3.60)
Investment and export promotion	22.00 (EUR 19.7)
Innovation	35.00 (EUR 31.3)
Labor	34.00 (EUR 30.4)
Project management and technical assistance	4.75 (EUR 4.25)

Systematic Operations Risk- Rating Tool (SORT)

Risk Category	Rating
1. Political and Governance	Substantial
2. Macroeconomic	Substantial
3. Sector Strategies and Policies	Moderate

* The total of the project components is less than the total amount of the loan (EUR 89.5 mn) as the 0.25% front end fee is being paid through the loan proceeds.

4. Technical Design of Project or Program	Substantial
5. Institutional Capacity for Implementation and Sustainability	Substantial
6. Fiduciary	Substantial
7. Environment and Social	Moderate
8. Stakeholders	Substantial
9. Other	Moderate
OVERALL	Substantial

Compliance

Policy

Does the project depart from the CAS in content or in other significant respects?	Yes [ ]	No [X]
Does the project require any waivers of Bank policies?	Yes [ ]	No [X]
Have these been approved by Bank management?	Yes [ ]	No [ ]
Is approval for any policy waiver sought from the Board?	Yes [ ]	No [X]
Does the project meet the Regional criteria for readiness for implementation?	Yes [X]	No [ ]

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

Legal Covenants

Name	Recurrent	Due Date	Frequency
Maintain PPS through Project implementation	X		Continuous

Description of Covenant

Loan Agreement Schedule 2, Section I.A.1. The Borrower shall maintain and operate, throughout Project implementation, PPS in a manner, with resources, staff, terms of reference, functions and responsibilities satisfactory to the Bank.

Name	Recurrent	Due Date	Frequency
Maintain PIU through Project implementation	X		Continuous

Description of Covenant

Loan Agreement Schedule 2, Section I.A.2. The Borrower, through PPS, shall establish and, thereafter, operate and maintain throughout Project Implementation the PIU, as a technical coordination unit of the Project, with technical experts and other personnel in adequate numbers and with qualifications, and with terms and conditions, all satisfactory to the Bank, including a PIU director, a procurement specialist, and a financial management specialist.

Name	Recurrent	Due Date	Frequency
Matching Grant Program and Safeguards	X		Continuous

Description of Covenant

Loan Agreement Schedule 2, Section I.A.3. In respect of Part A.3.(a) of the Project, the Borrower shall ensure that the Matching Grants Program is implemented in a manner satisfactory to the Bank, and in accordance with the Matching Grants Manual, the Environmental and Social Management Framework ("ESMF") and any applicable Environmental Management Plan ("EMP") thereunder.

Name	Recurrent	Due Date	Frequency
MoLEVSA's implementation of Part B.2 of the Project	X		Continuous

Description of Covenant

Loan Agreement Schedule 2, Section I.A.4. The Borrower, through MoLEVSA, shall carry out the procurement, financial management and other associated activities, in coordination with PPS for Project reporting purposes, all in accordance with the Project Operations Manual, and with resources, staff (including a procurement specialist), terms of reference, functions and responsibilities satisfactory to the Bank.

Conditions

Source Of Fund	Name	Type
IBRD	Project Implementation Unit	Effectiveness

Description of Condition

Loan Agreement Section 4.01(a). PIU has been established within the PPS in a manner satisfactory to the Bank and has selected at least the PIU director, procurement specialist and financial management specialist.

Source Of Fund	Name	Type
IBRD	MoLEVSA procurement specialist	Effectiveness

Description of Condition
Loan Agreement Section 4.01(b). MoLEVSA needs to select a procurement specialist, whose contract is to be signed immediately upon effectiveness, in order to support implementation of the Project.

Source Of Fund	Name	Type
IBRD	Project Operations Manual	Effectiveness

Description of Condition		
Loan Agreement Section 4.01(c). The Project Operations Manual has been adopted by the Borrower, through PPS, in a manner satisfactory to the Bank.		

Source Of Fund	Name	Type
IBRD	Retroactive financing	Disbursement

Description of Condition

Loan Agreement Schedule 2, Section IV.B.1 and 2(a). No withdrawal shall be made for payments made prior to the date of the Loan Agreement, except that withdrawals up to an aggregate amount not to exceed EUR 5,370,000 may be made for payments made up to 12 months prior to the date of the Loan Agreement, for Eligible Expenditures under Category (1). For withdrawals of retroactive financing amounts, the Borrower shall submit pursuant to the Additional Instructions: (i) an interim financial report providing evidence, satisfactory to the Bank, of EEPs incurred during the twelve (12) month period prior to the date of the Loan Agreement; and (ii) confirmation of achievement of DLIs, satisfactory to the Bank, for said twelve (12) month period.

Source Of Fund	Name	Type
IBRD	Results-based financing	Disbursement

Description of Condition

Loan Agreement Schedule 2, Section IV.B.2(b). For all other withdrawals [besides retroactive financing] under Category (1) of the Loan Agreement, the Borrower shall submit pursuant to the Additional Instructions: (i) an interim financial report providing evidence, satisfactory to the Bank, of EEPs for the pertinent calendar semester; (ii) confirmation of achievement of DLIs, satisfactory to the Bank, for said calendar semester.

Team Composition

Bank Staff

Name	Role	Title	Specialization	Unit
Thomas Edward Haven	Team Leader (ADM Responsible)	Senior Private Sector Development Specialist	Co-TTL	GTCDR
Dusko Vasiljevic	Team Leader	Private Sector Development Specialist	Co-TTL	GTCDR
Kashmira Daruwalla	Procurement Specialist	Senior Procurement Specialist		GGODR
Aleksandar Crnomarkovic	Financial Management Specialist	Sr Financial Management Specialist		GGODR
Alberto Criscuolo	Peer Reviewer	Senior Private Sector Development Specialist	Investment Climate	GTCDR
Arvo Kuddo	Peer Reviewer	Senior Labor		GSPDR

		Economist		
Chris Parel	Team Member	Consultant	Results-based management	GHNDR
Darko Dukic	Team Member	Consultant	Innovation	GTCDR
Dena Ringold	Peer Reviewer	Practice Manager		GSPDR
Harald Jedlicka	Team Member	Senior Investment Policy Officer	Investment Promotion	GTCDR
Johannes Koettl-Brodmann	Team Member	Senior Economist	Labor and social protection	GSPDR
Jose C. Janeiro	Finance Officer	Senior Finance Officer	Disbursement	WFALA
Marijana Jasarevic	Team Member	Operations Analyst	Labor and social protection	GSPDR
Marina Wes	Peer Reviewer	Country Manager		ECCPL
Matteo Morgandi	Team Member	Economist	Labor and social protection	GSPDR
Naima A Hasci	Safeguards Specialist	Sr Social Scientist	Social and gender issues	GSURR
Natasha Kapil	Team Member	Senior Private Sector Development Specialist	Innovation	GTCDR
Nina Rinnerberger	Safeguards Specialist	Natural Resources Mgmt. Spec.	Environmental issues	GENDR
Paulo Guilherme Correa	Peer Reviewer	Lead Economist		GTCDR
Ramiro Ignacio Jauregui-Zabalaga	Counsel	Senior Counsel		LEGLE
Raymond Muhula	Team Member	Senior Public Sector Specialist	Governance	GGODR
Smita Kuriakose	Peer Reviewer	Senior Economist	QER stage	GTCDR
Srdjan Svircev	Team Member	Public Sector Specialist	Governance	GGODR
Thomas Kenyon	Peer Reviewer	Senior Private Sector Development Specialist	QER stage	GTCDR
Ulrich Hoerning	Peer Reviewer	Senior Social Protection Economist	QER stage	GSPDR
Vinod K. Goel	Team Member	Consultant	Innovation	GTCDR
Zachary Mills	Team Member	Governance	Governance	GGODR

		Specialist		

Extended Team

Name	Title	Office Phone	Location

Locations

Country	First Administrative Division	Location	Planned	Actual	Comments

Consultants (Will be disclosed in the Monthly Operational Summary)

Consultants Required?	Consulting services to be determined

I. **STRATEGIC CONTEXT**

A. Country Context

1. **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. 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. The disastrous floods of May 2014 triggered a further recession. 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.

2. **Serbia has a window of opportunity to accelerate structural reforms to restart growth.** 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.

3. **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.

B. Sectoral and Institutional Context

4. **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.

5. **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 (see Annex 3 for more details). Serbia has a revealed comparative advantage (RCA) in several important sectors and other sectors are improving rapidly (see Annex 3). 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.

6. **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.

7. **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 (B40) constitute the bulk of the jobless, where the lack of labor income is a major deterrent to escaping poverty.[1] 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.

8. **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

[1] Many of the jobless in the B40 fall into two groups: (a) the pre-transition generation, aged 40 or more, who either lost their jobs during the transition and never found a proper new job, or entered the labor market as the transition was beginning and never gained a firm foothold; and (b) groups, especially minorities like the Roma but also women generally, who have never been strongly attached to the labor market. These groups now live either on public and private transfers or subsistence farming and are largely excluded from labor markets, especially formal jobs.

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.

9. 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).

10. **The table below summarizes the main constraints and building blocks for jobs and competitiveness and whether they are included in the operation or covered by other initiatives.** Detailed analysis on each of the constraints from the table is provided in Annex 3.

Table 1: Main constraints and building blocks for jobs and competitiveness

<table>
<tr><th>Constraint</th><th>Covered in project?</th><th>Covered elsewhere</th></tr>
<tr><td colspan="3">Labor supply</td></tr>
<tr><td>Skills</td><td>Partially: NES training programs</td><td>Technical, vocational, secondary, tertiary education part of parallel WB dialogue.</td></tr>
<tr><td>Job search constraints</td><td>Yes: NES services</td><td></td></tr>
<tr><td>Labor market participation incentives</td><td>Yes: in-work benefit for social assistance recipients</td><td>Minimum social security contribution issue in Second Programmatic State Owned Enterprises Reform DPL.</td></tr>
<tr><td colspan="3">Labor demand</td></tr>
<tr><td>Uncertainty</td><td rowspan="2">Yes: innovation matching grants; export promotion</td><td rowspan="2"></td></tr>
<tr><td>Appropriability</td></tr>
<tr><td>Where to invest</td><td>Yes: investment and export promotion; R&D and technology transfer</td><td></td></tr>
<tr><td>Access to finance</td><td>Partially: restructuring of MoE’s Development Fund</td><td>WB (Deposit Insurance Strengthening project), IFC (Debt Resolution and Business Exit Program), EIB, EBRD programs</td></tr>
<tr><td>Competition</td><td>No</td><td>EU accession reforms and SOE privatization (supported by WB SOE DPL)</td></tr>
<tr><td>Investment climate</td><td>No</td><td>Construction permits: WB Real Estate Management Project. Taxes: WB PFR and IMF. Inspections: EU and USAID.</td></tr>
<tr><td>Infrastructure and trade logistics</td><td>No</td><td>WB Corridor X Highway Project, WB Road Rehabilitation and Safety Project, WB policy dialogue on roads and railroads. IFC Trade Logistics Project.</td></tr>
<tr><td colspan="3">Governance</td></tr>
<tr><td>Strategic planning and policy coordination</td><td>Yes: Pilot inter-ministerial policy planning, monitoring and coordination system (in support of competitiveness and jobs reforms)</td><td>WB Public Sector Employment and Performance project (pipeline) and Serbia Rightsizing and Restructuring TA</td></tr>
</table>

11. **To address the constraints to jobs and competitiveness, Serbia needs to improve the efficiency of selected public programs, as well as strategic planning and policy coordination.** In Serbia, not enough attention in policy making is given to output and outcomes, and strategies are rarely evidence-based. According to the Bank's 2015 Systematic Country Diagnostic, policy coordination is among the weakest points for Serbia. Better planning and inter agency coordination should help address this, improve policy predictability and encourage more long-term investment.

12. **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. The sectoral and institutional context for the main components can be found in Annex 3.

C. Higher Level Objectives to which the Project Contributes

13. The higher level objectives to which the project contributes include increasing investment, productivity, exports, jobs, and the overall competitiveness and growth of the economy. The higher level and project objectives are aligned with Focus Area 2—private sector growth and economic inclusion—of the recently approved Serbia Country Partnership Framework FY16-FY20.

II. PROJECT DEVELOPMENT OBJECTIVES

A. PDO

14. 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.

Project Beneficiaries

15. The project beneficiaries, including Serbian firms, entrepreneurs, and active job seekers, are shown in Table 2 below. Where possible, quantitative indicators for these beneficiaries are included in the results framework (Annex 1).

16. **Twin Goals.** The project tackles the WBG's twin goals on several fronts. First, the interventions related to investment and export promotion and innovation are expected to lead to increased jobs and growth in the medium to long-term. International evidence shows that most of the cross-country and over-time variation in changes in social welfare is due to changes in average incomes.[2] Hence, the expected growth from these interventions will aid in reducing poverty and increasing the welfare of the bottom 40 percent of the population. Second, the interventions in the labor intermediation component directly address the bottom 40 percent. The interventions are targeted at improving the services to and work incentives for unemployed

[2] See Dollar, Kleineberg, and Kraay (2014), "Growth, Inequality, and Social Welfare Cross-Country Evidence", WB Policy Research Working Paper 6842; and www.voxeu.org/article/growth-inequality-and-social-welfare.

jobseekers, low-skill workers, and social assistance beneficiaries, the vast majority of whom are in the bottom 40 percent.

Table 2: Project Beneficiaries

Ministry/agency	Beneficiaries
Public Policy Secretariat (through strengthened capacity for policy planning, monitoring, and coordination)	Line ministries, which benefit from better overall policy planning and coordination.
Ministry of Economy (MoE); Serbia Investment and Export Promotion Agency (SIEPA); other MoE development agencies	Serbian and foreign firms that participate in MoE development agency programs. Male and female workers in said firms.
Ministry of Education, Science, and Technological Development (MoESTD); Innovation Fund	Serbian firms and entrepreneurs that benefit from matching grants and technology transfer support; workers in said firms. Spillovers from new innovations to other firms and workers. Researchers working in research and development institutes (RDIs) and local technology transfer offices (TTOs).
Ministry of Labor, Employment, Veteran and Social Affairs (MoLEVSA); National Employment Service (NES)	Active job seekers, especially those with low earnings potential, including women, Roma, and people with disabilities. Able-bodied beneficiaries of social financial assistance and their families. Firms looking to fill vacancies.

17. **Gender.** The project is fully gender-informed and addresses all three of the WBG's gender tags, including:

- *Gender analysis and/or consultation on gender related issues*. To ensure that the project neither continues nor exacerbates gender inequality in employment, gender analysis will be incorporated in component 4.C, improving work incentives of social assistance beneficiaries.
- *Specific actions to address the distinct needs of women and girls, or men and boys, or positive impacts on gender gaps*. Analysis of and recommendations on the active labor market programs ALMP's under component 4.B will take into account beneficiary characteristics, including gender indicators.
- *Mechanisms to facilitate monitoring and/or evaluation of gender impacts*. Gender disaggregated statistics where applicable, such as for owners of enterprises and startups in (component 3.A) and NES job placements that are female (component 4.A) will be monitored.

18. **Marginalized groups**, such as the Roma, will also benefit from the project through improved incentives for formal work. Given that many of the Roma are social financial assistance beneficiaries, they will benefit from the proposed new cash transfer conditional on having a formal job for recipients of social financial assistance.

19. **Citizen engagement.** The project engages citizens along several dimensions in both the preparation and implementation stages. During the preparation stage, there has been an extensive series of consultations with NGOs and business representatives, including the Serbia Chamber of Commerce, Foreign Investors Councils, National Alliance for Local Economic Development, Foundation for the Advancement of Economics, Center for Applied European Studies, American Chamber of Commerce, Student Association from the Faculty of Economics, Roma NGOs, and others. These consultations have informed the analysis of the constraints to job creation in Serbia and the design of the operation. Public consultations have also been held on the Environmental and Social Management Framework. During implementation, engagement will continue through periodic beneficiary surveys of innovation matching grant recipients and users of the National Employment Service (both of which are included as citizen engagement indicators).

PDO Level Results Indicators

20. PDO level results indicators include:

- New investor leads generated by a reformed investment promotion agency (number)
- Participants in export promotion programs that engage in new export activities (number)
- New collaborations facilitated between research organizations and the private sector (number)
- NES registered unemployed transitioning into formal job (% of total new formal jobs)

III. PROJECT DESCRIPTION

A. Project Components

21. **The project aims to improve the effectiveness and coordination of selected public programs to alleviate constraints to competitiveness and jobs.** This means addressing issues related to both firms and workers—labor demand and supply. Rather than attempting to address all job creation constraints, the operation focuses on a targeted set of achievable reforms selected based on the following criteria. The reforms have been prioritized by and have strong ownership of the Government. They have also been identified as key drivers of the competitiveness and jobs agenda by Bank and other analytical work.[3] Finally, the reforms aim to improve the efficiency of existing expenditures and have a catalytic impact by piloting new approaches that require little or no incremental funding. In an environment of fiscal consolidation, the activities mostly target areas where the Government is spending significant resources and would like to put these funds to more efficient use. Hence, the reforms largely focus on making existing spending more effective, rather than increasing Government spending beyond current levels.

22. **The project has two parts. Part A for EUR 85.025 million uses a results-based financing modality. Part B for EUR 4.25 million covers project management and supporting technical assistance.[4]** Part A reimburses "Eligible Expenditure Programs" (EEPs, see Table 4) conditioned on the achievement of "Disbursement-Linked Indicators" (DLIs). Part B reimburses direct expenditures based on "Statements of Expenditures". A complete description of the DLIs for each component is included in Annex 1 and the detailed project description, including results chains for each component is in Annex 2.

PART A: Results-Based Financing

23. Part A entails the implementation of EEPs subject to results-based financing (DLIs). It contains four Components.

[3] See for example: World Bank (2014), Rebalancing Serbia's Economy: Improving Competitiveness, Strengthening the Private Sector, and Creating Jobs; World Bank (forthcoming), Serbia Systematic Country Diagnostic; and Foreign Investors Council (2014), White Book: Proposals for Improvement of the Business Environment in Serbia.
[4] Total of the project components is less than the total amount of the loan (EUR 89.5mn) as the 0.25% front end fee is being paid through the loan.

Component 1: Policy planning, monitoring, and coordination (EUR 3.6 million)

24. This component supports the implementation of the Borrower's program for policy planning, monitoring, and coordination (PPMC) through developing and piloting an inter-ministerial PPMC system in support of competitiveness and jobs reforms (see DLI 1). This will also include development of individual planning and monitoring frameworks at the ministry level (to feed into the inter-ministerial PPMC system), and the piloting of the PPMC system, including through semi-annual progress reports and annual performance review reports with inputs from each participating ministry.

25. The component directly addresses two of the main challenges related to Serbia's policy making framework—weak strategic planning and policy coordination—and aims to increase the effectiveness of government spending targeting competitiveness and jobs. Through the PPMC framework, the participating institutions will set performance targets on competitiveness and jobs, monitor and evaluate progress, conduct analysis, and contribute to policy development. Results matrices with a hierarchy of outcome and output indicators will be developed by each ministry in collaboration with the Bank along with protocols on monitoring and reporting. A working group led by the PPS and comprising representatives from the three ministries will be created to oversee the planning and monitoring framework and coordinate policies. The working group should also include representatives from the MoF, MoPALSG and Prime Minister's office.

26. The PPMC framework is expected to lead to better designed and better coordinated policies, since they will become part of a clear, strategic framework with a robust monitoring and evaluation system. This builds on and links together existing government initiatives, including a Government Action Plan, sectoral strategies, and program-based budgeting (rolled out for the 2015 budget, but shows much room for improvement). The PPMC framework will incorporate and strengthen the relevant elements of each of these initiatives in the pilot thematic areas. The framework will be a work-in-progress in the coming years, requiring frequent adjustment and improvement. In addition, the project will liaise with MPALSG as it endeavors to help strengthen the communication and coordination between line ministries and local self-governments.

27. In addition to the DLI, the above reforms will be supported by a Bank-executed Competitive Industries and Innovation Program (CIIP) trust fund and through technical assistance provided through the project. The pilot PPMC framework in this project will be used to inform the design of the upcoming Public Sector Employment and Performance loan.

Component 2. Investment and Export Promotion (EUR 19.7 million)

28. This component supports implementation of the Borrower's program for investment and export promotion through (see DLI 2):

a. Developing and adopting a strategic framework and overall action plan for investment and export promotion, including restructuring the MoE investment and export promotion agencies,
b. Improving the Borrower's investment and export promotion programs and services.

29. Investment and export promotion functions, broadly defined, are performed by several agencies subordinated to the Ministry, including SIEPA (investment and export promotion), Development Fund (access to finance), AOFI (export credit and insurance), and National Agency

for Regional Development (micro and small enterprise support), and others. The system of support provided by the MoE's agencies is complex and non-transparent. Although significant public resources are spent on the support programs, it is not clear what the outcomes of these programs are and whether public resources are spent in an efficient manner. (For instance, about EUR 260 mn where administered by SIEPA between 2007 and 2013 on a per-job-created incentives program.) In addition the agencies have overlapping mandates, little coordination between them, and unclear links with the broader economic policy goals.

30. In general, reforms in the area of investment and export promotion can be related either to the institutional arrangements underpinning those activities, or to the substance of implementing the respective activities, such as investor outreach, aftercare, or incentives administration, or to both mentioned aspects. The specific reforms supported by the component actually refer to both, the institutions, and the way in which they carry out their mandates.

31. A primary area of focus for the reform is to restructure the current system of support and improve the provision of services provided by the individual agencies. This will be done in the context of strengthening the overarching strategic framework for investment and export promotion and the identification of target sectors for the development of sector policies based on value-chain analysis. In addition, the MoE seeks to strengthen transparency and governance arrangements by conducting more systematic analysis of the costs and benefits associated with its support programs.

32. The agency reform/ restructuring refers to one or more of the MoE's agencies responsible for investment and export promotion (SIEPA, NARR Development Fund, and AOFI). The restructuring could include the combination of existing or creation of new agencies. The overall action plan should include the strengthening of governance structures of the agencies, monitoring mechanisms and performance targets, and the improvement of existing or development of new programs and services. Opportunities for better communication of available support programs and coordination with local community initiatives will also be considered, as once investments reach implementation stage the capacity of local governments and utilities is often a bottleneck.

33. In addition to DLI 2, the reform process will be supported by a Bank-executed CIIP Trust Fund and through technical assistance provided through the project. The reform will also build off of a functional and organizational mapping of the Ministry of Economy and its agencies, which will be conducted through the Bank's Wage Bill Management TA.

Component 3: Innovation (EUR 31.3 million)

34. This component supports of implementation of the Borrower's program for innovation through:

a. Supporting the operations of the Innovation Fund and it's Matching Grants Program;
b. Supporting the Technology Transfer Facility (TTF) service lines at the Innovation Fund; and
c. Undertaking strategic planning for institutional reform of the public research and development sector.

35. These project activities will leverage the institutional capacity built at the Serbia Innovation Fund (IF) and the enterprise innovation programs piloted under the 2011 EU Instrument for Pre-Accession Serbia Innovation Project (EU IPA SIP) as well as lessons learned from the Bank executed technical assistance program with public research and development institutes (RDIs)

under this Bank-administered project. This project will also build on the strategic planning activities for the research and innovation sector as well as technology transfer initiatives of the 2013 EU IPA Serbia Research, Innovation, and Technology Transfer Project (SRITTP).

36. The sequence of the following activities reflects their importance for the innovation system in general and MoESTD's reform priorities in particular. The first two activities, (a) and (b), would effectively provide continued financial support for pilot projects implemented via the IF, with the first pilot having been successfully completed under SIP and the second one being launched via SRITTP. The subsequent activity (c) addresses the systemic issues in the public research sector that are in dire need of modernization if it is to meaningfully position Serbia in the European research and funding arena and contribute to the development of an innovation-led economy.

3.A Support enterprise innovation

37. This subcomponent includes a DLI that cover: a) allocating in the Republican Budget at least EUR 0.7 mn annually for the Innovation Fund's operating budget and EUR 2.7 mn annually for enterprise innovation matching grants (MG); b) committing at least 80 percent of the matching grant annual budget allocation using the IF's international peer review and investment committee mechanisms; c) conducting an evaluation of the IF's MG program; and d) developing a proposal for scaling up the matching grants program using government or donor funds. (See DLI 3.)

38. Serbia has laid strong institutional foundations and successfully demonstrated early enterprise innovation wins from the two ("Mini" and "Matching") R&D grant programs piloted by the IF under SIP. Over a three year period, the IF awarded the entire initial allocation of Euro 6 mn, funded by EU IPA, in financing to 53 startups and enterprises in different sectors and created or sustained some 300 high paying jobs. While several projects are still ongoing, some important early results include the development of 8 new products, sale of 2 products, filing of 23 national and 8 international Patent Cooperation Treaty patents, 8 trademark and 6 copyright applications; as well as establishment of multiple international partnerships by IF beneficiary enterprises.

39. The matching grant programs piloted by the IF to promote R&D in enterprises are a cornerstone of noteworthy innovation systems globally. These programs can be critical to building a strong pipeline of innovative startups and technology-based enterprises that create high value jobs in Serbia that will attract the attention of international investors interested in financing technology ventures. It is important that Serbia institutionalizes these programs in its annual budget given that EU IPA financing for the pilot program has been fully deployed and therefore the IF could not launch a new call for proposals in 2015. DLI 3 will ensure that a minimum budget is assigned to these programs, and the IF's essential features, i.e. its independent governance structure and decision making procedures, are upheld.

3.B Facilitate technology transfer and commercialization activities

40. This subcomponent includes DLIs that cover: a) designing and deploying one or more Technology Transfer Facility ("TTF") service lines; b) allocating at least EUR 0.9 million annually in the Government's 2017 and 2018 budgets to the TTF; c) initiating a minimum number of technology transfer transactions; d) evaluating the TTF; and e) preparing a government or donor proposal for scaling-up technology transfer activities. (See DLI 4.)

41. The challenges to commercialization of public research in Serbia are multiple given the decline of the traditional public enterprise sector client base and the absence of a functional system that could promote technology transfer within and beyond Serbia. Furthermore, there exists a very strong academic culture, fueled by an incentive system that places a clear premium on publications with little incentives for protection of intellectual property or its commercialization. A Bank-led technical assistance engagement with select public R&D institutes (RDIs) under SIP confirmed a rudimentary pipeline of projects with commercial potential. However, most high quality projects hail from the basic sciences, are at early technology readiness levels, and far from market readiness. It was estimated that the existing project pipeline would require as much as EUR 9 mn in support for research teams to further their innovative scientific ideas to a marketable level. Additionally, previous donor support for technology transfer was dedicated to training local technology transfer offices (TTOs). Given this learning and limited IPA funding, SRITTP was designed to pilot the establishment of a centralized TTF at the IF with the objective of attracting high quality transactional capacity at the IF and piloting transactions with local TTOs.[5] Current TTF funding under SRITPP (i.e. EUR 1.18 mn) is deemed insufficient to finance and demonstrate a strong tech transfer pipeline at this stage. The reforms supported by this project will build on the basic pilot activities to be financed under SRITTP and improve the odds of creating a demonstration effect in research commercialization.

3.C Design and adopt public research sector reforms

42. This subcomponent includes DLIs that cover: a) adopting a 2015-2020 R&I Strategy and its Action Plan that commits to reforming the public RDI sector; b) adopting a time bound R&I Infrastructure Roadmap and its Action Plan; c) conducting RDI self-assessments and RDI performance audits by international experts; d) defining and adopting RDI sector reform program, including performance based financing schemes; and e) preparing and submitting a donor proposal for technical assistance to conduct sector and RDI reform implementation. (See DLI 5.)

43. Serbia's public research sector suffers from the traditional post-transition malaise of being disconnected from contemporary needs and trends and therefore contributing neither to the Serbian economy nor society. It is highly fragmented, lacks strategic focus and critical mass of any significance in scientific areas, emphasizes quantity over quality of public expenditures in R&D, and for the most part has not succeeded in re-orienting its offering to the fledgling emergent enterprise sector domestically. If Serbia is to improve its global positioning it will have to revamp the structure and composition of financing of its public research; create incentives for both excellence and relevance of research for the industrial sector, including commercialization; and focus on integrating into European and global research trends and financing programs.

44. Through DLI 5, the project will support the design of research sector reforms that will focus on creating necessary incentives at the individual and institutional level as well as propose sector level changes. This process will require significant involvement of independent international

[5] The TTF is a special purpose entity being established within the IF to support existing technology transfer offices (TTOs) in the process of commercializing academic research via the design and deployment of key tech transfer service lines. In addition, it can also match Serbian companies interested in licensing global technologies.

expertise and thus this activity has extensive technical assistance needs described in Annex 2, Part B. The design of the sector reform program will be informed by in depth self-assessments to be conducted by the RDIs themselves as well as external audits of the RDIs with the participation of both local and especially international experts. The activity will develop performance based financing mechanisms at the researcher and RDI level as well as design reform scenarios at the sector level. The elected reform scenario is expected to require extensive financial support from the authorities and/or donors.

Component 4: Labor (EUR 30.4 million)

45. The Ministry of Labor, Employment, Veteran and Social Affairs (MoLEVSA) is revising a National Employment Strategy for the period 2011-2020, with the aim of guiding the policy reforms in the labor sector as well as recurrent spending of the MoLEVSA. The component will support the implementation of selected objectives of the Strategy. Specifically, the component supports implementation of the Borrower's program for labor reform through:

a. Enhancing the effectiveness of the NES labor intermediation services for employers and the unemployed;
b. Improving the effectiveness of the Borrower's active labor market programs; and
c. Facilitating the transition of social assistance beneficiaries into formal jobs.

4.A Enhancing the effectiveness of NES labor intermediation services

46. The reforms supported under this subcomponent will consist of three elements. The first element aims at increasing the quality of labor intermediation services offered by the NES to employers. Currently, only a small share of job matches in the Serbian labor market are carried out by the NES. It is vital that the NES improves its vacancy services, so as to increase the number of job opportunities for registered unemployed, and the quality of matches for employers. The second element aims at improving the quality of case management the NES provides to active job seekers. To this end, the NES will develop a new training and certification system for its case workers. The third element aims at evening out the caseload per case worker across NES branch offices and focus case workers on active jobseekers. Currently, the average caseload varies between around 200 to over 2,000 registered unemployed per case worker across branch offices (compared to less than 100 in the average OECD country). One reform to reduce caseloads will be to introduce a new list of active jobseekers. (According to the labor force survey, more than 50 percent of registered unemployed are actually not active job seekers). This should help case workers prioritize client work over other administrative tasks. The economic transition that Serbia is experiencing means that the prospective benefits of these reforms should not be overestimated in the short-term. At the same time, these measures will put the NES onto a path of stronger medium-term viability.

47. Concretely the subcomponent includes DLIs that cover: a) the NES adopting an action plan to enhance the quality of employer services and case management; b) certifying NES case workers; c) increasing collection of vacancies among employers; d) increasing the number of NES-registered unemployment cases transitioning into formal jobs; e) introducing a special registry of unemployed persons who are temporarily prevented from working; and f) reducing the dispersion in case load rates across NES branch offices.

4.B Improving the effectiveness of ALMPs

48. Improving the effectiveness of ALMPs will require reforms in two areas: (i) in the way ALMPs are targeted to beneficiaries, and (ii) in the way ALMPs are piloted, monitored, and evaluated. An initial reform will consist of refinement of the methodology to profile active job seekers, in order to better segment them according to their effective risk of becoming long-term unemployed. Scarce resources will then be concentrated on higher risk job seekers. Secondly, a more systematic use of evaluations of ALMPs will inform progressively the selection of training providers and the design to ALMPs. Extensive data collection on beneficiaries of ALMPs, including follow-up interviews, is already being carried out. In order to improve the design and targeting of programs, this information should be better translated into concrete analysis of the effects of programs, disaggregated by characteristics of beneficiaries. The feedback loop, from data collection to policy design, is central to evidence-based policy making and requires a new institutional setup either at NES or MoLEVSA. Moreover, engagement with local self-governments should be supported in order to strengthen their capacity to identify employment opportunities. In cooperation with MoPALSG, ALMPs should be fitted to the needs of unemployed at the local level, especially in the context of retrenchments and redundancies due to the ongoing right-sizing exercise.

49. The subcomponent includes a DLI that covers: a) developing and applying a new methodology to profile the unemployed; b) developing and implementing an action plan on monitoring, evaluation, and re-design of ALMPs; c) piloting a newly designed ALMP; and d) piloting engaging a training provider (service provider for labor market trainings) based on a performance based contract.

50. Finally, the fiscal consolidation currently in place and the upcoming wave of SOE restructuring call for the protection of the budget expenditures on ALMPs for the large stock of unemployed. For this reason, an important share of the financing under this component will be tied to the provision of ALMPs that have proved successful at improving the chances of employment, according to past impact evaluations.

4.C Facilitate transition of social assistance beneficiaries into formal jobs

51. Serbia has one of the highest tax wedges on low-paying jobs in the entire ECA Region and a social assistance benefit that is reduced by at least one dinar—often by much more—for every dinar earned formally. This combination makes low-paying work unviable in the formal sector. To counter these disincentives, the subcomponent includes a DLI that supports enhancing the activation of social assistance beneficiaries by designing and piloting a program to decrease work disincentives for a select group of social assistance beneficiaries. This could be in the form of a cash transfer conditional on having a formal job, for recipients of financial social assistance (a reform of social security contributions will be supported in a separate operation (SOE Reform DPL)).

52. The cash transfer, similar what some OECD countries name an in-work benefit, will be designed in a way so as to make formal work worthwhile compared to receiving benefits. The benefit would be implemented through either the existing social protection system or the NES. The fiscal implications will be carefully considered, but should be small or even positive as a substantial part would be financed from reduced social assistance payments and increased social

security contributions. The study should include an assessment of the potential to use a benefit to reduce the tax wedge for low productivity work.

PART B: Project Management and Technical Assistance (EUR 4.25 million)

53. Part B is split into two parts.

- Part B.1 will be carried out by the Project Implementation Unit (PIU) in PPS for the PPS, MoE, and MoESTD to support project management and implementation of Components 1, 2 and 3 from Part A of the Project through the carrying out of technical assistance activities relating to implementation, through the provision of goods, consultants' services, non-consulting services, Training and Operating Costs.
- Part B.2 will be carried out by MoLEVSA to support project management and implementation of Component 4 from Part A of the Project through the carrying out of technical assistance activities, through the provision of consultants' services.

54. For project management, the main expenses are expected to be for consultants to supplement the capacity of the PPS staff. Expertise will be needed to handle the fiduciary (both financial management and procurement), reporting, coordination, and safeguards requirements. These are expected to cost about EUR 0.5 mn over the life of the project.

55. For the TA to support the design and implementation of reforms related to Part A of the project, consulting services and training will be needed, as detailed in Table 7 in Annex 2. The TA needs are estimated at EUR 3 million. Regular coordination meetings on TA needs will be facilitated by the PPS, with participation from the line ministries and MoF. For Part B.1, technical experts from participating line ministries will be involved in the preparation of the Terms of Reference as well as selection committees as needed. Part B.2 will be separately carried out by MoLEVSA. The MoF will play an oversight role in the use of the TA funds, including periodic reviews of the planned TORs for key consultancies to be procured with project funds. The TORs for TA, where possible, will include knowledge transfer from international experts to build local capacity in Serbia. An additional EUR 0.8 million is allocated as a contingency for unforeseen TA and implementation support needs. Any unused TA budget will be added to the final set of DLIs in the last year of the project.

B. Project Financing

56. **Lending instrument**. The lending instrument is Investment Project Financing (IPF), using a results-based financing design with Disbursement-Linked Indicators (DLIs, 95 percent) and a small, catalytic TA component to support achievement of the DLIs and loan objectives. The IPF with DLIs was chosen because of its clear focus on results within multi-year reform programs, combined with the ability to reimburse existing Government expenditures in an environment of fiscal consolidation.[6]

57. The project would be implemented over a period of four years with financing from IBRD in the amount of EUR 89.5 million (USD 100 million equivalent). As mentioned above, the project

[6] This instrument was considered over the Program for Results (PforR) lending instrument because the supported reforms are not part of a single government program. The targeted reforms span multiple ministries, and programs. A PforR could be considered as a follow-up operation as the government's programs around the competitiveness and jobs agenda become better coordinated and integrated, including through support provided by this project.

is divided into two parts. Part A (EUR 85.025 million) will reimburse Eligible Expenditure Programs (Table 4), conditioned on compliance with DLIs (Table 5). Part B (EUR 4.25 million) disburses against statements of expenditure for project management and technical assistance activities. Under Part A, there are 9 DLIs; the amount per DLI is shown in Table 5.

58. The DLI achievement evidence will be sent by the line ministries to the PPS, who will conduct an initial review to determine whether it is acceptable. Once found to be acceptable by the PPS, it will then be shared with the Bank. The evidence provided for each of the DLIs then must be found acceptable by the Bank, both in terms of technical content and form in which it is presented. Where noted in the verification protocols in Annex 1, partial payments can be made for the partial completion of results. In the event a DLI is not achieved, a "request for reassessment" may be submitted by the Government, which must provide a justification and an Action Plan for meeting the indicator. At its discretion, the Bank can issue a waiver and determine the amount and timing of the withheld disbursement, depending upon the explanation in the Government request and the Action Plan. If a DLI is achieved early, then a request for payment (with supporting verification documentation) can be submitted during an earlier reporting cycle.

Table 3: Project Cost and Financing (EUR millions)

Project Components	EEPs (2015-2018)	IBRD Financing	Project cost*
Part A: Results-Based Financing	348.00	85.025	348.00
Part B: Project Management and TA		4.251	4.251
Front-End Fee		0.224	0.224
Total	**348.00**	**89.5**	**352.48**

* Project cost is the sum of the EEPs plus the TA (Part 2) financing and front-end fee. The EUR 85 million from IBRD in Part A reimburses a portion of the EEPs, hence it does not add to the total cost for that line.

Table 4: Eligible Expenditure Programs (EUR millions)

Budget line	2015
Ministry of Economy salaries (select units/agencies)	1.3
Researcher salaries (R&D Institutes)	72.7
National Employment Service salaries	13
Total (>Planned annual loan disbursements)	**87**

59. The EEPs are directly linked to the achievement of the DLIs. The EEPs are a set of defined expenditures for salaries incurred by the Borrower, through MoE, research institutes under MoESTD, and NES, under the Borrower's sector budget lines set forth in the Operational Manual. The EEPs finance the needed professionals that will be responsible for undertaking the reforms. The salaries related to the Ministry of Economy include the people responsible for designing and implementing improved export and investment promotion programs and services. The researcher salaries include the people who are expected to engage in innovation commercialization and technology transfer and activities, as well as the research sector reforms. The National Employment Service salaries cover the administrators and case workers tasked with making the labor market and labor intermediation programs more effective. The professionals working on the aforementioned activities will all contribute to the policy planning, monitoring, and coordination component.

Table 5: Amount per Disbursement-Linked Indicator and estimated annual disbursements (EUR millions)

DLI	Retro/ 2015	2016	2017	2018	Total
1. Policy planning, monitoring, and policy coordination					**3.6**
DLI 1: Policy planning, monitoring, and coordination system piloted (in support of competitiveness and jobs reforms)	0.9	0.9	0.9	0.9	3.6
2. Investment and export promotion					**19.7**
DLI 2: MoE investment and export promotion programs restructured		7.2	6.3	6.3	19.7
3. Innovation					**31.3**
DLI 3: Enterprise innovation supported via the Innovation Fund Matching Grants Program		3.6	3.6	3.6	10.7
DLI 4: Technology transfer and commercialization facilitated via the Innovation Fund Technology Transfer Facility		2.7	2.7	3.6	9.0
DLI 5: Public research sector reforms designed and adopted	2.7	2.7	3.6	2.7	11.6
4. Labor					**30.4**
DLI 6: Effectiveness of NES labor intermediation services delivered to clients (employers and unemployed) improved		2.7	1.8	2.7	7.2
DLI 7: Case load management in NES branch offices improved	0.9	2.7	2.7	2.7	9.0
DLI 8: Effectiveness of ALMPs improved through statistical evidence	0.9	2.7	2.7	2.7	9.0
DLI 9: Transition of social assistance beneficiaries into formal jobs facilitated		1.8	1.8	1.8	5.4
Total Expected DLI Disbursements	**5.4**	**26.9**	**26.0**	**26.9**	**85.0**

Note: numbers are rounded. The precise numbers per DLI can be found in Annex 1.

IV. IMPLEMENTATION

A. Institutional and Implementation Arrangements

60. The key coordinating agency will be the newly-created Public Policy Secretariat (PPS). The PPS is a policy unit under the office of the Prime Minister. The PPS will coordinate all of the results monitoring, reporting, fiduciary functions, and safeguards, in close collaboration with the line ministries. Capacity will have to be built in the PPS in terms of following Bank lending procedures. Qualified staff from within the PPS or consultants hired competitively will execute the project.

61. Three implementing institutions will cover the tasks planned under the project. These are the Ministry of Economy (MoE); Ministry of Education, Science and Technological Development (MoESTD, in coordination with the Innovation Fund); and Ministry of Labor, Employment, Veteran and Social Affairs (MoLESVA, in coordination with the National Employment Service). The Ministry of Education has experience implementing Bank projects through the Serbia Innovation Project. Capacity will be strengthened in the other ministries in terms of understanding Bank fiduciary and safeguards procedures for the TA and eligible expenditure programs.

62. Implementation support will be provided by the Bank throughout the project's lifespan (see Annex 5). This will include periodic supervision missions and a detailed midterm review roughly

1.5 years after project effectiveness. The midterm review will, among other things, analyze progress toward achieving all of the results indicators and DLIs and determine where adjustments are needed. In cases where not enough information was available at the time of project approval to establish indicator baselines and realistic targets, these will be determined or adjusted during the midterm review.

B. Results Monitoring and Evaluation

63. Results monitoring and evaluation will be a key part of the project through the piloting of a competitiveness and jobs policy planning, monitoring, and coordination (PPMC) system. Results monitoring is expected to take place on a semi-annual basis and be managed by an inter-ministerial working group with official representatives of the PPS and each of the line ministries. It is expected that this results monitoring system will become institutionalized within the PPS and line ministries through the PPMC system. If successful, this could be a prelude to a results-based management system that is rolled out in the future to other government entities. The PPS will coordinate the results monitoring and provide guidance on evaluations of select programs that will be undertaken by the line ministries. Examples of expected evaluations include select MoE (e.g. SIEPA) and MoLESVA (ALMPs) programs.

C. Sustainability

64. The results are expected to be fully sustainable given the results-based approach: disbursements are only made once the agreed-upon targets have been achieved. The DLIs encompass the key indicators that each line ministry needs to achieve to ensure that the reforms are fully implemented and institutionalized during the project’s life. Because the project largely reimburses existing government expenditures, there is low risk that the supported programs will fail due to lack of long-term financing from the government budget after the project ends.

V. KEY RISKS

A. Systematic Operations Risk- Rating Tool (SORT) Summary Table

Risk Category	**Rating**
1. Political and Governance	Substantial
2. Macroeconomic	Substantial
3. Sector Strategies and Policies	Moderate
4. Technical Design of Project or Program	Substantial
5. Institutional Capacity for Implementation and Sustainability	Substantial
6. Fiduciary	Substantial
7. Environment and Social	Moderate
8. Stakeholders	Substantial
9. Other	Moderate
OVERALL	Substantial

B. Overall Risk Rating and Explanation of Key Risks

65. **Overall, the project risk rating is Substantial.** The paragraphs below focus on the most important risk categories, as well as potential mitigation measures.

66. **Political and Governance:** The success of the program relies on continuous and engaged commitment from the Prime Minister, Deputy Prime Minister, Minister of Finance, Minister of Education, Science, and Technological Development, and Minister of Labor, Employment, Veterans, and Social Affairs, as well as the Public Policy Secretariat. The MoF needs to continue to support the small additional expenditures related to the innovation component, technical assistance, and project management and keep pressure on the line ministries to deliver results. The line ministers need to continue to support the reform programs over the life of the operation, otherwise the loan will not disburse. And, the line ministries need to continue to have an interest in policy planning and monitoring and meaningful policy coordination amongst themselves. The level and consistency of support is a substantial risk in Serbia, given political instability and frequent historical changes in ministers and their senior staff. Another risk highlighted by the Bank's Systematic Country Diagnostic is the excessive concentration of decision making at the top. One way to mitigate this risk is through strong communications with the general public, private sector, civil society, EU Delegation, etc. to maintain a broad-based platform of support for reforms. The Bank anticipates coordinating communications efforts around the competitiveness and jobs agenda with the Prime Minister's office. Periodic consultations with private sector and civil society representatives are expected to be done periodically by the PPMC Working Group. The Bank team consults closely on an ongoing basis with the EU Delegation in Serbia.

67. **Macroeconomic.** There are significant downside risks to the macroeconomic framework. External risks relate to lower-than-expected economic recovery in the Eurozone which would have an adverse effect on Serbia's economic outlook through exports, remittances and capital flows since the EU countries are Serbia's largest trading partners. If fiscal risks (e.g. related to difficulties reducing subsidies to SOEs), or a weakening in growth or the currency, were to materialize the government would need to undertake even greater fiscal consolidation efforts in 2015 and 2016 to ensure that public debt remains sustainable. Reduced exports and FDI due to the external situation or greater fiscal consolidation (resulting in reduced financing for competitiveness and jobs-related programs) could dampen the impact of the anticipated reforms. To mitigate these risks, the Bank is working closely with the government and the IMF to ensure that the reform of SOEs and public utilities remains on track and that it generates the required fiscal savings.

68. **Technical Design: Project complexity and TA.** The project will work with three ministries—the MoE (plus its development agencies), MoESTD, and MoLEVSA—as well as the PPS. This level of complexity presents challenges for project implementation, both within the government and the Bank. In addition, some of the reforms that must be undertaken to achieve the DLIs will require substantial technical assistance from external consultants. It will be challenging to provide adequate technical and operational advice with Bank supervision resources for each of the sub-components. At the same time, the government has expressed reluctance to borrow for TA. While EUR 4.25 mn has been allocated in the loan for TA and project management, the government would like to minimize the use of these funds and/or substitute them for resources from other donors. There is a risk that adequate resources are not

dedicated to the TA, either because the government is not willing to use the allocated loan proceeds for TA or because the potential external resources are inadequate from a technical, financial, or timing perspective, since they would be outside of the control of the project. To mitigate these risks, the team is seeking complementary resources, e.g. from the CIIP Trust Fund, and will leverage work from other WBG projects. The project will also collaborate with other donors, such as the EU and USAID.

69. **Institutional Capacity for Implementation and Sustainability**. Overall project coordination will be done by the PPS. The PPS was created under the new government in spring of 2014, and it does not have experience implementing Bank-financed projects. As a new institution, the PPS lacks capacity and a full set of official administrative procedures to implement policy coordination across other ministries is still being developed. This presents a substantial risk, both for implementation of the project—in terms of fiduciary and safeguards requirements and reporting of results across ministries—and coordination of the inter-ministerial PPMC Working Group. To mitigate this risk, the PPS is expected to hire additional personnel to handle fiduciary requirements and project coordination. The Bank will also provide TA through the CIIP trust fund to strengthen the capacity of the PPS.

70. **Fiduciary**. The PPS currently does not have fiduciary experience managing Bank projects, as mentioned above. This capacity will have to be built through establishing a Project Implementation Unit (PIU) within the PPS to be in charge of project implementation, and adequately staffing its fiduciary functions.

71. **Stakeholders**. Many of the reforms will have both winners and losers, and often the losers are more visible and organized at the time of the reform. Examples could include beneficiaries of MoE incentives and subsidies, case-workers in the National Employment Service, and researchers in the to-be-restructured research institutes. To mitigate this risk, the Government will need to clearly communicate the reform objectives and expected outcomes and benefits throughout the process.

VI. APPRAISAL SUMMARY

A. Economic and Financial (if applicable) Analysis

72. The project will largely reimburse existing, ongoing government expenditures (EEPs), such as ministry and researcher salaries. These reimbursements will be conditioned on a series of policy and process reforms specified in the disbursement-linked indicators. Since the project is not supporting new expenditures and investments, with the exception of some innovation-related activities, the economic impact of the supported activities will be indirect, through improved efficiency of key public programs. A summary of the economic and financial analysis for each component is shown below, and the details on the economic rationale and existing evidence related to the type of reforms that the project will support are included in Annex 6.

- *Component 1*: The establishment of a pilot competitiveness and jobs inter-ministerial policy planning, monitoring, and coordination (PPMC) system will help the government conduct better economic analyses of their programs. The PPMC Working Group is expected to help with cost-benefit analyses, gap analyses, and evaluations of select competitiveness and jobs-related programs, all of which will lead to improvements in the efficiency of public spending.

- *Component 2*: Although specific data on economic returns to investment and export promotion activities in Serbia are not available due to the lack of robust monitoring and evaluation systems (one of the issues that the project aims to address), cross-country analytical work has found the return on government investment in investment and export promotion activities to be largely positive on average. For example, a recent cross-country University of Oxford study has shown that one dollar spent on investment promotion potentially increases FDI inflows by 189 dollars and that 78 dollars spent on investment promotion create on average an additional job by a foreign affiliate. [7] For export promotion, the economic justification for government involvement is based on asymmetric information and other market failures (as described in Annex 6). A cross-country econometric analysis[8] found that export promotion agencies are effective in terms of having an impact on national exports. Their estimates suggest that 10 percent increase in export promotion agency budgets at the mean leads to a 0.6 to 1 percent increase in exports.
- *Component 3*: The economic rationale for investing in the research and innovation ecosystem lies in the long term implications for economic growth. The project seeks to support implementations of public financial instruments and programs that address key market failures associated with innovation, specifically underinvestment in R&D by the enterprise sector (matching grants have proven to be a cost-effective instrument to increase investment in R&D by firms), and key coordination failures that exist between the Serbian research and enterprise sectors (including support to technology transfer activities), as well as at the R&D sector, institution and individual level (support to MoESTD for RDI sector reform). Evidence of the impact of such interventions comes from international research. For example, an analysis of research and innovation matching grants in Colombia found that program participants increased employment by 13 percent and labor productivity by 16 percent compared to a control group. [9]
- *Component 4*: The component aims at improving the services offered by the NES to firms and jobseekers alike, and to improve the work incentives faced by a specific subset of jobseekers, namely work-able social assistance beneficiaries. The rationale for the provision of public employment services (PES) is twofold: first, PES enhance the efficiency of the labor market by increasing the speed and quality of job matches; second, efficient PES improve the employability and job opportunities of the unemployed in general and the most disadvantaged segments of the workforce in particular by providing active labor market programs (ALMPs) to them. With regard to work disincentives the aim is to balance the poverty-reducing effects of last-resort social assistance with sufficient incentives for beneficiaries to search and accept (formal) work, as the main sustainable way to achieve poverty reduction.

[7] Torfinn Harding and Beata S. Javorcik (2011). "Roll out the Red Carpet and They Will Come: Investment Promotion and FDI Inflows," The Economic Journal, vol. 121, issue 557.
[8] Lederman, Olarreaga, and Payton (2009). Export Promotion Agencies Revisited. World Bank Policy Research Working Paper 5125.
[9] Crespi G., Maffioli A., Melendez M. (2011) Public Support to Innovation: the Colombian COLCIENCIAS' Experience. Inter-American Development Bank.

B. Technical

73. The selected project components have been identified as key drivers of the competitiveness and jobs agenda by Bank and other analytical work, as mentioned above.[10] The policy planning and monitoring framework in the horizontal component is in line with international good practice and has been successful been implemented in other Bank projects. [11]

74. *Investment climate and export promotion*. The reform of the Ministry of Economy's investment and export promotion activities will take into account good international practices to address market failures and improve the effectiveness and efficiency of government spending in this area. The reforms will draw on a long history of Bank/IFC work, for instance benchmarking and helping upgrade investment promotion agencies.

75. *Innovation.* The technical design of the project components takes into consideration Bank experience around the world supporting innovation, research reforms, and commercialization. It also takes into account the existing capacity of the Innovation Fund and that of the current team at the MoESTD. In this project, components are designed based on the capacities built and demonstrated under SIP, and the ones being currently developed under SRITTP.

76. *Labor*. The technical design of the labor component is based on a series of World Bank TA diagnostics conducted in Serbia over the last five years on labor market, activation, and social safety nets. In addition, the design of the reforms in the NES take into account the experiences and learning accumulated within the Social Protection and Labor Global Practice, work with other clients in Europe, and recent studies of best practices in select OECD countries on management of public employment services. The project also aims at the institutionalization of an IPA-funded pilot activity to strengthen ALMP evaluations in the NES. The reform of work incentives in social assistance benefits builds on diagnostics used commonly in the OECD, which represent the latest innovation in the field.

C. Financial Management

77. The results-based financing part (Part A) of the project is intended to finance existing expenditures included in the state budget which relate to budgets of multiple ministries, departments, and agencies. Therefore, it will rely on the country's budgeting system. Part A will finance salaries within the MoE, MoESTD (R&D Institutes) and NES.

78. Due to the aforementioned activities, the payroll system within the Government's institutions has been in the center of the financial management assessment. All of the above institutions, except for the NES, are included in the centralized payroll system. The principal authority in charge of centralized payroll processing is the Treasury Administration of the MoF, whose statutory obligations in this regard are set out in amendments to the Law on Budget System, from

[10] See for example: World Bank (2014), Rebalancing Serbia's Economy: Improving Competitiveness, Strengthening the Private Sector, and Creating Jobs; World Bank (forthcoming), Serbia Systematic Country Diagnostic; and Foreign Investors Council (2014), White Book: Proposals for Improvement of the Business Environment in Serbia.
[11] See especially the ICRs for the first RBF project done by the Bank in Ceara, Brazil, and the second, the USD 1 bn Minas Gerais, Brazil operation. These were multi-sector loans and were followed by second and third operations.

2013. The centralized payroll system was assessed under the Public Expenditures and Financial Accountability (PEFA) and it is assessed to be reliable.

79. The NES, as an organization of mandatory social insurance, has a separate computerized payroll system, which was assessed to be reliable

80. A PIU will be established within the PPS. The PIU will include a person in charge of financial management responsibilities. The PIU will be in charge of the entire scope of financial management responsibilities for technical assistance under Part B, which will be implemented using traditional arrangements. Staff within the PIU will also assume some responsibilities for Part A of the project, which will be also described in the staff's Terms of Reference. These should include (i) collection of semi-annual and annual financial reports on budget execution from project beneficiaries under Part A, (ii) preparation of IFRs for Part A based on collected financial reports, and (iii) preparation of withdrawal applications for reimbursement under Part A, based on IFRs. All controls and procedures, including split of responsibilities for the project, will be described in the Project Operations Manual to be prepared by project effectiveness.

81. The PIU within the PPS will prepare separate semi-annual financial reports for Part A and Part B and deliver them to the Bank within 60 days after the end of the reporting period. IFRs for Part A will be presented in dinars, while IFRs for part B will be presented in EUR.

82. Separate annual project financial statements for Part A and Part B will be audited by a private audit firm acceptable to the Bank. The audit will be delivered to the Bank within six months after the end of the audited period.

83. There will be no designated account opened for the results-based financing part. The funds are expected to flow either to the Single Treasury Account (STA) if currency of reimbursement is RSD or to a foreign currency account within the NBS which the government indicates. The method of disbursement is envisaged to be reimbursement. IFRs will be the basis for disbursement for Part A. The currency of reimbursement will be at the government's choice, and if needed the conversion rate applied will be that as of the date of the Bank's processing of applications. As for Part B, a Designated Account (DA) will be opened in the National Bank of Serbia and used solely for inflows and outflows related to Part B of the project. For local currency payments, the funds will be converted to PPS sub-account within STA opened solely for the purpose of use of project funds for payments in local currency. The disbursement method used for this part will be primarily advances, with methods of direct payment and reimbursement being also allowed as alternatives. It will be a EURO account. Disbursement for Part B will follow a traditional model and be based on SOEs. After the funds have been withdrawn to DA, for portion of the part B for which beneficiary is MoLEVSA, respective amount of funds will be transferred from the DA to separate foreign currency account (EUR) used solely for the project funds, opened and administered by MoLEVSA at the NBS. MoLEVSA will execute payments for its portion of part B of the project from this account, while for local currency payments the funds will be converted to MoLEVSA sub-account within STA opened solely for the purpose of use of project funds for payments in local currency. The PIU will remain to be responsible for preparation of financial reports for whole of part B of the project, therefore the PIU should receive a copy of bank statements for movements on MoLEVSA project accounts (both foreign and local currency), as well as invoices related to MoLEVSA portion of part B, in order to have necessary information for preparation of financial reports.

84. The Disbursement Matrix (Table 6) below describes how disbursements are envisioned to take place over the life of the project. First, Bank fiduciary rules apply to the EEPs for all disbursements. EUR 5.4 million will be for retroactive payments based on the EEPs and completion of 4 DLIs during the 12 months previous to loan signing. For each of the 3 years over the life of the project (2016, 2017, and 2018), disbursements after the first semester will be possible based on mid-year progress and/or partial completion of each DLI for that year (assuming adequate EEP execution over that time period). Based on the expected mid-year progress and associated amounts detailed in the verification protocols in the DLI table in Annex 1, mid-year payments are expected to be about EUR 8.4 million in 2016, EUR 6.6 million in 2017, and EUR 5.9 million in 2019. These numbers are reflected in the mid-year payment lines in Table 6 below. They correspond to roughly one-third of the total estimated disbursements for each year. For example, in 2016, the mid-year disbursement would be an estimated EUR 8.4 million and the end-of-year disbursement upon full completion of each DLI would be EUR 18.5 million. There is no requirement to submit a mid-year progress or partial payment amount request before completion of the full DLI. If a DLI is fully completed, it can be paid regardless of whether a previous partial payment has been made or not.

85. After the end of each semester, the Government will have 60 days to present the financial reporting and DLI evidence to the Bank. The Bank will then review the evidence and reporting and determine what is acceptable and the amount of the disbursement for that period. Hence, Table 6 shows estimated mid-year disbursements taking place in September and end-of-year disbursements in March of the following year. Disbursements will be based on evidence of EEP expenditures and the full or partial completion of the DLIs, as defined by the verification protocols in Annex 1 and subject to updates in the Project Operations Manual. The EUR 4.25 million in technical assistance (Part B of the project) will be disbursed as needed over the life of the project as on Statements of Expenditures (SOEs).

Table 6: Disbursement Matrix

Date	Type	EUR M	DLI #	Explanation
After effectiveness	Retroactive vs EEP spent, plus front-end fee	5.6	4	Up to 20% allowed as retroactive; against previous 12 month EEPs before loan signing; EEP expenditures > payment; Bank fiduciary rules. DLIs met
9/2016	EEP spent in 1st semester, DLI progress report	8.4	Partials	1st semester EEP meet fiduciary rules (including safeguards); EEP expenditures > payment; DLIs met or partially met; allow 75 days to present, vet evidence.
3/2017	Remaining 2016 EEP spent, 2016 DLI results	18.5	9	2016 EEP spent (after subtracting 1st semester reimbursement) > disbursement and meet fiduciary rules. DLI compliance; allow 75 days to present, vet evidence.
9/2017	EEP spent in 1st semester, DLI progress report	6.6	Partials	Idem 9/2016
3/2018	Remaining 2017 EEP spent, 2017 DLI results	19.3	9	Idem 3/2017
9/2018	EEP spent in 1st semester, DLI progress report	5.9	Partials	Idem 9/2016
3/2019	Remaining 2018 EEP spent, 2018 DLI results	20.9	9	Idem 3/2017
2016-18	TA	4.25	--	As needed, SOE reimbursed, Bank fiduciary rules

Total		**89.5**		

D. Procurement

86. The PPS will have the overall responsibility for procurement activities for Part B.1 of the Project, as it is the key coordinating agency. For Part B.2 procurement will be the responsibility of MoLEVSA. An assessment of the capacity and the adequacy of the procurement and related systems in place with the PPS, and the capability of the implementing institutions to conduct procurement under the project, were carried out in April 2015. The assessment reviewed the organizational structure for implementing the project and the interaction between the project staff responsible for procurement and relevant units in the implementing institutions. The assessment concluded that most of the entities involved in project implementation, have no experience in implementing World Bank-funded projects and with Bank procurement, except for MoESTD. To address this capacity issue, it is proposed to hire experienced Procurement experts within the PPS and MoLEVSA. Details on procurement arrangements, procurement/selection methods, supervision arrangements and major procurement packages under the TA sub-components are provided in Annex 4.

87. An initial procurement plan will be developed by the PPS and reviewed by the World Bank, covering procurement activities expected under the project components and to be agreed at negotiations. After the Project is approved by the Board the procurement plan would be published on the respective implementing institutions' websites and the Bank's external website. The Procurement Plan would be updated in agreement with the Bank at least annually or as required to reflect the actual project implementation needs and improvements in institutional capacity. The prior review thresholds set out in the Procurement Plan will be reviewed from time to time and revised as needed during project implementation.

E. Social (including Safeguards)

88. The project does not anticipate any negative social impacts. The various components and sub-components of the project will not support reforms and/or grant and research financing that might result in displacement of assets or expropriation of property or land. The project does not anticipate any direct, indirect or induced negative social impacts as no construction or refurbishing of buildings is anticipated, such as training centers, which may induce acquisition of land and/or temporary displacement of socio-economic activities. Hence, the safeguards policy is not triggered. The expected social and institutional impacts, particularly for Component 3, were considered during the project preparation process and guidelines reflected in the ESMF. Gender, excluded groups, and citizen engagement are discussed above in the Project Beneficiaries section.

F. Environment (including Safeguards)

89. This Project has been classified as a category B project, as per the World Bank OP/BP 4.01 on Environmental Assessment. An Environmental and Social Management Framework (ESMF) has been prepared by the borrower. No activities that fall into the World Bank Environmental Category A will be financed by the Project. The draft ESMF was disclosed in English and Serbian via the Public Policy Secretariat (PPS) website (http://www.rsjp.gov.rs/okvirni-plan-za-upravljanje-zivotnom-sredinom-i-socijalnim-pitanjima/t) and at the World Bank Infoshop on April 3, 2015. Hard copies of the document are available at the PPS reception area and the World

Bank Country Office in Belgrade. A public consultation meeting was held in accordance with the requirements of the World Bank on April 21, 2015. The final ESMF document was re-disclosed locally and at the World Bank Infoshop on May 11, 2015.

90. Direct, physical environmental impacts could arise under Component 2 on Innovation, which includes DLIs supporting startups and enterprises in different sectors across Serbian regions and activities of the Technology Transfer Facility focusing on technology transfer outcomes. The main environmental concern deals with the Mini & Matching Grant Programs, housed within and administered by the existing Innovation Fund (IF), which will support the development of new or significantly improved technologies, products and processes. The program is open to applications in any field of science and technology in all industrial sectors. However, in the past, the majority of awarded grants has been in the innovation fields related to services, software and materials.

91. Possible indirect environmental and social impacts may result from TA provided under the Project, particularly related to reforms in Components 1 and 2, which will support better coordination and monitoring of government programs, and potential reforms to select MoE programs. No environmental impacts are expected as a result of Component 4 on Labor, which will provide capacity building to the NES to improve the effectiveness of labor market programs.

G. Other Safeguards Policies Triggered *(if required)*

92. No Safeguard policies other than OP/BP 4.01 on Environmental Assessment are triggered and the ESMF explicitly excludes support for activities that would trigger any other Safeguard policies. The Project will not support any sub-projects/grants that would necessitate involuntary land acquisition or any form of resettlement.

H. World Bank Grievance Redress

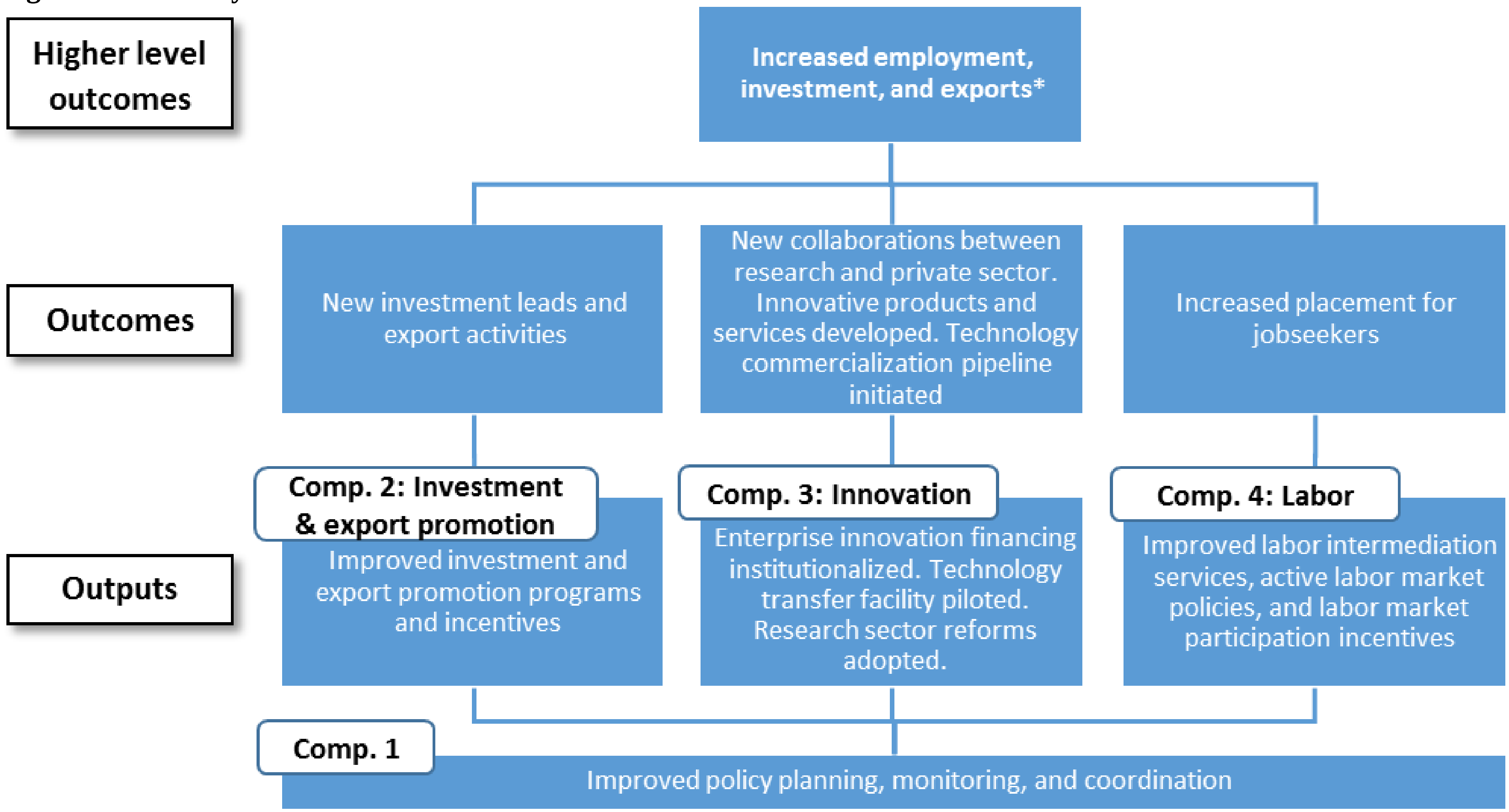
93. Communities and individuals who believe that they are adversely affected by a World Bank (WB) supported project may submit complaints to existing project-level grievance redress mechanisms or the WB’s Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed in order to address project-related concerns. Project affected communities and individuals may submit their complaint to the WB’s independent Inspection Panel which determines whether harm occurred, or could occur, as a result of WB non-compliance with its policies and procedures. Complaints may be submitted at any time after concerns have been brought directly to the World Bank's attention, and Bank Management has been given an opportunity to respond. For information on how to submit complaints to the World Bank’s corporate Grievance Redress Service (GRS), please visit http://www.worldbank.org/GRS. For information on how to submit complaints to the World Bank Inspection Panel, please visit www.inspectionpanel.org.

Annex 1: Results Framework and Monitoring

SERBIA: Competitiveness and Jobs

This annex presents: i) the summary results chain for the project; ii) PDO indicators; iii) Intermediate Results Indicators; iv) indicator descriptions (for ii and iii); and v) complete descriptions of the Disbursement-Linked Indicators with verification protocols.

Figure 1: Summary results chain



* Increased investment and exports are a measure of competitiveness.

PDO and Non-DLI Intermediate Indictors

Project Development Objectives

PDO Statement

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.

These results are at	Project Level

Project Development Objective Indicators

Indicator Name	Baseline	Cumulative Target Values		
		2016	2017	2018
New investor leads generated by the reformed investment promotion agency (Number), annual	20	22	25	30
Participants in export promotion programs that engage in new export activities (Number), annual	85	90	95	100
New collaborations facilitated between research organizations and the private sector (Number)	3	8	31	34
NES registered unemployment cases transitioning into formal job (Number), annual	232,280 (2014)	245,000	260,000	280,000

Intermediate Results Indicators

Indicator Name	Baseline	Cumulative Target Values		
		2016	2017	2018
Component 1: Policy Planning, Monitoring, and Coordination				
Annual performance reviews of pilot policy planning, monitoring, and coordination system (to support competitiveness and jobs reforms) (see **DLI 1**) (Number)	0	1	2	3

Component 2: Investment and Export Promotion				
MoE investment and export promotion programs restructured [**DLI 2]**	DLI table	DLI table	DLI table	DLI table
Number of documented interests by investors (Number), annual	61	67	74	82
Component 3: Innovation				
Private financing catalyzed through IF support programs (Amount USD) [see **DLI 3**]	(2014) 0.3 m	0.7 m	1.4 m	2.1 m
Enterprises and startups financed through matching grants (Number) [see **DLI 3**]	(2014) 11	15	30	45
Enterprises and startups financed with female owner (Number **-** Sub-Type: Breakdown) [see **DLI 3**]	(2014) 1	2	4	6
Innovative products or services developed by MG beneficiary firms (Number) [see **DLI 3**]	(2014) 16	7	17	27
Innovative products or services launched by MG beneficiary firms (Number) [see **DLI 3**]	(2014) 3	0	3	6
Technology transfer: IF TTF service lines deployed [see **DLI 4]** (Number)	0	2	5	5
Technology transfer: transactions initiated (Number) [see **DLI 4]**	0	0	5	10
R&I strategy and action plan and public research sector reforms designed and adopted [see **DLI 5**]	DLI table	DLI table	DLI table	DLI table
Citizen engagement: Innovation matching grant beneficiary annual survey (Number of surveys)	0	1	2	3
Component 4: Labor				
NES registered female unemployment cases transitioning into formal job (Number), annual	122,491 (2014)	130,000	137,000	145,000
Number of employers contacted per year by the NES (Number) [**see DLI 6**]	Field visits to 15,927 employers (2014)	17,000	20,000	23,000
% of total NES staff that is operating as certified case worker (Percentage) [**DLI 6**]	0 (2014)	50	85	85
Standard Deviation of mean case load per branch office over all branch offices [**DLI 7**]	381 (2014)	350	300	250

Net placement rate of NES start-up support program for self-employment 6 months from completion (Percentage)	37 (2013)	37	39	42
Net placement rate of NES hiring subsidy program for new employment 6 months from completion (Percentage)	41 (2013)	41	43	46
Number of new or re-designed ALMPs in the NES [**DLI 8**]	0	0	0	1
Average effective tax rate for social assistance beneficiary with two children and nonworking spouse transitioning to a half-time minimum wage job [**DLI 9**]	100%			70%
Citizen engagement: Number of employers reached by client satisfaction and needs survey	0	1,000	2,000	3,000

Indicator Description

Project Development Objective Indicators

Indicator Name	Description (indicator definition etc.)	Frequency	Data Source / Methodology	Responsibility for Data Collection
New investor leads generated by the reformed investment promotion agency (Number)	Action demonstrating investor interest (e.g. a formal meeting between the potential investors and agency, site visit, MOU, etc.) following the initial contact or expression of interest by the investor.	Semi-annual	Progress reports	MoE
Participants in export promotion programs that engage in new export activities (Number)	Number of participants in export promotion programs and services that export existing products to new markets or customers, new products to new or existing markets, or sell new products into export-oriented value chains	Semi-annual	Progress reports	MoE
New collaborations facilitated between research organizations and the private sector (Number)	New collaborations facilitated by the IF through its innovation and technology transfer programs, e.g. between firms, RDIs, university, innovation centers,	Annual	Annual & Progress Reports	Innovation Fund

	investors, other consortia members, etc.			
NES registered unemployment cases transitioning into formal job (Number), annual	N/A	Annual	Social security administrative data on new formal employment matched with NES database of registered unemployed	NES

Intermediate Results Indicators

Indicator Name	Description (indicator definition etc.)	Frequency	Data Source / Methodology	Responsibility for Data Collection
Component 1: PPMC				
Annual performance reviews of pilot policy planning, monitoring, and coordination system (to support competitiveness and jobs reforms) (Number)	See DLI 1 description for contents of performance reviews.	Semi-annual	Progress reports	PPS
Component 2: Investment and Export Promotion				
MoE investment and export promotion programs restructured (Text)	See DLIs table below.	Semi-annual	Progress reports	MoE
Number of documented interests by investors (Number)	This is the inquiry stage of the investment generation process and might include actions by the investor such as: a call or a walk in to the Investment Promotion Agency seeking information, or a contact with the investors by the IPA where the investor responds positively by sharing information about their needs or requests a follow up.	Semi-annual		
Component 3: Innovation				

Private financing catalyzed through IF support programs (Amount USD)	Private financing committed by participants in mini, matching, collaborative grant schemes and technology transfer activities	Semi-annual	Progress reports	Innovation Fund
Enterprises and startups financed through matching grants (Number)	Number of enterprises and startups financed by the Innovation Fund.	Semi-annual	Innovation Fund quarterly reports	Innovation Fund
Enterprises and startups financed with female owner (Number - Sub-Type: Breakdown)	Number of enterprises and startups financed by the Innovation Fund with female owners or co-owners.	Semi-annual	Innovation Fund quarterly reports	Innovation Fund
Innovative products or services developed by MG beneficiary firms (Number)	N/A	Semi-annual	Innovation Fund quarterly reports	Innovation Fund
Innovative products or services launched by MG beneficiary firms (Number)	Products or services developed and launched with initial sales revenue generated	Semi-annual	Innovation Fund quarterly reports	Innovation Fund
Technology transfer: IF TTF service lines deployed (Number)	IF TTF roll out of services to support commercialization process	Semi-annual	Innovation Fund annual report	Innovation Fund
Technology transfer: transactions initiated (Number)	N/A	Semi-annual	Innovation Fund annual report	Innovation Fund
R&I strategy and action plan and public research sector reforms, designed and adopted (Text)	See DLIs table below.	As needed	Government orders adopting strategy and action plan and research sector reform	MoESTD
Citizen engagement: Innovation matching grant beneficiary annual survey (Number of surveys)	N/A	Annual	Report of survey results	Innovation Fund
Component 4: Labor				

NES registered female unemployment cases transitioning into formal job (Number), annual	N/A	Annual	Social security administrative data on new formal employment matched with NES database of registered unemployed	NES
Number of employers contacted per year by the NES (Number)	Employers reached by NES staff for the purpose of vacancy collection through individual visits or phone interview	Semi-annual	Management Information System of the NES	NES
% of total NES staff that is operating as certified case worker (Percentage)	% of staff that has passed the new certification process, to be defined as part of this project	Semi-annual	Management Information System of the NES	NES
Standard Deviation of mean case load per branch office over all branch offices	Standard deviation of the mean ratio of active jobseekers to case workers in NES branches	Semi-annual	Management Information System of the NES	NES
Net placement rate of NES start-up support program for self-employment 6 months from completion	Additional percentage of program participants who were in a formal job 6 months after program completion, compared to the (econometrically generated) control group of nonparticipants	Annual	NES staff elaboration of data from Information System of the NES and social security administrative data	NES
Net placement rate of NES hiring subsidy program for new employment 6 months from completion	Additional percentage of program participants who were in a formal job 6 months after program completion, compared to the (econometrically generated) control group of nonparticipants	Annual	NES staff elaboration of data from Information System of the NES and social security administrative data	NES
Number of new or re-designed ALMPs in the NES	ALMPs that were not offered the previous year or that are implemented differently than the previous year	Annual	Annual KPI reports, measured through NES information system	NES
Average effective tax rate for social assistance beneficiary with two children and nonworking	% of gross income foregone by worker through income tax, social contributions and withdrawal of social assistance (FSA and Child Allowance) when transitioning	Annual	Simulations based on legislation on social assistance, social security minimum wage, and	MoLEVSA

spouse transitioning to a half-time minimum wage job	to a formal job paid at half the minimum wage		income tax	
Citizen engagement: Number of employers reached by client satisfaction and needs survey	Number of employers surveyed	Semi-annual	Client satisfaction and need assessment survey	NES

Preliminary Disbursement-Linked Indicators Table with Verification Protocols

DLI	Baseline	Retroactive/2015	2016	2017	2018
1. Policy planning, monitoring, and coordination					
DLI 1: Policy planning, monitoring, and coordination (PPMC) system (in support of competitiveness and jobs reforms) piloted	No Competitiveness and Jobs policy planning, monitoring, or coordination framework exists. Systematic benchmarking, fixing targets, M&E and reporting, incentives and budgeting not done by line ministries.	Inter-ministerial Competitiveness and Jobs PPMC Working Group ("PPMC WG") formally created by the Participating Institutions Each Participating Institution adopts institution-specific mandates and reporting lines for participation in PPMC system.	PPMC WG publishes on the PPS website one semi-annual progress report and one annual performance report of the PPMC system with inputs from each Participating Institution.	PPMC WG publishes on the PPS website one semi-annual progress report and one annual performance report of the PPMC system with inputs from each Participating Institution.	PPMC WG publishes on the PPS website one semi-annual progress report and one annual performance report of the PPMC system with inputs from each Participating Institution.
Amount of the Loan Allocated to DLI 1		(EUR 0.895 million)	(EUR 0.895 million)	(EUR 0.895 million)	(EUR 0.895 million)

Verification protocol:
The Participating Institutions are the PPS, MoE, MoESTD, and NES (in cooperation with MoLEVSA).

Retroactive/2015: *Inter-ministerial C&J policy planning, monitoring, and coordination working group (PPMC WG):* Decree (or MoU) establishing PPMC WG signed by MoF, MoE, MoESTD, MoLEVSA, and PPS. Decree should cover leadership, membership (from each of the signatory institutions), resourcing, and mandate. Mandate should include inter alia: (a) oversight of the PPMC launch and implementation process and protocols, (b) liaison with those responsible for PPMC in participating ministries', including suggestions regarding activities, indicators, targets, (c) assure alignment of activities, indicators, and targets with Government priorities, (d) data analysis, policy development, and M&E, (e) semi-annual PPMC WG meetings and progress reports (based on inputs from the ministry-level PPMC units), (f) annual performance reviews, including progress against targets, identification of constraints to improved performance, and suggested performance improvement measures (based on inputs from each ministry), (g) support to the development of impact evaluations in the participating ministries, and (h) competitiveness and jobs policy coordination across participating ministries.

Ministry-level mandates and responsibilities: The MoE, MoESTD (specifically the science and innovation branch of the ministry), and the NES (in cooperation with the MoLEVSA) should each identify their position or unit responsible for participation in the PPMC system, and the mandate of said position or unit, by ministerial decree or other verifiable change to internal procedures. Each unit should have a mandate and protocols to: (a) develop KPI (Key Performance Indicators) hierarchies (see KPI notes below), (b) establish baselines, (c) fix yearly targets, (d) create a platform to track/ monitor indicators and relevant budget performance, (e) identify & troubleshoot problems, (f) periodically evaluate and revise protocols and targets as needed, (g) provide semi-annual progress reports to their line minister and the inter-ministerial PPMC WG, and participate in WG meetings, (h) provide annual performance reviews with performance improvement measures to their line minister and PPMC WG, and (i) use the progress reports and performance reviews to inform program-based budgeting decisions.

2016-2018: Semi-annual reports should cover all KPIs for each ministries' PPMC system, including KPI baseline values at project inception, progress, and

DLI	Baseline	Retroactive/2015	2016	2017	2018
targets for the following 2 years. Reports should also identify the relevant budget lines and activities associated with each indicator. Inputs from each ministries' PPMC unit should be shared with the PPMC WG according to reporting protocols established in the PPMC WG minutes. Reports should be publicly available and published on appropriate Government website(s), e.g. of the individual ministries and/or the Public Policy Secretariat. *KPIs for each of the participating ministries are expected to cover, inter alia:* *Investment and export promotion:* Indicators to be defined as part of MoE agency reform process. Examples include: a) Export promotion: exports as a % of GDP; number and growth of export-oriented SMEs supported by the export promotion agency. b) Investment attraction: investment generated; number of firms that invest; number of investment MoUs signed; number of documented interests by investors (broken down by priority sectors). c) General: number of firms that benefit from sector support programs; number of events with the private sector to discuss agency reform process; user satisfaction with agency programs, etc. *Innovation*. Patents: Number of new patents filed, broken down by: a) Innovation Fund beneficiaries, national patents; b) IF beneficiaries, international patents; c) RDIs, national patents; d) RDIs, international patents). Technology transfer: number of transactions initiated and number completed; value of technology transfer transactions completed; value of "in-licensing". Applied research publications (number), broken down by national and international journals. Publicly fund research projects with diaspora engagement (number). Amount of contract research conducted. Publicly funded research projects with international participation (number). Belgrade Technopark (BTP): occupancy level (%); number of tech firms and organizations housed in BTP; number of BTP incubator startups raising external financing; number of BTP startups/spinoffs receiving matched Business Acceleration Network support. *Labor*: Employer services: frequency of contacts with employers; number of employers contacted; vacancy registration; time to fill vacancies; satisfaction of clients with employer services. Case management: number of case workers; number of case workers certified; number of successful job matches; frequency of engagement with active jobseekers; satisfaction of jobseekers with case workers services; ratio of active jobseekers per case worker across offices; number of active job seekers with risk profiles. ALMPs: number of new or re-designed ALMPs piloted; number of ALMP participants tracked after completion; placement rates of ALMPs. KPIs should be defined at national and branch office - and at case worker level where possible. The specific wording be chosen during the time of the project. *Annual performance reviews* should discuss performance problems in each KPI, budget adequacy, and performance improvement measures (both planned and taken). Similar to the semi-annual progress reports, they should be publicly available and published on appropriate Government website(s), e.g. of the individual ministries and/or the Public Policy Secretariat. *Mid-year progress and partial payments*: For 2016, EUR 0.224 million can be disbursed based on the publication of one semi-annual report (e.g. at mid-year). The remainder of the DLI amount can be disbursed based on full completion of the DLI for that year. The same applies for 2017 and 2018.					
2. Investment and export promotion					
DLI 2: MoE investment and export promotion programs restructured	MoE agencies have overlapping mandates and weak, non-transparent performance history		Strategic framework and overall action plan for investment and export promotion ("Action Plan") prepared and adopted by the MoE.	Action Plan for year 2017 implemented, monitored, and updated. Number of investment leads generated increased by at least 10 percent from previous	Action Plan for year 2018 is implemented, monitored, and updated. Number of investment leads generated increased by at least 10

DLI	Baseline	Retroactive/2015	2016	2017	2018
			Sectoral policies and sector-specific implementation plans adopted for target sectors identified in the strategic framework.	year.	percent from previous year.
Amount of the Loan Allocated to DLI 2			(EUR 7.16 million)	(EUR 6.265 million)	(EUR 6.265 million)
Verification protocol: *2016*: The strategic framework and action plan should include an initial identification of target sectors, 3 year performance targets, and monitoring mechanisms. The action plan should be time-bound, costed, and sequenced, and cover reforms or restructuring of one or more of the MoE's key agencies responsible for investment and export promotion (i.e. SIEPA, Development Fund, AOFI, and/or NARR). The restructuring could include the combination of existing or creation of new agencies. The action plan should also include the strengthening of governance structures of the selected agencies and the improvement of existing or development of new programs and services. Sectoral policies should include policies for investment and export promotion and value chain strengthening in the identified target sectors, with performance targets and monitoring mechanisms and sector specific action plans. The sectoral policies should be aligned with the revised Industrial Strategy for 2011-20. The strategic framework, action plan and sectoral policies should be officially endorsed in a letter signed by the Minister of Economy and be acceptable to the Bank. *2017-2018*: Implementation will be verified by semi-annual progress reports prepared by the MoE that cover the elements specified in the action plan, including: progress toward performance targets, proof of changes to the governing structure (e.g. revision of the agency legal bases, bylaws, and/or internal operating procedures), funding, cost/benefit analyses of the new/improved programs and services, etc. The year-end progress report should update the performance targets for the following 3 years and update the actions in the plan for the following year (as needed to improve performance). *Mid-year progress and partial payments:* For 2016, EUR 2.685 million can be disbursed based on the terms of reference designed and consultants hired to complete the strategic framework, overall action plan, and sector specific policies; the remainder (EUR 4.475 million) can be disbursed based on the completion and adoption of the framework, overall action plan, and sector-specific policies (with action plans). For both 2017 and 2018, EUR 3.58 million can be disbursed based on completion of the action plan requirement and the remainder of the DLI amount (EUR 2.685 million) on the number of investment leads. (Both are envisioned to take place at year-end, rather than mid-year.)					
3. Innovation					
DLI 3: Enterprise innovation supported via the Innovation Fund ("IF") Matching Grants Program ("MGP")	EUR 0.7M, 2014, operational budget EUR 1.8M, 2013, MG grant budget		At least EUR 0.72 million allocated for IF's 2016 operational budget. At least EUR 2.7 million allocated to MGP in the Borrower's 2016 budget for IF. At least 80% of 2016 IF	At least EUR 0.72 million allocated for IF's 2017 operational budget. At least EUR 2.7 million allocated to MGP in the Borrower's 2017 budget for IF. At least 80% of 2017 IF	At least EUR 0.72 million allocated for IF's 2018 operational budget. At least EUR 2.7 million allocated to MGP in the Borrower's 2018 budget for IF. At least

DLI	Baseline	Retroactive/2015	2016	2017	2018
			MGP budget committed using IF's international peer review and investment committee selection process.	MGP budget committed using IF's international peer review and investment committee selection process. MGP implementation evaluation conducted.	80% of 2018 IF MGP budget committed using IF's international peer review and investment committee selection process. Proposal for scaling-up MGP submitted by MoESTD to the Borrower or development partner donor institutions
Amount of the Loan Allocated to DLI 3			(EUR 3.58 million)	(EUR 3.58 million)	(EUR 3.58 million)
Verification protocol: *2016-2018*: For each year, IF confirms operational and MG budget allocations received. For 80% MG budget committed, see IF reports. Commitment of funds should be done in line with the IF's relevant operations and grant manuals acceptable to the Bank. *2017*: Matching grants evaluation report. 2018: MOESTD submits financing proposal to government or donors on behalf of IF. *Mid-year progress and partial payments:* For 2016, 2017, and 2018, EUR 1.193 million can be disbursed based on allocation of the IF operational and MG fund in the Borrower's (Republican) budget. For 2016, EUR 2.387 million can be disbursed once 80% of the IF budget is committed. For 2017 and 2018, EUR 1.987 million can be disbursed once 80% of the IF budget is committed. For 2017, EUR 0.4 million can be disbursed upon completion of the IF MG implementation evaluation. For 2018, EUR 0.4 million can be disbursed once the government or donor proposal is submitted.					
DLI 4: Technology transfer and commercialization facilitated via the IF TTF	No public entity with demonstrable TT transactional capacity exists No centralized technology transfer facility (TTF) or service lines exist		At least one TTF service line deployed.	At least EUR 0.9 million allocated in the Borrower's 2017 budget to TTF operations and services, and at least 3 technology transfer transactions initiated.	At least EUR 0.9 million allocated in the Borrower's 2018 budget to TTF operations and services, and at least 7 technology transfer transactions initiated. TTF program evaluation conducted and proposal for

DLI	Baseline	Retroactive/2015	2016	2017	2018
					scaling-up technology transfer activities submitted by MoESTD to the Borrower or development partner donor institutions.
Amount of the Loan Allocated to DLI 4			(EUR 2.685 million)	(EUR 2.685 million)	(EUR 3.580 million)
Verification protocol: *2016:* One or more TT service lines deployed and verified by IF monitoring reports. *2017:* Allocation of EUR 0.9 million for TTF and number of transactions initiated, to be confirmed by IF. *2018*: Allocation of EUR 0.9 million for TTF and number of transactions initiated, to be confirmed by IF. *Mid-year progress and partial payments*: For 2016, EUR 0.9 million can be disbursed once one or more TTF service lines is designed; the remainder (EUR 1.785 million can be disbursed once they are deployed. For 2017, EUR 1.8 million can be disbursed once TTF funds are allocated in the Borrower's (Republican) budget (e.g. at mid-year); EUR 0.885 million can be disbursed once 3 tech transfer transactions have been initiated (e.g. at year-end). For 2018, EUR 1.8 million can be disbursed once TTF funds are allocated in the Borrower's (Republican) budget (e.g. at mid-year); EUR 0.89 million can be disbursed once the 7 cumulative tech transfer transactions have been initiated (e.g. at year-end). EUR 0.89 million can be disbursed based on completion of program evaluation and submission of Government/donor proposal.					
DLI 5: Public research sector reforms designed and adopted	Current Strategy for Innovation expires in 2015 No sector reform strategy or RDI level restructuring paths identified.	2015-2020 research and innovation strategy adopted by the Borrower including commitment to reforming public RDI sector.	Time bound action plan to implement research and innovation strategy action plan adopted by the Borrower. Time bound action plan to implement research and innovation infrastructure roadmap and action plan adopted by the Borrower. At least 50 RDI self-assessments completed. Pilot performance audits of at least 4 RDIs carried out by international experts.	Performance audits of at least 20 RDIs carried out by international experts. RDI sector reform program adopted by the Borrower, including performance based financing schemes, and deployment timeline	Proposal (including costing, targets and timelines) for technical assistance funding to conduct RDI sector reform submitted by MoESTD to the Borrower or development partner donor institutions.

DLI	Baseline	Retroactive/2015	2016	2017	2018
Amount of the Loan Allocated to DLI 5		(EUR 2.685 million)	(EUR 2.685 million)	(EUR 3.58 million)	(EUR 2.685 million)
Verification protocol: *Retroactive/2015:* Government order adopting R&I Strategy is based on recommendations from SRITTP and includes commitment to conduct RDI sector reforms Component 3. *Partial payments:* For adoption of R&I Strategy disburse EUR 0.9 million and for including sector reforms EUR 1.785 million. *2016*: R&I Strategy Action Plan and Infrastructure Roadmap and Action Plan should reflect recommendations from SRITTP Component 3. MoESTD report to detail results of the self-assessments and pilot audits by international experts. *Partial payments*: 1/3 (EUR 0.895 million) can be paid for each requirement met. *2017:* The RDI performance audits should build on the 2016 pilot and be completed by international experts. RDI sector reform program, including performance based management at the institution and individual level, adopted by Government. *Partial payments*: For 2017, ½ (EUR 1.79 million) can be paid for each requirement met.					
4. Labor					
DLI 6: Effectiveness of NES labor intermediation services delivered to clients (employers and unemployed) improved	0% of case workers certified with new certification system Number of employers visited per year by the NES: 15,927 (2014) Number of NES-registered unemployment cases transitioning into formal job: 232,280 (2014)		Action plan to enhance the quality of employer services and case management adopted by NES ("NES Action Plan")	85% of the total number of NES case workers as of December 31, 2017 are certified according to newly adopted standards under NES Action Plan	Number of employers contacted by the NES within the last 12 calendar month period: 23,000 Number of NES-registered unemployed individuals transitioning into formal jobs within the last 12 month calendar period: 280,000
Amount of the Loan Allocated to DLI 6			(EUR 2.685 million)	(EUR 1.79 million)	(EUR 2.685 million)
Verification protocol: *2016*: The action plan and related KPIs will be sent to the World Bank with cover letter stating its official adoption by the NES management, and be considered satisfactory to the World Bank. The plan will adopt the final list of KPIs to monitor the quality of employer services and case management. It will also include recommendations to be implemented throughout the project duration, including those planned to be implemented within one year from adoption of the action plan, as well as performance targets for 2018. Regarding case officers, the action plan should include changes to the regulations, standards for certification of case workers, curriculum for training case workers, KPIs to monitor certification and individual performance of case workers starting from 2016. NES rule book has to be revised and system to track the indicator must be in place. If any necessary legislation has to be revised, MoLEVSA submits new legislation to government. *Certification* system will focus both on compliance with regulations and on capabilities of case workers in working face-to-face with clients. Case workers need to be certified within 12 months from appointment.					

DLI	Baseline	Retroactive/2015	2016	2017	2018
2017: The number of case workers includes staff with case worker functions under both permanent and temporary contracts. Case worker certification rates are verified through the periodic reports of the monitoring unit. The December 31, 2017 date is used to calculate the total number of case workers as of that date. The DLI can be met anytime that at least 85% of that number of case workers are certified. *2018:* Target values for these indicators will be set in the action plan to be prepared during 2016. As a result, the values may have to be revised at the time of the Project midterm review. The numbers will be reported through periodic reports of the NES monitoring unit. *Mid-year progress and partial payments:* For 2016, EUR 0.9 million can be disbursed based on provision of a draft action plan (e.g. at mid-year). For 2017, EUR 0.9 million can be disbursed once at least 40% of caseworkers (based on the number of case workers employed as of June 30, 2017) are certified (e.g. at mid-year). For 2018, EUR 0.9 million can be disbursed once at least 11,500 employers have been contacted and 140,000 NES registered unemployed transitioned into a formal job (e.g. at mid-year). The remainder of the DLI amounts can be disbursed once the full targets have been met (e.g. at year-end).					
DLI 7: Case load management in NES branch offices improved	Standard deviation of mean case load per branch office over all branch offices: 381.	Special registry of unemployed persons who are temporarily prevented from working established by NES.	Staffing reforms adopted by NES for 2016 are implemented, and targets on case load per branch office are published on the NES website.	Standard deviation of mean case load per branch office is 300 or less.	Standard deviation of mean case load per branch office is 250 or less.
Amount of the Loan Allocated to DLI 7		(EUR 0.895 million)	(EUR 2.685 million)	(EUR 2.685 million)	(EUR 2.685 million)
Verification protocol: "Mean case load per branch office" is computed as the ratio of registered unemployed per case worker in each branch office for the baseline. As of 2016, it will be computed as active jobseekers (to be defined in DLI 8) per case worker in each branch office. The standard deviation of mean case load is computed across the mean of all branch offices). Verification of DLI is based on the periodic reports of the monitoring unit *Retroactive:* NES will have two separate registries: the registry of active job seekers and the registry of persons temporarily prevented from working, in accordance with the law, which will ensure the improvement of performance, in terms of employment mediation for active job seekers, i.e. focusing of the case workers on the employment of active job seekers. This would help decreasing the caseload per case worker. *2016*: Staffing plan: designed and adopted by the NES. Increase in the number of caseworkers can be achieved through a combination of (i) reassignment of administrative staff to case worker functions, (ii) redeployment of temporary workers, (iii) mobility of case workers from offices with low case load to offices with high case load, or other measures. For verification the plan should be sent to the World Bank with cover letter stating its official adoption by the NES management, and be considered satisfactory to the World Bank. Case workers must be certified within 12 months from appointment to be considered in the caseload indicator. *2017-2018*: At mid-term review, a target on how much the standard deviation has to decrease for the remainder of the project will be set. Verification of DLI based on the periodic reports of the monitoring unit. *Mid-year progress and partial payments:* For 2016, EUR 0.9 million can be disbursed once staffing reforms are designed (e.g. at mid-year); the remaining EUR					

DLI	Baseline	Retroactive/2015	2016	2017	2018
1.785 million can be disbursed once the full DLI is met (e.g. at year-end). For 2017, EUR 0.9 million can be disbursed once the standard deviation of mean case worker per branch office has been reduced to 350 (e.g. at mid-year); the remaining EUR 1.785 million can be disbursed upon completion of the full target. For 2018, EUR 0.9 million can be disbursed once the standard deviation of mean case worker per branch office has been reduced to 275 (e.g. at mid-year); the remaining EUR 1.785 million can be disbursed upon completion of the full target.					
DLI 8: Effectiveness of ALMPs improved through statistical evidence	Number of new or re-designed ALMPs piloted: 0. Number of registered unemployed with newly developed risk profiles: 0.	Rule book redefining "low-risk group" of its current risk profiling as "requiring minimal to no NES services", taking into account registered unemployed individuals' self-assessment of service needs, adopted by NES.	Action plan on monitoring, evaluation and re-design of ALMPs; and on profiling of registered unemployed individuals approved by NES management.	50% of unemployed individuals registered in NES as of December 31, 2017 have a risk profile according to the new methodology.	NES starts pilot of a re-designed ALMP, taking into account evidence from previous evaluations of ALMPs undertaken by NES. At least 1 service provider for labor market trainings hired based on a performance based contract.
Amount of the Loan Allocated to DLI 8		(EUR 0.895 million)	(EUR 2.685 million)	(EUR 2.685 million)	(EUR 2.685 million)
Verification protocol: *Retroactive:* New methodology to re-define "low-risk group" to "requiring minimal to no NES services" has to be found acceptable to the World Bank. *2016: Action plan* should be satisfactory to the World Bank, and cover two parts: (part 1) strategy for monitoring, evaluation and re-design of ALMPs, and (part 2) jobseekers profiling tool. Both results of the DLI need to be met for DLI disbursement. The development of both parts should be informed by technical assistance. Adequate resources and deadlines should be identified for the implementation of each component. For verification the plan should be sent to the World Bank with cover letter stating its official adoption by the NES management, and be considered satisfactory to the World Bank -Part 1 should: (i) regulate the evaluation of ALMPs, which should institutionalize the quantitative evaluation methods piloted by the NES in previous TAs (such as IPA project); (ii) recommend KPIs to monitor regularly outcome indicators of ALMPs offered by the NES; (iii)) establish the design of an in-depth evaluation on one of the ALMPs ("in-depth" is a study to understand the causes of observed outcomes from quantitative evaluation results and informs the changes in the design of the program). -Part 2: A profiling tool is defined as the method to segment registered unemployed according to their risk of becoming long-term unemployed, and to the level of active support that is required in order to bring the unemployed back into employment. The risk-profiling tool should allow to separate registered unemployed of each branch into two broad categories, those requiring no or minimal support from NES (see DLI 7); and those requiring medium to intensive support. The action plan should establish how to target case work and ALMPs for different customer profiles. *2017*. Verification of DLI on assignment of risk profile to jobseeker is based on the periodic reports of the monitoring unit. *2018*: DLI consists of two results. Disbursement equal to half of the DLI total amount can be made upon completion of each result.					

DLI	Baseline	Retroactive/2015	2016	2017	2018
First result: ALMP pilot. Result is verified through transmission to the World Bank of report endorsed by NES management and adopted in National Employment Action Plan. The report should include description of the intervention, including relevant evidence from evaluations that were incorporated into its design, information on target, profile and number of participants, duration and location of intervention, number of individuals who completed the intervention. Verification of DLI will require an NES progress report on the pilot implementation. Second result: Verification will be executed when the World bank receives tender documentation; and after contracting of providers has been completed *Mid-year progress and partial payments:* For 2016, EUR 0.9 million can be disbursed on the basis of a draft ALMP action plan (e.g. at mid-year); the remainder (EUR 1.785 million) can be disbursed based NES management approval of an acceptable action plan (e.g. at year-end). For 2017, EUR 0.9 million can be disbursed once 25% of unemployed as of June 30, 2017 have a risk profile (e.g. at mid-year) and the remainder (EUR 1.785 million) once 50% have a risk profile. For 2018, EUR 0.45 million can be disbursed based on the design of the pilot (e.g. and mid-year) and EUR 0.9 million based on the NES progress report on the implementation of the pilot. EUR 0.45 million can be disbursed upon publishing of the tender for performance-based contract (e.g. at mid-year) and the remaining EUR 0.885 million upon contracting of providers.					
DLI 9:Transition of social assistance beneficiaries into formal jobs facilitated	AETR for a social assistance beneficiary household with two children, where one adult member transitions into a formal job at minimum wage, where the job is: half-time: 100%, full-time: 83%		Study to (i) design a program to reduce disincentives to enter formal jobs for social assistance beneficiaries; and (ii) improve activation of social assistance beneficiaries through improved services, carried out by the Borrower.	Pilot program to support formal employment of a select group of beneficiaries of social assistance and/or child allowance selected in accordance with criteria set forth in the Project Operations Manual, established by the Borrower.	Average effective tax rate for a social assistance beneficiary household with two children and who participates in pilot program for the previous calendar year, where one adult member transitions into a formal job at minimum wage, where the job is: Half-time: 70% or less, Full-time: 70% or less.
Amount of the Loan Allocated to DLI 9			(EUR 1.79 million)	(EUR 1.79 million)	(EUR 1.79 million)
Verification protocol: Definition of average effective tax rate (AETR): percentage of formal gross income that is foregone by the worker through taxation, contributions, and withdrawal of social benefits when transitioning into a formal job, either full time or at half time, at minimum wage. *2016:* The study should at a minimum: (i) assess current work disincentives; (ii) study best practice from OECD countries on formal employment of low productivity workers, including beneficiaries of social assistance; and (iii) provide recommendations on the design and implementation arrangements for a pilot to support formalization of a select group of beneficiaries of financial social assistance and/or child allowance; (iv) provide scenarios of budgetary implication including expenditure on social assistance, tax revenues; and (v) provide recommendations on how to improve services and institutional setup for activation, including linkages between NES and social welfare centers, and defining financial assistance that the beneficiaries would receive from the NES as an ALMP instead of the centers for social work so that the formal employment would yield higher income compared to receiving financial social assistance.					

DLI	Baseline	Retroactive/2015	2016	2017	2018
2017: Establishment of pilot program is verified by the adoption and implementation of needed regulations. *2018:* A decrease for the average effective tax rate will be determined at mid-term review. Verification of the DLI is through an analytical paper transmitted with cover letter from the Ministry to the World Bank, which shows the computation of AETR based on the existing regulations and legislation. *Mid-year progress and partial payments:* For 2016, EUR 0.7 million can be disbursed once the consultants are contracted to undertake the study. For 2017, EUR 0.7 million can be disbursed based on the description of the pilot design; the remainder (EUR 1.09 million) can be disbursed based on adoption of required regulations. There will be no partial payment for 2018.					

Annex 2: Detailed Project Description

SERBIA: Competitiveness and Jobs

1. **The project has two parts. Part A for EUR 85.02 million uses a results-based financing modality. Part B for EUR 4.25 million covers project management and supporting technical assistance.[12]** Part A reimburses "Eligible Expenditure Programs" (EEPs)[13] conditioned on the achievement of "Disbursement-Linked Indicators" (DLIs). Part B reimburses direct expenditures based on "Statements of Expenditures". A complete description of the DLIs for each component is included in Annex 1. Project component structure is shown in the diagram below.

Project component structure

1. Policy Planning, Monitoring, and Coordination
PPS, MoE, MoESTD, MoLEVSA, MoPALSG, MoF. Amount (DLIs): EUR 3.6m

	2: Investment and Export Promotion	**3: Innovation**	**4: Labor**
Reforms and investments	• Restructure Ministry of Economy investment and export support programs / agencies	• Support enterprise innovation • Facilitate tech transfer and commercialization • Design public research sector reforms	• Improve the effectiveness of labor intermediation services and active labor market programs • Facilitate social assistance beneficiaries' transitioning into formal jobs
Amount (DLIs)	*EUR 19.7 million*	*EUR 31.3 million*	*EUR 30.4 million*
Responsible Ministry	*Ministry of Economy*	*Ministry of Education, Science and Technological Development*	*Ministry of Labor, Employment, Veteran and Social Affairs*
Project Management and Technical Assistance *(Coordinated by the Public Policy Secretariat; EUR 4.25m)*			

PART A: Results-Based Financing

2. Part A entails the implementation of EEPs subject to results-based financing (DLIs). It contains four components: a horizontal "policy planning, monitoring, and coordination" component (Component 1) plus three sectoral components: 2. Investment and export promotion; 3. Innovation; 4. Labor.

Component 1: Policy planning, monitoring, and coordination (EUR 3.6 million)

3. This component includes a DLI that covers: a) the creation of an inter-ministerial policy planning, monitoring, and coordination (PPMC) framework (in support of competitiveness and

[12] Total of the project components is less than the total amount of the loan (EUR 89.5mn) as the 0.25% front end fee is being paid through the loan.
[13] For the definition of EEPs, see Section III.B and Table 4 in the main text above.

jobs reforms), led by the Public Policy Secretariat and with participation of the Ministry of Economy, Ministry of Education, Science, and Technological Development (science and innovation secretariat), and National Employment Service (in cooperation with MoLEVSA); b) the development individual planning and monitoring frameworks at the ministry level (to feed into the inter-ministerial PPMC system), and c) the piloting of the PPMC system, including through semi-annual progress reports and annual performance review reports with inputs from each participating ministry (see DLI 1).

4. The component directly addresses two of the main challenges related to Serbia's policy making framework—weak strategic planning and policy coordination—and aims to increase the effectiveness of government spending targeting competitiveness and jobs. Through the PPMC framework, the three Ministries' participating departments (with leadership and support from the PPS) will set performance targets on competitiveness and jobs, monitor and evaluate progress, conduct analysis, and contribute to policy development. Results matrices with a hierarchy of outcome and output indicators will be developed by each ministry in collaboration with the Bank along with protocols on monitoring and reporting. A working group led by the PPS and comprising representatives from the three ministries will be created to oversee the planning and monitoring framework and coordinate policies. The working group should also include representatives from the Ministry of Finance, Ministry of Public Administration and Local Self-Government and Prime Minister's office.

5. The PPMC framework is expected to lead to better designed and better coordinated policies, since they will become part of a clear, strategic framework with a robust monitoring and evaluation system. This builds on and links together existing government initiatives, including a Government Action Plan (in progress), sectoral strategies (some of which are in the process of being created or updated), and program-based budgeting (which was rolled out for the 2015 budget, but shows much room for improvement). The PPMC framework will incorporate and strengthen the relevant elements of each of these initiatives in the pilot thematic areas. The framework will be a work-in-progress in the coming years, requiring frequent adjustment and improvement. If successful, it could be rolled out to embrace all of the three ministries' activities and serve as a prototype for the GoS.

6. The PPMC Working Group will aggregate results from the 3 ministries, exercise oversight, troubleshoot, assist with M&E, cost-benefit analyses and gap analyses, and serve as a forum for evaluating and adjusting the PPMC platform. It will also permit regular reporting on progress on the competitiveness and jobs agenda to the highest levels of government, allowing for the escalation of problems and performance gaps to the right political level in a timely fashion. Anticipated steps include:

- Establish a Working Group with relevant parts of MoE, MoESTD, MoLEVSA[14] to collaborate to develop and establish a PPMC framework focused on job creation and

[14] For the MoE, this should start with the Serbia Investment and Export Promotion Agency and potentially later be expanded to the Development Fund, Export Credit and Insurance Agency, and National Agency for Regional Development, or their successors. For the MoESTD, it should include the research and innovation-related activities (under the State Secretary for Innovation). For the MoLEVSA, it should cover the National Employment Service and incentives for formal employment.

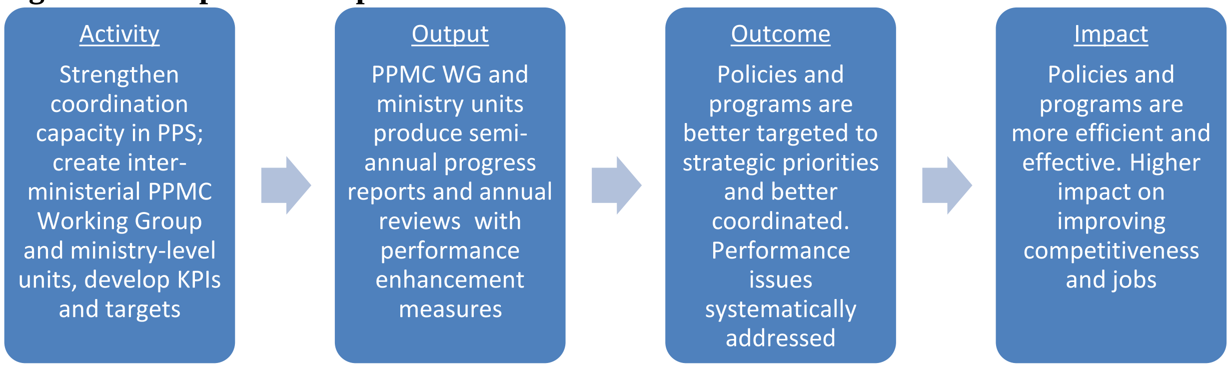
competitiveness. The Working Group will be led by the PPS, which will also provide analytical and administrative support and serve as the day-to-day “secretariat”. Representatives from the MoF, MoPALSG, and possibly the Prime Minister’s Delivery Unit are also expected to participate.

- Adopt mandate of the Working Group, including, *inter alia*: (a) oversight of the PPMC launch and implementation process and protocols, (b) liaison with participating Ministries’ planning and monitoring units including suggestions regarding activities, indicators, targets, (c) assure alignment of activities, indicators, and targets with Government priorities, (d) data analysis, policy development, and M&E, (e) semi-annual PPMC WG meetings and progress reports (based on inputs from the ministry-level units), (f) annual performance reviews, including progress against targets, identification of constraints to improved performance, and suggested performance improvement measures (based on inputs from the ministry-level units), (g) support to the development of impact evaluations in the participating ministries, and (h) competitiveness and jobs policy coordination across participating ministries.
- Ongoing functioning of the Working Group in line with mandate. There should be at least semi-annual meetings to monitor progress, troubleshoot, address performance gaps, etc. with minutes for each meeting.

7. *Ministry-level mandates and responsibilities*: The MoE, MoESTD (specifically the science and innovation branch of the ministry), and the NES (in cooperation with the MoLEVSA) should each identify the position or unit responsible for participation in the PPMC system, and the mandate of said position or unit, by ministerial decree or other verifiable change to internal procedures. Each unit should have a mandate and protocols to: (a) develop KPI (Key Performance Indicators) hierarchies, (b) establish baselines, (c) fix yearly targets, (d) create a platform to track/ monitor indicators and relevant budget performance, (e) identify & troubleshoot problems, (f) periodically evaluate and revise protocols and targets as needed, (g) provide semi-annual progress reports to their line minister and the inter-ministerial PPMC WG, and participate in WG meetings, (h) provide annual performance reviews with performance improvement measures to their line minister and PPMC WG, and (i) use the progress reports and performance reviews to inform program-based budgeting decisions. The KPIs tracked should, among other things, include the DLIs and results indicators that are part of this loan.

8. These reforms will be supported through both a DLI and technical assistance. The TA is described in Part B below and should include capacity building to the PPS and PPMC WG to design and manage the PPMC framework. The TA is expected to come from a combination of donor funding (e.g. the WB-executed CIIP Trust Fund) and proceeds from this loan. The pilot PPMC framework in this project will be used to inform the design of the upcoming Public Sector Employment and Performance loan.

Figure 2: Component 1 expected results chain



Component 2. Investment and Export Promotion (EUR 19.7 million)

9. This component supports a reform agenda led by the Ministry of Economy to restructure and improve the functioning of its investment and export promotion programs through (see DLI 2):

a. Developing and adopting a strategic framework and overall action plan for investment and export promotion, including restructuring the MoE investment and export promotion agencies,

b. Improving the Borrower's investment and export promotion programs and services.

Currently, these functions are performed by several agencies subordinated to the Ministry, including SIEPA (investment and export promotion), Development Fund (access to finance), AOFI (export credit and insurance), and National Agency for Regional Development (micro and small enterprise support), and others.

10. Currently, the system of support provided by the MoE's development agencies is complex and non-transparent. The agencies have overlapping mandates, no coordination between them, and no clear links with the Government's broader economic policy goals. A particular area of interest of the MoE is to strengthen the overarching strategic framework for investment attraction, including the identification of target sectors and the development of sector or value-chain specific initiatives to provide a sharper focus for the above mentioned support programs, in line with national development priorities.

11. Further, although significant public resources are spent on the support programs, it is not clear what the outcomes of these programs are and whether public resources are spent in an efficient manner. (For instance, about EUR 260 million where administered by SIEPA between 2007 and 2013 on a per-job-created incentives program.) Cost benefit analysis of existing support programs is currently not carried out in a systematic way by the MoE development agencies, nor on a central level in the MoE. Also, assessment of real impact achieved through different instruments (e.g. in terms of attracting additional investment or generating sustainable employment) is not carried out in a systematic manner.

12. The DLI requires: a) the development and adoption of a strategic framework and action plan for investment and export promotion, including identification of target sectors, agency reform/ restructuring, and new or improved services (2016), b) the action plan to be implemented, monitored, and updated (2017 and 2018), and c) increases in the number of investment leads

generated (see DLI 2). The strategy and action plan should include 3 year performance targets, and monitoring mechanisms. The action plan should be time-bound, costed, and sequenced, and cover reforms or restructuring of one or more of the MoE's key agencies responsible for investment and export promotion (i.e. SIEPA, Development Fund, AOFI, and/or NARR). The restructuring could include the combination of existing or creation of new agencies. The action plan should also include the strengthening of governance structures of the selected agencies and the improvement of existing or development of new programs and services.

13. Implementation will be verified by semi-annual progress reports prepared by the MoE that cover the elements specified in the action plan, including: progress toward performance targets, proof of changes to the governing structure (e.g. revision of the agency legal bases, bylaws, and/or internal operating procedures), evidence of funding, cost/benefit analyses of the new/improved programs and services, etc. The year-end progress report should update the performance targets for the following 3 years and update the actions in the plan for the following year (as needed to improve performance). In addition to the DLI, these reforms will be supported by a Bank-executed CIIP trust fund.

14. In general, reforms in the area of investment and export promotion can be related either to the institutional arrangements underpinning those activities, or to the substance of implementing the respective activities, such as investor outreach, aftercare, or incentives administration, or to both mentioned aspects. The specific reforms supported by the investment and export promotion component refer to both the institutions and the way in which they carry out their mandates.

15. The development of the overarching strategic framework for investment and export promotion, including the identification of target sectors and the development of sector or value-chain specific initiatives, will provide a sharper focus for the MoE's support programs to be aligned with national development priorities, and a solid platform for the development of reform / restructuring proposals for the Ministry's subordinated agencies. The implementation of the strategy should be underpinned by the development of a meaningful monitoring and evaluation framework flowing from clearly specified goals and targets. The purpose of such an M&E framework will be twofold: (i) to allow the MoE to check that enough progress is being achieved towards the overarching goals, to set appropriate targets for its agencies and to allocate resources accordingly; and (ii) to allow the agencies to more effectively manage their organization and resources.

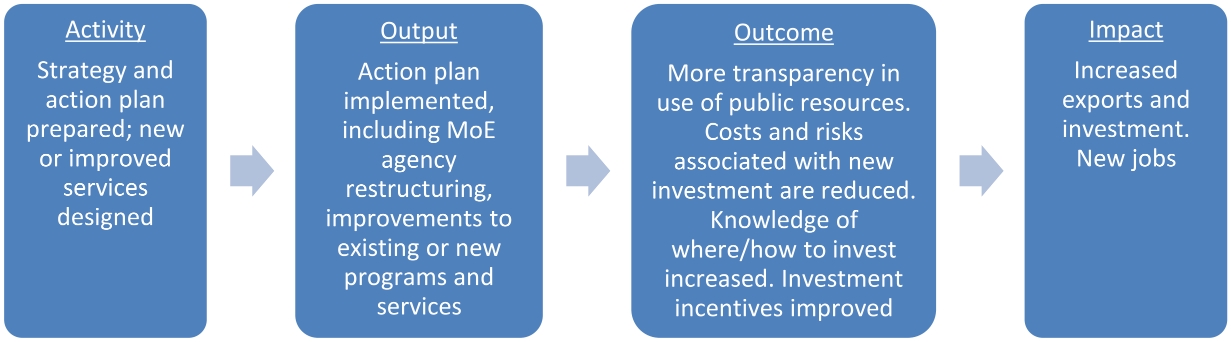
16. With respect to the new and/or redesigned services, services related to **export promotion** fall into four broad categories: 1) country image building (advertising, promotional events, but also advocacy); 2) export support services (exporter training, technical assistance, capacity building, including regulatory compliance, information on trade finance, logistics, customs, packaging, pricing); 3) marketing (trade fairs, exporter and importer missions, follow-up services offered by representatives abroad); and 4) market research and publications (general, sector, and firm level information, such as market surveys, on-line information on export markets, publications encouraging firms to export, importer and exporter contact databases). Practices in any of these areas could be strengthened through the reform process.

17. The reforms to be implemented in the area of **investment promotion** are geared towards maximizing the Government's efforts in promotion by aligning them more closely with international best practice. Evidence from the most recent studies on excellence in investment promotion suggests that best practices fall into four broad categories. Successful investment promotion frameworks have (i) clear strategic FDI goals and targets that (ii) target competitive sectors for FDI, (iii) have lead promotion agencies that have strong cooperation with other investment promotion actors, and (iv) that have a conducive organizational culture, working methods, and organization.

18. Cross-country analytical work has found the return on government investment in investment and export promotion activities to be largely positive on average (for more details see Annex 6). Through targeted TA, the project would be expected to help Serbia achieve the higher returns on invested public resources through the implementation of good international practice in the investment and export support programs. Investment incentives are another area that fall under the Ministry of Economy's agency restructuring. A nuanced approach needs to be applied to assess the effectiveness of incentive policies, taking into account type of investment (i.e. resource seeking, market seeking, efficiency seeking), and the sector in which investment is taking place. The expected benefits are twofold: higher revenue from possibly increased investment; and social benefits—such as jobs, technology transfers, spillovers, and positive externalities. These will need to be balanced against cost such as revenue losses from investments that would have been made even without the incentives and indirect costs such as economic distortions and administrative and leakage costs. Through the TA component, and the complimentary support from the CIIP trust fund, the project is expected to help the authorities design mechanisms to properly evaluate these trade-offs and align decisions on incentives with broader economic goals.

19. The provision of new / improved support programs and services will be underpinned by strengthened governance and monitoring arrangements. Analysis of the costs and benefits associated with different support programs is expected to be conducted on a systematic basis. This analysis would be geared towards assessing the 'real' impact achieved through different programs in terms of the pursued policy objectives, e.g. investment attraction, export growth, or employment generation. Opportunities for better coordination with local development initiatives will also be considered, as once investments reach implementation stage the capacity of local governments and utilities can often become a bottleneck. The systematic analysis of expenditures and outcomes will lead to a more effective allocation of Government resources towards activities potentially achieving the highest impact.

Figure 3: Component 2 expected results chain



Component 3: Innovation (EUR 31.3 million)

20. The innovation component supports implementation of the Borrower's program for innovation through:

a. Supporting the operations of the Borrower's Innovation Fund and it's Matching Grants Program;
b. Supporting the Technology Transfer Facility (TTF) service lines at the Innovation Fund; and
c. Undertaking strategic planning for institutional reform of the public research and development sector

21. These project activities will leverage the institutional capacity built at the Serbia Innovation Fund (IF) and the enterprise innovation programs piloted under the 2011 EU Instrument for Pre-Accession Serbia Innovation Project (EU IPA SIP) as well as lessons learned from the Bank executed technical assistance program with public research and development institutes (RDIs) under this Bank-administered project. This project will also build on the strategic planning activities for the research and innovation sector as well as technology transfer initiatives of the 2013 EU IPA Serbia Research, Innovation, and Technology Transfer Project (SRITTP).

22. The sequence of the following activities reflects their importance for the innovation system in general and MoESTD's reform priorities in particular. The first two activities, i.e. (a) enterprise innovation and (b) technology transfer, would effectively provide continued financial support for pilot projects implemented via the Innovation Fund, with the first pilot having been successfully completed under SIP and the second one being launched via SRITTP. The subsequent activity (c) addresses the systemic issues in the public research sector that are in dire need of modernization if it is to meaningfully position Serbia in the European research and funding arena and contribute to the development of an innovation-led Serbian economy.

3.A Support enterprise innovation

23. This subcomponent includes a DLI that covers: a) allocating in the Republican Budget at least EUR 0.72 mn annually for the Innovation Fund's operating budget and EUR 2.7 mn annually for enterprise innovation matching grants; b) committing at least 80 percent of the matching grant annual budget allocation using the IF's international peer review and investment committee mechanisms; c) conducting an evaluation of the IF's matching grants program; and d)

developing a proposal for scaling up the matching grants program using EU IPA funds. (See DLI 3.)

24. Serbia has laid strong institutional foundations and successfully demonstrated early enterprise innovation wins from the two ("Mini" and "Matching") R&D grant programs piloted by the Innovation Fund under SIP. The project supported the capacity building of the IF's program management team, which is supported in its daily operations by a reputable international advisory team that includes strategic, operational, and regional advisors. The advisory team guides the IF program management team in the design of new financial instruments and programs to support enterprise innovation and technology transfer and leverage international funding to that end. Examples include the IF's management of the forthcoming collaborative research grant scheme as well as the technology transfer facility to be piloted under SRITTP, and the IF's participation in debt and equity schemes envisioned under the Western Balkans Enterprise Development and Innovation Facility (WB EDIF).

25. Notably, the IF has established an independent governance structure, with a robust international peer review system and a distinguished Investment Committee that includes international and diaspora representatives experienced in managing technology firms, scientific research, commercialization, and the investor community. Since 2011, the IF piloted two financial instruments – the Mini and Matching Grant programs – over 4 calls. The IF has awarded the entire IPA allocation of Euro 6 million in financing to 53 startups and enterprises in different sectors and across Serbian regions and created or sustained some 300 high paying jobs.

26. While several projects are still ongoing, some important early results include the development of 8 new products, sale of 2 products, filing of 23 national and 8 international Patent Cooperation Treaty patents, 8 trademark and 6 copyright applications; as well as establishment of multiple international partnerships by IF beneficiary enterprises.

27. The continuously growing pipeline of applicants, 471 over 3 years, serves in part as testament to the credible governance system established by the IF. With the number of applicants more than doubling in every new call for proposals, the IF's advisory team estimates that the Mini and Matching grant programs could easily allocate EUR 6-8 million annually over the coming 5 year period. The programs piloted in SIP have exceeded expectations set out at the onset of the project given the grim circumstances in the Serbian economy overall, and especially in the private sector.

28. The matching grant programs to promote research and development (R&D) in enterprises that have been piloted by the IF are a cornerstone of noteworthy innovation systems globally. In the long run, countries that invest in enterprise R&D and innovation do so with the objective of increasing high value added employment and contributing to growth in the local economy. In the medium to longer term, depending on the amount of funding dedicated to such programs, it can be expected that the matching grant programs that support technology development projects in medium sized companies will have a greater chance to create and sustain high value jobs owing to both likely lower technology and market risk levels associated with these projects. As far as the mini grant program is concerned, given the high risk levels associated with startups, employment depends on the success rate of these projects, which tends to be much lower

globally. However, given that these ventures hold greater promise to develop technologies that are globally novel or even disruptive, the returns on the few that succeed tend to be worth the patience. The rationale for public intervention arguably is highest in the earliest stages of R&D and innovation associated with startups, given both the high levels of technology and market risk, while the productivity gains are most likely from investments in incremental technology upgrading activities among the young growth oriented enterprises and therefore these programs must remain a core element of government support going forward in Serbia.

29. These programs can be critical to building a strong pipeline of innovative startups and technology-based enterprises that create high value jobs in Serbia that will attract the attention of international investors interested in financing technology ventures. It is important that Serbia institutionalizes these programs in its annual budget given that EU IPA financing for the pilot program has been fully deployed. DLI 4 will be used to ensure that a minimum budget is assigned to these programs, and the IF's essential features, i.e. its independent governance structure and decision making procedures are upheld.

30. Key details of the mini and matching grants include the following:
Mini Grants
- Up to **EUR 80,000** for projects lasting up to 1 year
- Beneficiaries: micro and small enterprises, majority private Serbian ownership, incorporated in Serbia for no longer than 2 years
- Features: Proof of concept, prototyping, basic IP protection
- Private sector co-financing minimum: 15%

Matching Grants
- Up to **EUR 300,000** for projects lasting up to 2 years
- Beneficiaries: micro, small, and medium private enterprises incorporated in Serbia with already established market presence
- Features: New innovative products/services to boost competitiveness and existing portfolios
- Private sector co-financing minimum: 30%
- *Governance for Mini and Matching Grants:* Two stage process includes international peer review and final decision making by its independent international Investment Committee.

3.B Facilitate technology transfer and commercialization activities
31. This subcomponent includes a DLI that covers: a) the design and deployment of one or more Technology Transfer Facility services lines; b) allocating at least EUR 0.9 mn annually in the Government's 2017 and 2018 budgets to the TTF; c) initiating a minimum number of technology transfer transactions; d) conducting an evaluation of the TTF; and e) preparation of a donor proposal for scaling-up the TTF activities. (See DLI 4.)

32. The challenges to commercialization of public research in Serbia are multiple given the decline of the traditional public enterprise sector client base and the absence of a functional system that could promote technology transfer within and beyond Serbia. Furthermore, there exists a very strong academic culture, fueled by an incentive system that places a clear premium

on publications with no incentives for protection of intellectual property or its commercialization.

33. A Bank-led technical assistance engagement with select public R&D institutes under SIP confirmed that there is a rudimentary pipeline of projects with commercial potential. However, most high quality projects hail from the basic sciences, are at early technology readiness levels, and far from market readiness. It was estimated that the existing project pipeline would require as much as EUR 9 million in commercialization support for research teams to further their innovative scientific ideas to a marketable level. Given this learning and limited IPA funding, SRITTP was designed to pilot the establishment of a centralized Technology Transfer Facility (TTF) at the IF with the objective of attracting high quality transactional capacity at the IF and piloting transactions with local TTOs.[15] Current TTF funding (Euro 1.18 million) is deemed insufficient to finance and demonstrate a strong tech transfer pipeline at this stage. The reforms supported by this project will build on the basic pilot activities to be financed under SRITTP and improve the odds of creating a demonstration effect in research commercialization.

3.C Design and adopt public research sector reforms

34. This subcomponent includes a DLI that covers: a) commitments in the R&I Strategy to reform public RDI financing and identification and adoption of priority areas for research; b) RDI self-assessments and audits by international experts; c) definition of research performance financing schemes; d) design of RDI sector reform program; and e) preparation and submission of a donor proposal for TA to conduct sector and RDI reform implementation planning. (See DLI 5.)

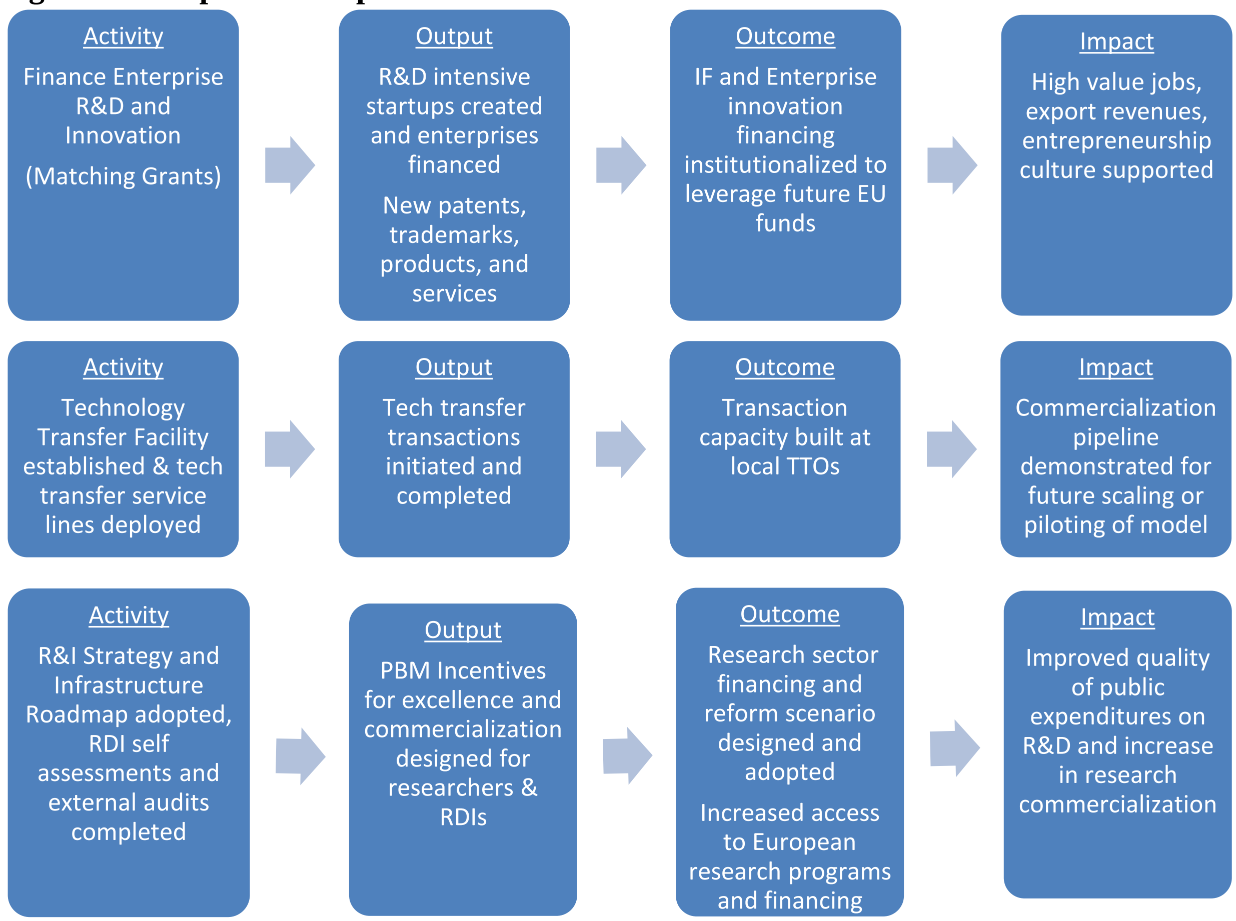
35. Serbia's public research sector suffers from the traditional post-transition malaise of being disconnected from contemporary needs and trends and therefore contributing neither to the Serbian economy nor society. Furthermore, the Serbian research sector is highly fragmented, lacks strategic focus and critical mass of any significance in scientific areas, emphasizes quantity over quality of public expenditures in R&D, and for the most part has not succeeded in re-orienting its offering to the fledgling emergent enterprise sector domestically, beyond the IT industry. If Serbia is to improve its global positioning it will have to revamp the structure and composition of financing of its public research; create incentives for both excellence and relevance of research for the industrial sector, including commercialization; and focus on integrating into European and global research trends and financing programs.

36. Through DLI 5 the project will support the design of research sector reforms that will focus on creating necessary incentives at the individual and institutional level as well as propose sector level changes. This process will require significant involvement of independent international expertise and thus this activity has extensive technical assistance needs described in Part B below. The sector reform program will be informed by deep dive assessments to be conducted at

[15] The TTF is a special purpose entity being established within the IF to support existing technology transfer offices (TTOs) in the process of commercializing academic research via the design and deployment of key tech transfer service lines. In addition to providing services to technology transfer units at RDIs and universities, it can also match Serbian companies interested in licensing global technologies.

RDIs as well as a review of public expenditures on R&D with participation of local and international experts. The activity will develop performance based financing mechanisms at the researcher and RDI level as well as design reform scenarios. The elected reform scenario will likely require extensive financial support from the authorities and donors.

Figure 4: Component 3 expected results chain



Component 4: Labor (EUR 30.4 million)

37. The labor component will support three main activities:

a. Enhance the effectiveness of the Borrower's National Employment Service (NES) labor intermediation services for employers and the unemployed;
b. Improve the effectiveness of the Borrower's active labor market programs (ALMPs);
c. Facilitating the transition of social assistance beneficiaries into formal jobs;

38. The operation will support MoLEVSA in the implementation of these selected objectives of the National Employment Strategy (currently being revised). At the core of activities supported by the operation is the improvement of the capacity and the services provided by NES. The NES performs a key function of the Serbian labor market by being the matchmaker between

employers and job seekers. Every well-functioning labor market needs a well-developed public employment service to support employers in filling job openings and job seekers in finding suitable jobs. In addition, the NES has the additional responsibility of supporting those job seekers that face difficulties in the labor market by providing programs to enhance job seekers prospects, like training; wage subsidy programs, especially for disabled or otherwise disadvantaged jobs seekers; start-up support for prospective self-employed; or public works for those who have not had work for a long time. In that sense, the NES is not only a match-maker that ensures a well-functioning labor market, but also a provider of social services for vulnerable groups. In addition, the operation will support the activation of social assistance beneficiaries, the most vulnerable group in Serbian society. Such beneficiaries are characterized by low competiveness in the labor market, they can expect to earn only low wages, and usually depend on social assistance benefits: altogether they face a particular disincentive to joining low-wage or part-time formal jobs compared to the rest of the workforce, and a re-design of social benefits could considerably strengthen their incentives to look for and find formal jobs.

4.A Enhancing the effectiveness of NES labor intermediation services

39. This subcomponent includes DLIs that cover: a) the NES adopting an action plan to enhance the quality of employer services and case management; b) the certification of NES case workers; c) increased collection of vacancies among employers; d) increasing the number of NES-registered unemployment cases transitioning into formal jobs; e) introducing a special registry of unemployed persons who are temporarily prevented from working; and f) a reduction in the dispersion in case load rates across NES branch offices (see DLIs 6 and 7).

40. Improvements in the NES job placement performance will require a set of organizational changes to introduce a policy planning and monitoring framework, and to increase the capacity and number of staff dedicated to frontline client work.

41. As it is the case for the other beneficiary agencies, the project will support the introduction of a *policy planning and monitoring framework within the NES*. This will be accomplished through the designation of a dedicated unit that should set, and track through the NES information system, key performance indicators (KPIs) across all reform areas in the NES, and communicate with the PPMC working group. At a minimum, these KPIs should cover the areas of contacts between NES and employers, case work, job matching, case load by case worker, and effectiveness of ALMPs. Significant technical assistance will be necessary to define those KPIs and implement a system to collect data and compile and publish KPIs. The NES will regularly set targets for KPIs (once a year for the following year) and quarterly monitor and publish KPIs on national, branch office, and even case worker level when appropriate. In addition, the system of KPIs will be reviewed once a year by NES and other stakeholders and adjusted when appropriate. This first element is key for the entire component on labor to enable proper implementation and monitoring of reforms in all areas. The unit will also be responsible for the preparation of regular progress reports.

42. A second priority that the project will start to tackle is to *increase the number of staff that are engaged in front-line activities* with employers and active jobseekers, and to reduce the time spent on administrative tasks. Currently, the average caseload varies between a couple of hundred to over 2,000 registered unemployed per case workers across branch offices. These numbers compare very unfavorably to advanced OECD countries, where the caseload is typically

below 100 per case worker. The project will support various reforms: (i) to the extent possible, a re-deployment of administrative staff to the front line as case workers; (ii) an evening out of caseload across branch offices by deploying temporary case workers to offices with the highest case load; and, maybe most importantly, (iii) a reduction of cases by introducing a new list of active job seekers. This last reform aims at better separating active job seekers from those who register as unemployed, but are not looking for work because they are either inactive or work informally. According to the labor force survey, more than 50 percent of registered unemployed are actually not active job seekers. Focusing the case work on active job seekers might be the single most important reform to improve the effectiveness of NES and allowing case worker to shift from registry work to actual case work. Over time, the high discrepancies in average case load across branch offices should be reduced, and, unless the total number of registered unemployed grows significantly, the mean caseload for case officers should fall.

43. Third, the project will build *capacity of frontline workers*, who at the moment deal both with employers and the unemployed, through the introduction of a new training curriculum for staff. The certification will require case workers to attend training, learn about all procedures and principles of NES case management, and get tested in order to receive certification. In addition, case workers will receive regular training and will be required to get re-certified every three years. The principles of case work will be updated on a regular basis, taking into account best practice from OECD countries and specific circumstances and constraints in Serbia. The curriculum should include practical skills to deal with disadvantaged groups. In addition, the NES will study HR adjustments that should increase the motivation and the prestige of case workers, compared to other professions in the institution.

44. On the labor demand side, the number of vacancies in the NES registry remains largely insufficient and it has been declining over time: although this is in large part a reflection of the state of the economy, the NES should prioritize resources and innovative efforts for *the collection of more vacancies*, as this is the only means to service the large stocks of registered unemployed. A specific strategy to revisit employers' services offered by the NES will be prepared through the project. The key, though, will be to increase not only the quality of outreach, but also the frequency of outreach to employers by case workers to collect vacancies and actively assist employers in filling vacancies with the best candidate in due time. Achieving this goal could also potentially include the recruitment of additional temporary workers with specific skills to enhance the collection of vacancies.

45. T*he introduction of profiling methods* will allow to better segment customers in different subgroups with varying level of need for support, and to identify those segments that stand to benefit most from the existing set of active measures and thus reduce potential dead-weight loss by assigning ALMPs to individuals who could find their job autonomously. Stronger clarity on the extent to which existing enrolled individuals are genuinely seeking to enter into the available pool of jobs, rather than in search of a specific (often hard to find) occupation or simply in order to comply with benefit conditionality will also allow to differentiate customer streams and identify solutions for each typology, without denying the right to being served to all those who would like to be.

46. The recent reduction in civil service salaries, the ongoing constraints in the civil service to hire new workers, and budget limitation in financing of active measures mean that the

prospective benefits of these reforms should be not be overestimated, particularly in the short-term. At the same time, these measures will put the NES onto a path of stronger medium-term viability.

4.B Improve the effectiveness of ALMPs

47. This subcomponent includes a DLI that covers: a) the development and the application of a new methodology to profile the unemployed; b) developing and implementing an action plan on monitoring, evaluation, and re-design of ALMPs; c) piloting a newly designed ALMP and d) piloting engaging a training provider (service provider for labor market trainings) based on a performance based contract (see DLI 8).

48. Improving the effectiveness of ALMPs will require reforms in two areas: (i) in the way ALMPs are targeted to beneficiaries, and (ii) in the way ALMPs are designed, piloted, monitored, and evaluated—and how evidence is used to re-design ALMPs. With regard to the first element, the key reform is to develop a better way to profile active job seekers according to their risk of becoming long-term unemployed. This risk-profiling in itself requires intensive data usage and will assist case workers in pooling active job seekers according to risk groups. This pooling is then the basis of deciding what kind of assistance and/or ALMP to offer to which active job seeker at what time. Low-risk job seekers will obtain relatively little assistance in the beginning as they are expected to find jobs quickly. Higher risk job seekers will receive specific measures right away. Those who are already long-term unemployed might be linked to

49. With regard to the second element, the more systematic use of evaluations of ALMPs that the NES has already demonstrated to be capable of producing will inform progressively the selection of providers and approaches to active labor market programs. This will be complemented by a stronger monitoring of performance of individual labor offices, as a first step to increase the level of accountability not as much to procedures but more to outcomes, taking into account the different challenges that NES offices face in the territory. For this purpose, a new benchmarking tool will be developed and the results made public periodically. Improving monitoring and accountability is an essential step to progressively increase the autonomy of offices at the local level.

50. An extensive data collection on beneficiaries of ALMPs, including follow up interviews after completion of the program is already being carried out. However, in order to improve the design and targeting of programs, this information should be better translated into concrete analysis of the effects of programs, disaggregated by characteristics of beneficiaries. The feedback loop, from data collection to policy design, is central to evidence-based policy making and requires a new institutional setup either at NES or MoLEVSA. The project will support the formulation and the implementation of this new setup, drawing from the experience of similar reforms in high and middle income countries of the EU.

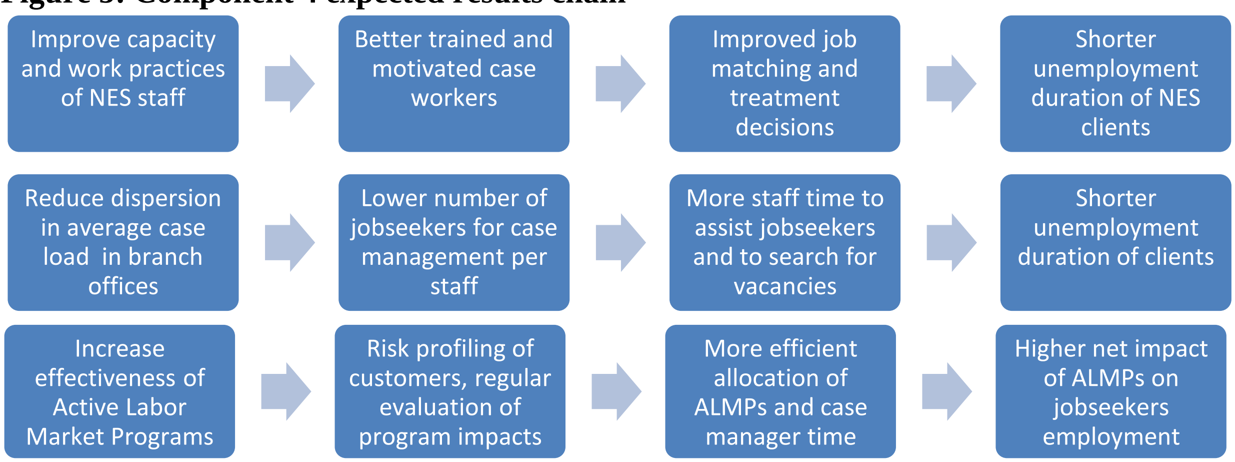
51. Finally, the fiscal consolidation currently in place and the upcoming wave of SOE restructuring call for the protection of the budget expenditures on ALMPs for the large stock of unemployed. For this reason, an important share of the financing under this component will be tied to the provision of ALMPs that have proved successful at improving the chances of employment, according to past impact evaluations.

4.C Facilitate the transition of social assistance beneficiaries into formal jobs

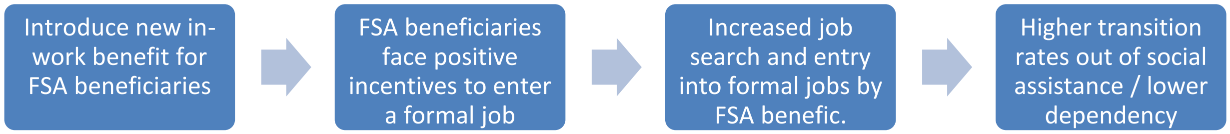
52. Serbia has one of the highest tax wedges on low-paying jobs in the entire ECA region and a social assistance benefit that is reduced by at least one dinar—often by much more—for every dinar earned formally. This combination of high labor taxes and bad design of social benefits makes low-paying work unviable in the formal sector. The main reason for the high taxation on low-wage earners is the minimum social security contribution that is not adjusted by actual hours worked. As a consequence, social contributions for low-paying part-time jobs are prohibitively high. In addition, social assistance for poor families is designed in such a way that for every formally earned dinar the benefit is reduced by a dinar or more, so that all formal income earned in addition to benefits is effectively fully taxed away, or even reduces net income, sometime substantially. Especially for households that receive social assistance and also have children, accepting, for example, a formal half-time job paid at minimum wage substantially reduces disposable income because social assistance benefits without any formal income are significantly higher than income from form work once taxes, contributions, and lost benefits are taking into account. Even for a single household with no children, net income from a full-time job at minimum wage is not significantly higher than social assistance with no formal income.

53. The subcomponent includes a DLI that supports enhancing the activation of social assistance beneficiaries by designing and piloting a program to decrease work disincentives for a select group of social assistance beneficiaries (see DLI 9). This should lead to an improvement of work incentives for the poor who are eligible for FSA.[16] The conditional cash transfer—or, as similar benefits are called in high-income OECD countries, an in-work benefit—will be designed in a way so as to partially reimburse eligible workers for their lost benefits (for reduced social financial assistance) and social security contributions. The benefit would be implemented through either the existing social protection system or the NES. The fiscal implications will be carefully considered, but should be small or even positive as a substantial part would be financed from reduced social assistance payments and increased social security contributions. An extension of the in-work benefit to low-wage earners in general (not only social assistance beneficiaries) will be considered as part of the study supporting the design of the pilot program.

Figure 5: Component 4 expected results chain



[16] A reform of social security contributions will be supported in a separate operation (SOE restructuring DPL).



PART B: Project Management and Technical Assistance (EUR 4.25 million)

54. Part B is split into two parts.

- Part B.1 will be carried out by the Project Implementation Unit (PIU) in PPS for the PPS, MoE, and MoESTD to support project management and implementation of Components 1, 2 and 3 from Part A of the Project through the carrying out of technical assistance activities relating to implementation, through the provision of goods, consultants' services, non-consulting services, Training and Operating Costs.
- Part B.2 will be carried out by MoLEVSA to support project management and implementation of Component 4 from Part A of the Project through the carrying out of technical assistance activities relating to implementation of Component 4 from Part A of the Project, through the provision of consultants' services.

55. For project management the main expenses are expected to be for consultants to supplement the capacity of the Public Policy Secretariat staff. Expertise will be needed to handle the fiduciary (both financial management and procurement), reporting, coordination, and safeguards requirements of the project. These are expected to cost about EUR 0.5 million over the life of the project.

56. The technical assistance needs for each of the Part A components are shown in the table below. Regular coordination meetings on TA needs will be facilitated by the PPS, with participation from the line ministries and MoF. For Part B.1 technical experts from participating line ministries will be involved in the preparation of the Terms of Reference as well as selection committees as needed. Part B.2 will be separately carried out by MoLEVSA. The MoF will play an oversight role in the use of the TA funds, including periodic reviews of the planned TORs for key consultancies to be procured with project funds. The TORs for TA, where possible, will include knowledge transfer from international experts to build local capacity in Serbia. Any unused TA budget will be added to the final set of DLIs in the last year of the project. (The money will be split evenly across each of the DLIs in the final DLI payment request.) Total TA needs are estimated at around EUR 3 million, with an additional EUR 0.9 million allocated for unforeseen TA and project management expenses. Additional details on the Innovation component TA are included below the table.

Table 7: TA to support to the implementation of the Results-Based Financing reforms

Objective	Activities	Timing	Total Cost (EUR 000s)	Non-project funding (EUR 000s)	Cost to Project (EUR, 000)
Part B.1					
Component 1. Policy planning, monitoring, and coordination			**590**	**215**	**375**
Establish pilot PPMC system	- Advise on and facilitate the PPMC working group and ministry-level units, including support for assigning roles and responsibilities, conducting analysis, defining the process to select performance targets (covering investment and export promotion, innovation, employment, etc.), establishing a monitoring and evaluation system (institutional mandate, responsibility, and partnership), defining the reporting structure and requirements, and promoting other factors that support a results-based culture.	2015-16		WB CIIP	
Support implementation of PPMC system	- Provide support to address key gaps in the functioning of the PPMC system, and adapt, to correct identified issues - Change management and strengthen capacity for PPMC, including targeted training and capacity building of a core group in the sector ministries - Consult with other ministries on possibilities for broader roll out of the PPMC system	2016-18			
Develop methodologies for evidence-based policy-making, cost-benefit analysis, and impact evaluation	- Work with PPS and line ministries to design and implement evaluation tools, including training and knowledge transfer to those who will be responsible for the evaluations	2016-18			
Component 2: Investment and export promotion			**930**	**310**	**620**
Reform of the investment and export promotion agencies based on international good practice	- Review existing programs, portfolio, performance, procedures, and organizational structure of the agencies (SIEPA, NARR, AOFI, Development Fund) - Design new programs, procedures, and functions as needed - Implementation support to new programs and services, including evaluations	2015 2015-16 2016-2017		WB CIIP and WB/EU functional reviews TA	
Establish monitoring and evaluation center in the Ministry of Economy	- Develop key performance indicators and targets for the Ministry and the agencies reporting to the Ministry - Establish reporting structures and mechanisms - Contribute to the work of PPMC group	2015-2018		WB CIIP	
Develop and	- Initial sector prioritization exercise	2015		WB CIIP	

implement sector support policies based on value chain analysis	- Perform initial value chain analysis in 2-3 select sectors. - Identify value chain support interventions that could be done by MoE agencies - Build capacity in the MoE and agencies to implement sector support policies and perform future value chain analyses	2015-16 2016 2016-2018			
Component 3: Innovation			**1,510**		**1,510**
RDI sector assessment	- Design RDI self- assessment methodology - Analyze RDI self-assessment results - Design of RDI sector external audit methodology - Deploy assessment of RDIs (pilot, 60 RDIs) - International benchmarking of RDI sector audit results and workshop	2016-17			
Establish performance-based management system for RDIs	- Design performance-based management system (for RDIs and individuals)	2016-17			
Design RDI sector reform	- Design sector level reform paths & Action Plans	2016-18			
Contingency for unforeseen TA and implementation support		**TBD**	**790**		**790**
Part B.2					
Component 4: Labor			**445**		**445**
Improve profiling process to better target unemployed with adequate services	- Improve risk profiling system of unemployed	2016			
Strengthen capacity of NES and MoLEVSA to produce and use statistical evidence to improve the design and implementation of ALMPs	- Support NES to improve methodology for evaluation of ALMPs - Support NES and MoLEVSA to use evidence from evaluations to design and re-design ALMPS	2016-18			
Improve work incentives of social assistance beneficiaries	- Redesign tax and benefits to reduce work disincentives and operationalization in benefit system	2016 and 2018			
Project implementation support			**510**		**510**
Total Costs			**4,775**	**525**	**4,250**

57. *Innovation TA (EUR 1.51 million).* Design of the public research sector reforms (Part A, 2.C) strongly depends on the quality of the assessments conducted, relevance of the reform designed, and expertise of the independent international guidance leveraged. Therefore, the project proposes a significant technical assistance program to facilitate the design reforms of the public research sector with the view to improve focus, relevance, quality, and efficiency. The proposed TA program consists of four main stages:

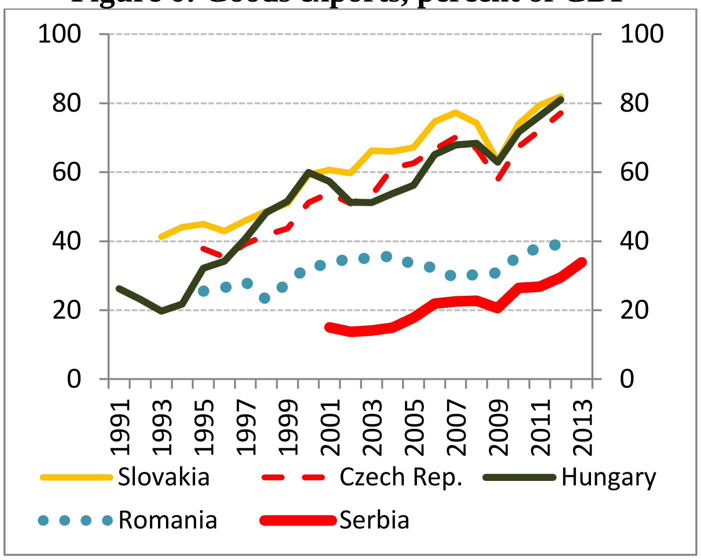
a. Assessment of RDIs and initial benchmarking according to international standards. This exercise will be based on local self-assessment by RDIs and external audit by international experts, according to methodology developed by the TA team. The self-assessment data collected will serve as the initial information for in-depth analysis, to be performed in the field by an international expert team. This part is considered the most resource intensive, since each RDI would require multiple visits to complete the audits and propose institution and sector level reform paths. It is envisioned that the international team would be paired with local experts to retain capacity to conduct institutional audits in future years.
b. Establishment of Performance Based Management (PBM) for researchers and RDIs, Indicators for PBM will be developed with MoESTD in consultation with RDIs. It is envisaged that an audit/ public expenditure review may be conducted to inform PBM design.
c. Based on the RDI sector assessment, the TA team will develop RDI sector reform paths to guide MoESTD on research sector and institution level reform options and be adopted by the Government of Serbia.
d. Reform implementation will require significant financing by either Government of Serbia and or the donor community. MOESTD will be responsible for submitting the adopted reform plans for further financing

Annex 3: Detailed Institutional and Sector Context

SERBIA: Competitiveness and Jobs

1. **In the early phase of transition (2001-2008) Serbia had a very strong growth episode, where the annual growth rate averaged 5 percent.** The Serbian economy recovered significantly from the shocks that had occurred during the 1990s on the back of the rapid implementation of structural reforms, increased trade integration with Europe and the rest of the world, and the post-conflict reconstruction of infrastructure. Thus, GDP in 2008 was in real terms about 50 percent higher than in 2001. However, this growth was almost entirely based on strong capital inflows and rapidly expanding domestic consumption. The current account deficit (CAD) averaged 10.2 percent of GDP, peaking in 2008 at over 20 percent of GDP. The CAD was financed mainly through new lending from abroad, and to a lesser extent through FDI. As a result, total external debt increased by EUR 10 billion over 2001-2008. At the same time exports remained very low compared to regional peers, reflecting weak competitiveness (Figure 6).

Figure 6: Goods exports, percent of GDP



Source: NBS, Eurostat and World Bank staff calculations

2. **The international financial crisis, coupled with "reform fatigue", led to a significant economic slowdown.** The global financial crisis exposed the weaknesses of the previous consumption-led growth model. Access to cheap financing stopped almost immediately, which pushed the Serbian economy into recession. The Serbian economy contracted by 3.5 percent in 2009 and by another 1.5 percent in 2012, and by further 2.0 percent in 2014. As a result, Serbia's GDP remains below pre-crisis level.

3. **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 (Table 8).[17] Serbia's RCA is particularly evident in agriculture and food products; this is followed by textiles, apparel, leather, and until recently iron and steel. 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. To build on its comparative advantage, Serbia will need to accelerate structural reforms of its economy.

Table 8: Revealed comparative advantage of Serbia's exports

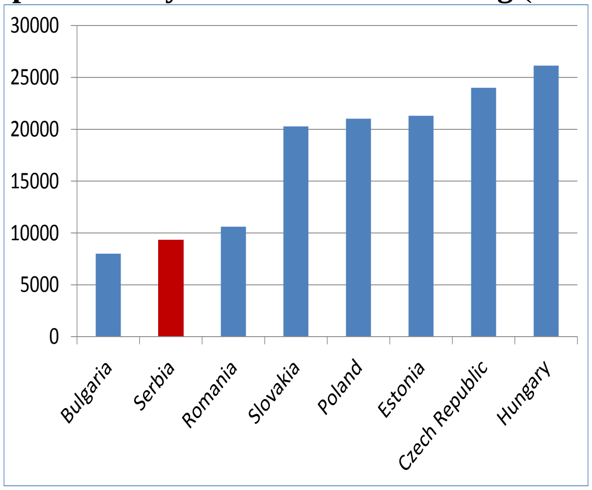
type	exports 2007	share 2007	rca 2007	exports 2012	share 2012	rca 2012	CAGR 2007-2012
Agriculture, meat and dairy, seafood	716	8.1%	2.09	1,387	12.3%	2.62	14.1%
Food, beverages, tobacco, wood, paper	1,350	15.4%	2.54	1,813	16.1%	2.59	6.1%
Extractive industries	442	5.0%	0.30	580	5.2%	0.25	5.6%
Chemicals, plastics, rubber	1,439	16.4%	1.23	1,550	13.8%	0.99	1.5%
Textiles, apparel, leather, footwear	782	8.9%	1.56	947	8.4%	1.54	3.9%
Iron, steel, and other metals	2,420	27.5%	2.72	1,887	16.8%	1.87	-4.9%
Machinery, electronics, transportation equipment	1,267	14.4%	0.38	2,577	22.9%	0.67	15.3%
Other industries	370	4.2%	0.71	514	4.6%	0.72	6.8%

Source: UN COMTRADE. Note export values are in USD million

4. **Lack of competitiveness and weak exports are a consequence of low productivity and insufficient investment, in particular in export oriented sectors.** For example, manufacturing as the most important exporting sector has been underperforming greatly. Since 2000, the sector grew by less than 1 percent annually, which resulted in its relative decline and is now below 20 percent of GDP, much lower than in more successful new member states of the EU, where productivity in manufacturing is also more than double compared to Serbia (Figure 7). Low productivity is directly linked with low investment: on a per capita basis, accumulated FDI to manufacturing in Serbia is on average three or four times lower than in comparator countries (Figure 8). Although part of this is due to the fact that Serbia opened up its economy a decade later than most of the new EU member states, it also reflects a weak investment climate. The importance of FDI can be illustrated by the fact that currently 73% of Serbia's exports are by firms which received, or were founded by, FDI. Further details and data supporting these findings can be found in the 2014 World Bank report entitled "Rebalancing Serbia's Economy: Improving Competitiveness, Strengthening the Private Sector, and Creating Jobs".

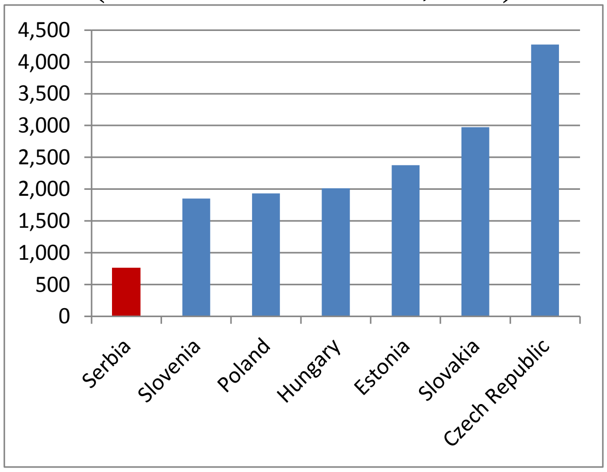
[17] A "revealed comparative advantage" means that Serbia's share of world exports in that category exceeds Serbia's share of total world export.

Figure 7: (Real) Apparent labor productivity level for manufacturing (2012)



Source: World Bank staff elaborations based on Serbian SBS data.
Note: (Real) labor productivity measured as value added (at factor cost) per person employed. Real values are Euro (2005) adjusted. CAGR for international peers – based on Eurostat data – is for the 2008-2011 period; for productivity levels international peer info is for 2011.

Figure 8: FDI in manufacturing, stock p.c. (Thousands of US dollars, 2012)



Source: World Bank staff elaborations based on the data from OECD and National Bank of Serbia.

5. **An export-led growth strategy needs to be complemented by efforts to foster job creation for the bottom 40 percent, which requires expanding low-paying (part-time) jobs in the non-tradable, especially service sector**. The conclusion of the recently concluded Systematic Country Diagnostic (SCD) is that restoring and sustaining growth is a necessary, but insufficient condition for poverty reduction and shared prosperity. Growth must also include meaningful job creation for the poor if it is to have an optimal impact in reducing poverty and increasing the welfare of the bottom 40 percent. Growth alone, especially if focused on exports and high-productivity jobs, will not allow Serbia to achieve the twin goals of ending extreme poverty and promoting shared prosperity. Lack of labor income is a key constraint for the bottom 40, but the majority of the bottom 40—the de-skilled transition generation aged 40 and older, women, and Roma—are unlikely to significantly benefit from export-led growth. Rather, the current pattern of employment shows that the bottom 40 are more likely to work in low-paying jobs in the non-tradable sector, especially services, and for micro enterprises. For meaningful employment for the bottom 40 to be generated, unlocking the potential for formal, low-paying casual part-time work is key, which will foremost require reforms of social security contributions and a re-design of social benefits to reward formal work. In addition, the services provided to the unemployed through the National Employment Service (NES) need to be enhanced.

6. **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.

7. **On the labor supply side, problems include:**

- *Job search constraints*. This implies addressing informational gaps, e.g. educating workers or helping firms advertise.
- *Limited participation in the labor force and high informality,* especially among older workers, low-educated women, members of ethnic minorities, and social assistance beneficiaries. Policies to increase participation in the formal economy include both addressing incentives to work and reducing barriers to entering the labor force.
- *A lack of job-relevant skills*. This implies the need for better education and worker training. Some evidence comes from the 2013 World Bank Group (WBG) Enterprise Survey, where 11 percent of Serbian firms identified an inadequately educated workforce as a major constraint. This compares to an average of 14 percent of firms in Eastern Europe and Central Asia and 24 percent in all countries. Hence, lack of job-relevant skills appears to be a problem in Serbia, but less so than in many other countries.

8. The project addresses policies that should affect the skill and job search constraints of the current workforce, through better vacancy collection and job matching services, increased emphasis on effectiveness of labor market training, and through the improvement of work incentives. A vast area of potential education reforms for the future workforce (technical, vocational, secondary, and tertiary education) are outside the scope of the current project. These are covered by complementary initiatives, including a parallel WB dialogue on the subject and a potential future "Inclusive Education and Skills" loan.

9. Looking at the **labor demand side**, it is hard to have job creation when firms are not investing and innovating. In Serbia, investment, exports, and productivity growth are relatively low (as shown above), suggesting that firms are not investing enough. Possible reasons for low investment include:

- *Uncertainty about returns to investment*. The project aims to help with this by reducing the risk associated with investments in research and development and innovative activities through matching grants. Export promotion activities can also reduce uncertainty about returns by providing information to potential exporters about demand in foreign markets (both on price and quantity), trade costs, etc.

- *Lack of appropriability of returns to investment: Innovative and first-mover firms incur higher initial costs and can be copied*. Copying can be good for the overall economy, but it creates a disincentive for first-movers since they do not fully appropriate the returns to their "discovery". This implies reducing the cost of investing for products and services that are new to the market. The project support to innovative activities will lower the costs to first movers. Export promotion activities will also lower the costs for exporters looking to export new products or to new markets. (Follower firms can then copy the first movers without incurring discovery costs.)

- *Firms, entrepreneurs, and investors do not know where to invest.* This can imply increasing competition, providing market intelligence, training management, fostering R&D and technology transfer, etc. The project will support the restructuring of the Ministry of Economy's investment and export promotion programs. Among other things, these will be designed to provide firms with information on the costs and benefits of potential investment and export opportunities. Management training, e.g. through manufacturing extension services, could also be part of the restructured MoE programs. R&D and technology transfer will be stimulated through the innovation component of the project via support to the Innovation Fund.

- *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*. According to the 2013 Enterprise Survey, 16 percent of Serbian firms identified access to finance as a major constraint, compared to 17 percent in ECA and 29 percent on average in all countries. Access to finance issues are largely addressed outside of the project, including through the WB's Deposit Insurance Strengthening Project (P146248) and a potential new WB operation to reduce non-performing loans (NPLs). The EIB and EBRD also have access to finance initiatives. Within the project, the Ministry of Economy's Development Fund (which runs several subsidized loan programs, mostly targeting SMEs) will be considered for possible restructuring to improve the effectiveness and targeting of the Fund's programs.

- *Lack of competition does not induce firms to invest and innovate*. This implies reducing barriers to entry, addressing anti-competitive behavior, and/or integrating markets. In Serbia, the ongoing reform of state-owned enterprises (SOE) will encourage more competition, as will the reforms related to EU accession.

- *Investment climate constraints raise costs and lower returns on investment.* Serbia ranks 91st out of 189 economies in the 2015 Doing Business Report, which is below most countries in the region. The two worst ranked indicators are *Dealing with Construction Permits* (rank 186) and *Paying Taxes* (rank 165). Another pain point for businesses are inspections, which are not coordinated, span over 30 inspectorates, and are based on a large number of outdated laws and bylaws. On the other hand Serbia, is doing fairly well at *Starting a Business*, where practices are relatively close to global best practices. Construction permits reform is partially covered through a separate WB land management operation. Tax reform is part of the Bank's Public Expenditure Review and IMF program. Inspections reform is covered by the EU Instrument for Pre-Accession (IPA) program and technical assistance (TA) from USAID. Hence, investment climate reforms are not a direct part of this operation.

- *Infrastructure and trade logistics bottlenecks decrease returns on investment.* Infrastructure connectivity is a key area that needs strengthening. Other World Bank programs are providing support in this area, including on highways (e.g. Corridor X), roads, and railroads. Serbia is ranked 63rd out of 160 countries in the World Bank's Logistics Performance Index 2014[18], a marked improvement from its 83rd ranking in 2010. The lowest ranking is in customs (113th) which adversely impacts border crossing times and costs. Support has been provided in this area by the IFC's Western Balkans

[18] The Logistics Performance Index (LPI) is based on a worldwide survey of global freight forwarders and express carriers. It looks at six areas of performance: (i) customs; (ii) infrastructure; (iii) international shipments; (iv) logistics competence; (v) tracking and tracing; and (vi) timeliness.

Trade Logistics Project, which provided TA related to risk management, procedural simplifications, reduction of import licenses for technical products, and reduction of clearance times at land borders, the Belgrade airport, and on the Danube.

10. **The table below summarizes the main constraints and building blocks for jobs and competitiveness and whether they are included in the operation or covered by other initiatives.**

Table 9: Main constraints and building blocks for jobs and investment

Constraint	Covered in project?	Covered elsewhere
Labor supply		
Skills	Partially: NES training programs	Technical, vocational, secondary, tertiary education part of parallel WB dialogue and pipeline Inclusive Education and Skills project.
Job search constraints	Yes: NES services	
Labor market participation incentives	Yes: in-work benefit for social assistance recipients	Minimum social security contribution issue in 2nd SOE DPL.
Labor demand		
Uncertainty	Yes: innovation matching grants; export promotion	
Appropriability		
Where to invest	Yes: investment and export promotion; R&D and technology transfer	
Access to finance	Partially: restructuring of MoE's Development Fund	WB (deposit insurance, NPLs) EIB, EBRD programs
Competition	No	EU accession reforms and SOE privatization (supported by WB SOE DPL)
Investment climate	No	Construction permits: WB land project. Taxes: WB PER and IMF. Inspections: EU and USAID.
Infrastructure and trade logistics	No	WB work on roads and railroads. IFC trade logistics project.
Governance		
Strategic planning and policy coordination	Yes: Pilot inter-ministerial policy planning, monitoring and coordination system (in support of competitiveness and jobs reforms)	WB Public Sector Employment and Performance project (pipeline) and "Rightsizing" TA

11. **To address the above constraints to jobs and competitiveness, Serbia needs to improve the capacity of key institutions, as well as strategic planning and policy coordination.** In Serbia, little attention in government is given to output and outcomes, and strategies are rarely evidence-based. According to the Bank's 2015 Systematic Country Diagnostic, policy coordination is among the weakest points for Serbia. This is likely due to Serbia's history of multi-party governing coalitions, where different parties controlled different ministries and they had little incentive to collaborate with each other. With its current Parliament where a single party has the absolute majority, Serbia has a unique opportunity to increase inter-ministerial collaboration. Moreover, coordination between line ministries and local self-governments should be strengthened, as well as among local-self-governments themselves. Better planning and inter agency coordination should help improve policy predictability and encourage more long-term investment. This will be facilitated by the project through the creation of an inter-ministerial "policy planning, monitoring, and coordination" working group.

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

Investment climate and export promotion

12. **Serbia needs stronger and better-defined FDI, export promotion, and sectoral support frameworks and institutions.** The current system of state support for investment and export promotion is fragmented, non-transparent, and lacking proper evaluation mechanisms. There is a perception of the current system contributing to an uneven playing field, as politics tend to interfere in making decisions on what programs to support. For example, two of the important institutions, Development Fund and AOFI (Export Credit and Insurance Agency), in addition to running programs supporting the private sector, are also directly used to administer a system of soft loans and guarantees to help ailing and uncompetitive state owned companies. This can lead to a skewed decision making process. Various forms of state support for private investors—primarily in the form of direct subsidies, subsidized loans, and guarantees—are currently administered by four different agencies at the national level (described below), and a network of smaller regional development agencies. All of these agencies have overlapping mandates, and there are no clear coordination mechanisms or links to broader economic policy goals, e.g. focusing on value chains with solid export potential. Furthermore, none of these agencies has been the subject of a thorough impact assessment to evaluate results. The system includes the following agencies, all of them formally reporting to the Ministry of Economy (MoE):

a. **SIEPA (Serbian Investment and Exports Promotion Agency):** administers the per-job-created subsidies for private sector investors, which are financed from the government budget. In total, from 2007 to 2013 about EUR 260 million was spent for these incentives. There have been several changes to the design of SIEPA programs, but in principle, these are subsidies that typically range from EUR 5,000 to 10,000 per job created, and are paid out in three or four tranches, matching the investment cycle. SIEPA also provides services such as organizing visits to fairs, matchmaking of companies, etc.

b. **Development Fund:** runs several subsidized loan programs, mostly targeting SMEs. Typically, these are loans for purchases of equipment, and in some cases for operational capital. The programs are financed from their own revenues; in 2013 the planned amount for the programs was approximately EUR 100 million. The Development Fund is also used for administering soft loans to state owned companies from the Privatization Agency portfolio, which are financed from the government budget.

c. **AOFI (Export Credit and Insurance Agency):** runs programs for short term export financing, factoring, export credit insurance, and guarantees. It is financed mostly through its own revenues, and the cumulative value of its programs over the previous eight years is several hundred million Euros.

d. **NARR (National Agency for Regional Development):** originally set up as SME Agency, runs subsidy programs, mostly targeting small and micro companies.

In addition to these agencies, there are also subsidized loan programs run directly by the MoE.

13. **The government very recently initiated a discussion on consolidating and reforming these agencies**, to increase transparency and efficiency, and to provide greater value to investors and exporters. Another aim is to bring the system in line with EU state aid policies. Preliminarily, the reform process would unfold in three stages.

a. The first stage would be an evaluation of the current system of agencies described above, their capacity, and the programs and services that they offer.

b. The second stage would be designing the reformed agencies, including their activities, budgets, targets and lines of reporting. This would include rationalizing the number of export credit schemes that are available and developing more efficient financial instruments for support to investment. This activity will further include developing new services provided by the reformed agencies, for example value chain analysis and support programs, developing a manufacturing extension program, developing capacity for market intelligence services, etc.

c. The third stage would be implementation of the new system.

Innovation

14. **Fostering private sector R&D and innovation can be important to increasing productivity and creating the exports and jobs of the future.** Serbian research and development (R&D) spending, though reasonable when compared with other countries in the Balkans, is heavily concentrated in the public sector. Among most transition economy peers, the private sector is increasingly playing a significant role in R&D. Channeling R&D investments at the enterprise level facilitates both the absorption of existing productivity enhancing technologies from abroad as well as the creation of new technological breakthroughs. This will be particularly important if Serbia intends to promote the creation of high value added jobs and the export orientation of its enterprise sector in the long term. However, R&D in Serbia is led by public universities and R&D Institutes (RDIs). R&D expenditure by the higher education sector is nearly double that of the business sector (0.44 percent of GDP compared with 0.24 percent, respectively). Moreover, 0.24 percent of GDP on business R&D expenditures is much lower than the EU average of 1.3 percent. (Source: EU ERA Watch, 2012 data.)

15. **Innovation outcomes remain minimal and Serbian R&D activities generate little to no economic value.** Research entities have shown capacity to generate knowledge, but they are weak in converting knowledge to industrial use or wealth. Activities around transfer or commercialization of research, including sale or licensing of IP or spin-off creation are limited. This is reflected in Serbia's low innovation ranking in the Global Competitiveness Index, where Serbia ranks 108 (of 144 countries), compared to 66 in Romania, 68 in FYR Macedonia, and 78 in the Slovak Republic (Source: World Economic Forum, Global Competitiveness Report 2014-2015).

16. **Weak innovation outcomes are likely related to limited institutional capacity, poor incentives for commercialization and weak public-private collaboration in R&D.** Private sector interactions with the public research system are weak and infrequent. This is likely related both to the weak domestic demand from ailing public enterprise sector and negligible financing to the enterprise sector to stimulate R&D and innovation. As a result, R&D carried out by universities and RDIs is generally not linked to current industry needs. A 2012 report from the National Council for Science and Technological Development finds that the most problematic aspects for innovation in SMEs include both the lack of technology transfer from universities to the private sector as well as from abroad.

17. **To foster economic competitiveness, Serbia has been focused on establishing an institutional framework and enacting regulatory reforms to support research and innovation in recent years, in line with objectives of the Europe 2020 strategy.** This has included the adoption of the first R&D strategy in recent history, the 2010-15 Strategy of Scientific and Technological Development of Serbia. Additionally, the 2010 Law on Innovation Activities provides the legal basis for the operations of innovation support organizations, including the Innovation Fund. Amendments to the Innovation Law and the Law on Research and Development were implemented to stimulate patenting and encourage transfer of academic research to industry. Some reforms, such as those in higher education, have resulted in notable achievements. In 2012 the University of Belgrade made it to the Shanghai Top 500 Universities list. However, comprehensive national reforms have been sporadic and have had limited impact so far. Furthermore, these reforms have fostered an academic and research culture that prioritizes quantity over quantity and this would be the logical transition in next reform period. This is largely due to political economy considerations, including severe resources constraints and intermittent leadership with ownership over these issues.

18. **In 2011, the EU Delegation and the Government of Serbia (GoS) invited the World Bank to administer the Instrument for Pre-Accession (IPA) financed Serbia Innovation Project (SIP).** The aim of the project was to support the operationalization and capacity building of the recently established Innovation Fund, and assist in formulation of RDI sector reform policy through close engagement with a selected group of research institutes. Notable results have been achieved under the Serbia Innovation Project in spite of a highly complex eco-political environment. A strong governance structure has been established at the Serbia Innovation Fund (IF) and the capacity of its program management team to pilot basic early stage financial instruments for enterprises has been vetted. In addition, the dialogue with the research institute community, led by the Bank team under SIP, has identified the need for strategic restructuring of the RDI sector (including legislative and regulatory reforms) in order to improve research and technology transfer outcomes. Some early wins from the IF's operations and takeaways from the RDI engagement conducted under SIP are discussed under Component 2.

19. **The successes of SIP have been acknowledged by new GoS and the EU Delegation who are partnering with the World Bank on a new EU IPA 2013 project that is expected to start at the beginning of 2015.** The Serbia Research, Innovation, Technology Transfer Project will support a collaborative research grant scheme as well as technology transfer activities via the Innovation Fund and the design of the 2015-20 Strategy of Research, Development and

Innovation of Serbia. The Competitiveness and Jobs operation will build on and complement these IPA-financed pilot activities.

20. **Finally, an important and highly complementary agenda is the building of the national innovation ecosystem and its actors.** The establishment of institutions that can nurture researchers and entrepreneurs towards investment readiness - be they business angel funds, via incubation, acceleration, or any other combinations of financing and mentoring - are critical. These activities, however important, are beyond the financial scope of this project and will need to be designed and supported through dialogue with emergent private actors and the donor community via separate activities entirely.

Labor

21. **In Serbia, creating more and better job opportunities is critical to increasing shared prosperity.** Since the global crisis escalated, a significant number of jobs in Serbia were lost, and unemployment remains high. Just before the crisis, in 2007/08 the total number of employed people in Serbia was around 2.7 million. Since then, the number of employed has dropped sharply, both in the formal and informal sectors. As of October 2013, the total number of employed people in Serbia was around 2.3 million. Although precise data is not available, the vast majority of job losses have been in the private sector, including in the informal sector. However, as the GoS engages in the new wave of privatization and restructuring of loss-making State Owned Enterprises (SOEs), job losses in the order of tens of thousands are also expected in the public sector in the immediate future. Importantly, as found by the recently concluded SCD, the lack of labor income is the key constraint for the bottom 40 percent to emerge from poverty or from the risk of being poor. Employment for the bottom 40 percent is hence the main vehicle to boost shared prosperity,

22. **Serbia has very low employment rates, with large segments of the population being economically inactive.** In 2013, the employment rate of the working age population was just 47 percent, compared with the average employment rate of 62 percent for new EU member states. The structure of employment is unfavorable, with almost half of the people with formal employment working in the public sector. Out of a workforce of 4.6 million, just over 1 million are formally employed in the private sector. In the future, it is clear that the vast majority of new jobs will need to come from the private sector, particularly given the ongoing privatization initiative, which will likely result in large job losses in state-owned enterprises.

23. **Many inactive and unemployed have low levels of education and skills, yet low-wage jobs are highly taxed and firms employ relatively little low-skilled labor in production.** Comparing Serbian firms to other Eastern European countries reveals that they use significantly less unskilled labor: the share of unskilled workers in production is 14 percent while the ECA average is 24 percent. One likely explanation is that Serbia has a relatively high tax wedge on low-wage earners. The main reason for the high tax wedge is the minimum social security contribution, which is set at about 40 percent of the average wage. This means that anyone earning less than the average wage, including part-time workers, have to pay social security in the same amount as a full time worker. This makes any formal part-time work unviable, but also makes full time work below 40 percent of average wage relatively expensive and could deter

firms from employing more unskilled labor. Yet, it is exactly these low-paying (part-time) jobs that would be suitable for the large pool of unemployed and the inactive population.[19]

24. **The National Employment Service is the main provider of active labor market programs for the unemployed**. Labor market programs includes active and passives measure, with bulk of the spending going towards the passive measures. Overall spending on labor market programs amount to less than 1 percent of GDP. There is an array of active measures, from training (vocational training and post-education training), employment incentive programs (employment subsidies for self-employment, rehabilitation programs and work ability assessments), to direct job creation through public works.

Table 10: Spending and Beneficiaries of Active Labor Market Programs

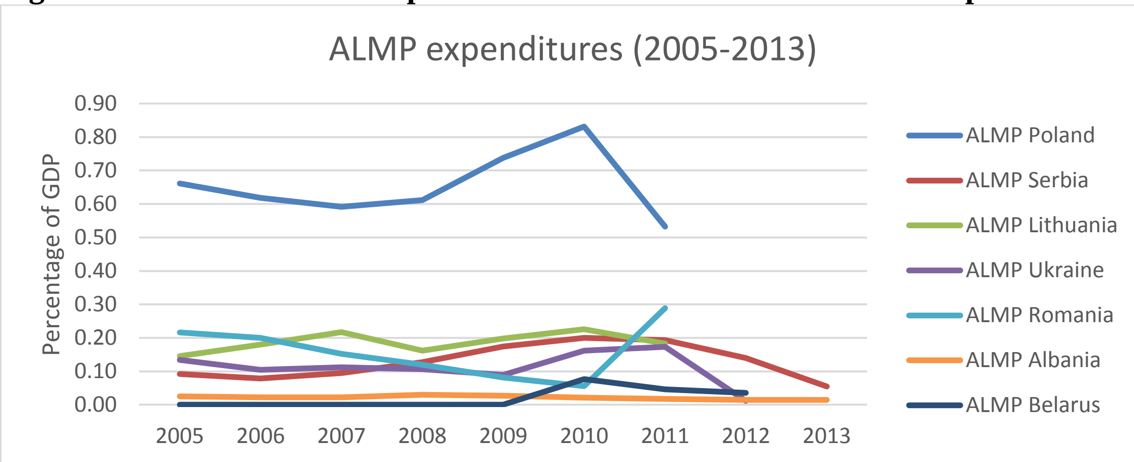
Program	Spending (Million dinar)			Beneficiaries		
	2011	2012	2013	2011	2012	2013
Career guidance	7.54	6.74	2.64	86,822	102,738	84,315
Training	374.60	297.95	157.90	5,246	6,318	2,630
Employment incentives	2,934.22	2,208.29	538.95	17,542	2,910	2,563
Wage subsidies for job creation	1,366.51	242.62	257.67	6,978	1,077	1,600
Sheltered Employment and Rehabilitation*	356.37	697.26	405.29	2,552	2,629	2,409
Public Works	697.88	519.00	236.16	5,278	4,115	1,629
Start-up incentives	594.19	327.53	273.68	3,725	1,946	1,681
Donor Funded ALMPs	94.29	34.60	9.87	508	185	126
Total (excluding donor-funded)	6,331	4,299	1,872	128,143	121,733	96,827

*From the Budgetary Fund for Professional Rehabilitation and Enhancing Employment of Persons with Disabilities
Source: Serbia National Employment Service

25. However ALMPs represented only 0.05 percent of GDP in 2013, compared to 0.14 percent in 2010, which is low relative to other Eastern European countries (see figure below). Passive measures (unemployment benefits mainly) accounted for 0.62 percent in 2013, which is relatively high compared to other ECA countries. Obviously the very high rates of unemployment in Serbia drive the latter figure, but the disproportion in the number of those in need compared to the available resources remain problematic, and calls for strong tool to prioritize and target interventions.

[19] Social security reform is being supported by the World Bank's SOE DPL series.

Figure 9: Trends in ALMP expenditures in Serbia and other ECA comparator countries



Source: World Bank elaboration based on data provided by MoLESVA and World Bank Social Protection Expenditure Evaluation Database (SPEED) database.

26. **Reforms are needed to better help unemployed workers find jobs,** and to motivate the out of work population, in particular socially disadvantaged groups (such as last resort social assistance beneficiaries, and the long term unemployed), to actively seek employment and to equip them with the necessary skills to work in the private sector. At the core of this agenda are the reforms of the National Employment Service (NES), and the improvement in targeting and scaling-up of the best-performing active labor market programs (ALMPs) that the NES already provides. The capacity of the NES needs to be strengthened with the ultimate objective of increasing the number of successful job matches per registered unemployed. This can be achieved through a number of key reforms, aimed at: (i) reducing the case load of NES case-managers to a manageable size; (ii) improving profiling of beneficiaries to better identify the most deserving cases for the scarce active measures, and in general strengthening case management; (iii) enhancing decentralization of resources; and (iv) improving vacancy collection and management. At the same time, ALMPs, ranging from training to subsidy programs and public works—which overall show promising results from impact evaluations—need to be streamlined, monitoring and evaluation needs to be improved, and the targeting of programs to beneficiaries needs to be enhanced.

27. **Finally, an important complementary agenda is reforms to technical, vocational, secondary, and tertiary education**. Adequate education and skills are the basis for successful work careers, but including reforms in these areas would overextend the scope of the project and will be addressed in separate tasks (either analytical or operational).

Annex 4: Implementation Arrangements

SERBIA: Competitiveness and Jobs

Project Institutional and Implementation Arrangements

1. The key coordinating institution will be the newly-created Public Policy Secretariat (PPS)[20]. The PPS is a policy unit under the office of the Prime Minister. The PPS will coordinate all of the results monitoring, reporting, fiduciary functions, and safeguards, in close collaboration with the line ministries. Capacity will have to be built in the PPS in terms of following Bank lending procedures. Qualified staff from within the PPS or consultants hired competitively will execute the project.

2. Multiple implementing institutions will cover the tasks planned under the project. These are the Ministry of Economy; Ministry of Education, Science and Technological Development (in coordination with the Innovation Fund); and Ministry of Labor, Employment, Veteran and Social Affairs (in coordination with the National Employment Service). The Ministry of Education has experience implementing Bank projects through the Serbia Innovation Project. Capacity will be strengthened in the other ministries in terms of understanding Bank fiduciary and safeguards procedures for the TA and eligible expenditure programs.

3. Given that the project is primarily reimbursing existing government expenditures that have minimal procurement and safeguards implications, the main job of the implementing institutions will be to work towards the achievement of the agreed-upon results and disbursement-linked indicators. This will include detailed results reporting on a semi-annual basis through the pilot policy planning, monitoring, and coordination system. It will also include supplying the necessary information at the end of each year with respect to compliance with the DLI verification protocols.

Financial Management, Disbursements and Procurement

Financial Management and Disbursement

4. **Risk analysis**. Overall combined fiduciary risk and financial management residual risk are rated as substantial.

5. **Payroll system.** The results-based financing part of the project (Part A) will finance salaries within the MoE, MoESTD (R&D Institutes), and National Employment Service. This refers to the cost of salaries under line item 411 of the economic classification of the budgets for the MoE and NES, as well as specialized services line item 424 of economic classification of the

[20] The PPS's coordinating role is fully aligned with the broader Public Administration Reform strategy led by the Deputy Prime Minister and Minister of Public Administration and Local Self-Government The PPS is conducting a reform of the public policy management through which it will introduce a legislation package (a law on planning system and two bylaws) in order to set the background processes, methodologies and typology of documents to support development of a modern policy making system.

MoESTD under which researchers' salaries are budgeted and accounted for. The payroll system within Government institutions has been the center of the financial management assessment. All of above institutions, except for the National Employment Service, are included in the centralized payroll system. The principal authority in charge of centralized payroll processing is the Treasury Administration of the Ministry of Finance, whose statutory obligations in this regard are set out in amendments to the Law on Budget System, from 2013. The role of the Treasury Administration is two-fold: (i) the calculation of income, and (ii) managing a database of employed, elected, appointed and engaged persons, which pertains to their income. The system is assessed to be reliable. There are ex-ante and ex-post controls applied. To prevent fictitious personnel. Timesheets signed off by employee and a supervisor are reviewed in the scope of the process. These are based on a staff time tracking system within each entity with electronic registration of presence in the premises.

6. Both the direct budget beneficiaries (DBBs) and indirect budget beneficiaries (IBBs) and the Treasury Administration maintain databases of personnel for employees whose payroll is centrally processed. The State Audit Institution (SAI) reported that there are only rare instances of DBBs who have not yet introduced electronic personnel records. In the Treasury Administration, the personnel records are available electronically. Information in the personnel database is changed solely on the basis of documentary proof supplied by the DBBs/IBBs.

7. The payroll data is centralized and computerized in the TREZAR system. Each month, data in the payroll TREZAR system is cross-checked against data from a separate personnel database. Changes in the payroll are entered manually. Any changes in the payroll must correspond to changes in the personnel database. Segregation of duties in the process is adequate.

8. The Sector for Payroll Processing Unit within the Treasury sends the recapitulation of the calculation to DBBs and IBBs for review and confirmation before the release of funds. The payments for all institutions currently in the system are made by the Treasury, directly to the bank accounts of each individual. Payments are made timely within prescribed dates.

9. The quality and completeness of payroll data, personnel records and personnel database, as evidenced by the percentage of retroactive adjustments, is deemed satisfactory. The SAI notes that payroll processing and calculation carried out by the Treasury is orderly and harmonized. For the IBBs, on a very limited sample, the SAI has not encountered major problems with respect to completeness of records, safekeeping of the databases, and updating of the information therein, but it is noted that the system could be made more orderly.

10. All the changes to personnel data and the corresponding payroll changes are updated monthly, on the basis of personnel documentation submitted to the Treasury's Sector for Payroll Processing by the Human Resources Department of each DBB/IBB.

11. Only appointed officers from the Sector for Payroll Processing can enter changes to the records in the personnel database maintained by the Treasury Administration. They access the personnel records with a unique password and may make the necessary changes solely on the basis of authentic documentary proof. Access and changes to payroll records are likewise restricted to authorized staff only.

12. For monthly changes in the payroll, based on attendance at work (timesheets) for all employees and accompanying documentation to justify absences (e.g., annual leave, sick leave, paid leave, etc.), the appointed officer at Sector for Payroll Processing performs the control by cross-referencing the overall hours with the previously calculated total available working hours and ensures that the difference in the total hours available and the total hours claimed is justified.

13. Each salary payment is preceded by filing of the personal income tax (PIT) return to the Tax Administration. A salary payment order can only be generated with a reference to the number of notification on successfully filed PIT returns issued by the Tax Administration. To prevent fictitious employment, the documentary proof required to register a new employee is prior registration with the mandatory insurance funds and a copy of the Employment Book.

14. The IT system generates logs, but the Sector for Payroll Processing reported that such logs are not reviewed in the course of regular operations—although they present an audit trail of changes to personnel records and payroll. The SAI has not raised issues related to the integrity of data in the centralized payroll and personnel records at the Treasury Administration. The low rate of retroactive adjustments noted above suggests that controls to avoid payment errors are robust.

15. The National Employment Service, as an organization of mandatory social insurance, has a separate computerized payroll system. Calculation of salaries is automatic based on entered coefficients and list of employees. Controls over the system are adequate, as only authorized employees working on payroll calculation can access the system. The register of employees is updated monthly. Segregation of duties in the process is appropriate. There is staff time tracking system within each entity with electronic registration of presence in the premises. The salary calculation is signed by the preparers and by the Head of Finance, before being submitted for the Director's signature of the payment request, and then on to the Treasury for execution.

16. **Project Implementation Unit.** A PIU will be established within the PPS by project effectiveness. The PIU will include a person in charge of financial management responsibilities. The PIU will be in charge of entire scope of financial management responsibilities for technical assistance under Part B, which will be implemented using traditional arrangements. Staff within PIU will also assume some responsibilities for Part A of the project, which will be also described in the staff's Terms of Reference. These should include: (i) collection of semi-annual and annual financial reports on budget execution from project beneficiaries under part A, (ii) preparation of IFRs for Part A based on collected financial reports, and (iii) preparation of withdrawal applications for reimbursement under Part A, based on IFRs. All procedures and split of responsibilities for the project will be described in the Project Operations Manual to be prepared by project effectiveness. In addition to core PIU staff, a qualified person which will execute transfers and payments for MoLEVSA portion of funds under part B, and ensure delivery of financial information and documentation for that part to the PIU, will be selected within MoLEVSA. The selection is expected to be completed by project effectiveness.

17. **Planning and Budgeting**. The project is in its largest part intended to finance existing expenditures included in the state budget, therefore it will rely on the country's budgeting system. The Government's budget process still includes a number of weaknesses, with reforms resulting in gradual improvements. Supplementary budgets are passed practically every budget year on one to two occasions. There are variances between the budget and actual figures, which according to the Public Expenditures and Financial Accountability (PEFA) assessment (ongoing) have been brought down to reasonable levels of deviations, with particular improvements on the revenue side. Nevertheless, although salaries are among items with least variances, the option of reimbursement of actually executed expenditures will be used as a disbursement method for the project, which will mitigate the risk imposed by deficiencies in the budgeting process in the country. Planning and budgeting for Part B of the project will be done by PIU (to be established) in coordination with other beneficiaries of funds.

18. **Accounting system.** Accounting systems within Treasury and other involved institutions (PPS, MoE, MoESTD, relevant institutes, and NES) are assessed to be reliable and will be relied upon during project implementation. The PIU within the PPS will use Excel spreadsheets to record financial information related to Part B of the project, while records for Part A will include only relevant line items of expenditures financed by the project extracted from relevant institutions' financial reports. Due to the value of transactions under Part B and limited records needed for Part A, using Excel spreadsheets by the PIU is assessed to be sufficient for providing transparent and reliable financial information.

19. **Financial Reporting.** The PIU within the PPS will prepare separate semi-annual financial reports for Part A and Part B of the project and deliver them to the Bank within 60 days after the end of the reporting period. The reporting currency will be EUR. The reports will be prepared in line with cash-basis International Public Sector Accounting Standard (IPSAS), which is also prescribed by local legislation for government entities. IFRs for Part A will be prepared in the manner that semi-annual and annual financial reports on budget execution from project beneficiaries under Part A will be collected by the PIU. Based on that, the PIU will extract relevant line items financed by the project and compile them into the IFR for Part A. Since the PIU will maintain complete accounting records for Part B, it will prepare IFRs for Part B based on that. IFRs for Part A will be presented in dinars, for disbursement purposes, while IFRs for Part B will be presented in EUR. IFRs for Part A will include:

- Cash Receipts and Payments (including comparison of budget vs. actual)
- Reimbursement request
- Explanatory Notes and Accounting Policies

IFRs for Part B will include:

- Cash Receipts and Payments (including comparison of budget vs. actual)
- Expenditures by activity
- Account statement
- Explanatory Notes and Accounting Policies

20. **Internal Controls.** Financial Management and Control (FMC), as designed by the Public Internal Financial Control (PIFC) framework required in the EU accession process, is not widely established and implemented across the government. Nevertheless, there is a system of internal controls, which as designed and implemented in implementing institutions, is assessed to be

reliable, in particular in relation to payroll controls (described in details above in the payroll system section). This system is the focus of most of the project's Eligible Expenditure Programs. All procedures to be applied for the project, will be summarized in the Project Operations Manual to be prepared by project effectiveness. Description of procedures will include details of flow of funds, split of responsibilities and communication channels for MoLEVSA portion of part B of the project.

21. **External Audit.** Separate annual project financial statements for Part A and Part B will be audited by a private audit firm acceptable to the Bank. The audit will be delivered to the Bank within six months after the end of the audited period. Audit Terms of Reference will be agreed and they will indicate additional areas on which the auditors will express opinion and which will primarily relate to functioning of the payroll. The audit will be conducted in line with International Standards on Auditing (ISA).

22. **Flow of Funds.** There will be no designated account opened for Part A of the project. The funds are expected to flow to either Single Treasury Account (STA) if reimbursement is made in dinars, or to a foreign currency account within the NBS indicated by the government as the beneficiary account. The method of disbursement is envisaged to be reimbursement. IFRs will be basis for disbursement for the Part A. There would be two withdrawals of funds annually: (i) mid-year subject to documenting eligible expenditures for the period January-June through IFRs and progress in achieving DLIs, and (ii) year-end disbursement subject to both eligible expenditures for the period July-December presented in IFRs, and achieved DLIs. The currency of reimbursement under Part A will be at the government's choice, and if needed the conversion rate applied will be that as of the date of the Bank's processing of applications. The PIU within the PPS is expected to compile information on eligible expenditures for Part A and prepare withdrawal applications for reimbursement of expenditures. As for Part B, a Designated Account will be opened in the National Bank of Serbia and used solely for inflows and outflows related to Part B of the project. For local currency payments, the funds will be converted to PPS sub-account within STA opened solely for the purpose of use of project funds for payments in local currency. The disbursement method used for this part will be primarily advances, with methods of direct payment and reimbursement being also allowed as alternatives. It will be a EURO account. Disbursement for Part B will follow traditional model and be based on SOEs. After the funds have been withdrawn to DA, for portion of the part B for which beneficiary is MoLEVSA, respective amount of funds will be transferred by the PIU from the DA to separate foreign currency (EUR) account used solely for the project funds, opened and administered by MoLEVSA at the NBS. MoLEVSA will execute payments for its portion of part B of the project from this account by means of deposited authorized signatories for the account being MoLEVSA designated officials, while for local currency payments the funds will be converted to MoLEVSA sub-account within STA opened solely for the purpose of use of project funds for payments in local currency. The PIU will remain to be responsible for preparation of financial reports for whole of part B of the project, therefore the PIU should receive a copy of bank statements for movements on MoLEVSA project accounts (both foreign and local currency), as well as invoices related to MoLEVSA portion of part B, in order to have necessary information for preparation of financial reports. MoLEVSA will communicate its cash needs to the PIU at the time of each withdrawal in order for such amount of funds to be included in the withdrawal application. MoLEVSA officials should be among authorized signatories for requesting direct payments, in which case such requests must be communicated to the PIU. Procedures relating to flow of funds

in general, and in particular to the flow of funds for which MoLEVSA is beneficiary and effective channels of communication between MoLEVSA and PIU thereof, will be described in details in the POM.

23. **Financial management actions.** The following financial management actions will need to be implemented:

a. Project Operations Manual for technical assistance component will be prepared (condition of effectiveness).
b. Project Implementation Unit within the Public Policy Secretariat will be established and appropriately staffed (condition of effectiveness).
c. Person assigned with executing payments for MoLEVSA portion of part B selected, the selection expected by effectiveness (an agreed action plan).

24. **Financial Management Covenants.** It will be required that the following covenants for the project are complied with:

a. Appropriate financial management system is maintained by the Client throughout implementation.
b. Delivery of financial reports as indicated in financial reporting section.
c. Delivery of annual audits as indicated in external audit section.

Procurement

25. ***General*.** Procurement for the proposed project will be carried out in accordance with the World Bank's Procurement of Goods, Works, and Non-Consulting Services under IBRD Loans and IDA Credits & Grants by World Bank Borrowers" dated January 2011 and revised July 2014. Consulting services would be procured following the Bank's Guidelines "Selection and Employment of Consultants under IBRD Loans and IDA Credits & Grants by World Bank Borrowers" dated January 2011 and revised July 2014, as well as the provisions stipulated in the Financing Agreement. The World Bank Guidelines on Preventing and Combating Fraud and Corruption in Projects Financed by IBRD Loans and IDA Credit and Grants dated October 15, 2006 and revised on January 2011, would also apply. The general description of various items under different expenditure categories is provided below. For each contract to be financed by the loan, the different procurement methods or consultant selection methods, the need for prequalification, estimated costs, prior review requirements, and time frame would be agreed between the Borrower and the Bank team and reflected in the Procurement Plan.

26. An assessment of the capacity of the adequacy of the procurement and related systems in place within PPS and the capability of the implementing institutions to conduct procurement under the project was carried out in April 2015. The assessment reviewed the organizational structure for implementing the project and the interaction between the project staff responsible for procurement and relevant units in the implementing institutions.

27. The project will be implemented by multiple institutions: (i) the Ministry of Economy (MoE), (ii) Ministry of Education, Science and Technological Development (MoESTD); and (iii) Ministry of Labor, Employment, Veteran and Social Affairs (MoLEVSA, in coordination with the NES). Only the MoESTD has experience in implementing Bank projects. The key coordinating agency will be the newly created Public Policy Secretariat (PPS), a policy unit

under the office of the Prime Minister. Capacity will have to be built within the implementing institutions and the PPS.

28. *PPS:* The assessment concluded that the PPS does not have adequate capacity in Bank funded projects and with Bank procurement procedures[21]. Once the project becomes effective, the PPS will employ a Procurement expert with experience in World Bank procurement procedures.

29. *Ministry of Economy:* The PPS will carry out the procurement activities for MoE. Technical experts from MoE will be involved in the preparation of the Terms of Reference for its respective component.

30. *Ministry of Education, Science and Technological Development:* The MoESTD has experience in implementing Bank projects through the Serbia Innovation Project. The ministry also has a PIU for a project financed by the European Investment Bank, Central Investment Bank of Europe, and experience managing EU IPA funds. The PPS will carry out the procurement activities for the MoESTD. Technical experts from MoESTD will be involved in the preparation of the Terms of Reference as well as selection committees, as relevant.

31. *Ministry of Labor, Employment, Veteran and Social Affairs:* The public procurement department at the National Employment Service (NES), has a total of six staff experienced in the Public Procurement Law. In 2014, the Project Implementation Sector was formed within the NES, consisting of two departments: (i) Department for Implementation of IPA Funds and (ii) General Project Department. These are newly established departments and the staff do not have capacity in Bank-funded projects and with Bank procurement procedures. Since the project funds under Part B.2 will be executed by MoLEVSA, with the related fiduciary responsibilities, a procurement and a financial management and implementation specialists will be hired to support the staff in the Ministry's Department for International Relations and Projects and NES with all the necessary procedures. The MoLEVSA procurement specialists will work closely with the procurement specialist hired by PPS. Technical experts from MoLEVSA will be involved in the preparation of the Terms of Reference for its respective component.

32. Given that out of the three implementing institutions, only one has experience in implementing Bank-funded projects, the overall project risk for procurement is rated "high". After the mitigation measures are implemented, the residual risk would be "substantial". The risks associated with procurement and mitigation measures were identified in the assessment of the agency's procurement capacity and are summarized in the table below:

Description of Risk	**Risk Rating**	**Mitigation Measures**	**Residual Risk Rating**
Potential procurement delays: arrangements for clearance of evaluation reports by the PPS may lead to procurement delays	H	(i) The Bank, PPS and MoLEVSA have agreed on a timeline to finalize hiring of consultants under the project. The Bank team will closely monitor adherence to the timeline;	S

[21] The PPS has a unit for management of project supported activities designed in its organizational chart and active in management of IPA funds and few other small donor funded projects that PPS is a beneficiary of.

Description of Risk	Risk Rating	Mitigation Measures	Residual Risk Rating
due to consultation with the respective implementing institutions;		(ii) Intensive procurement training for the PPS and the implementing institutions involved in conducting procurement; (iii) A qualified procurement expert familiar with Bank procurement procedures to be hired within PPS who will also provide on-the-job training to the other implementing institutions and to the evaluation committee members. The expert will provide assistance in the preparation of bidding documents/Invitation To Quote (ITQs), bid/consultant evaluation reports and contract agreements. Training in procurement under Bank guidelines will also be provided by Bank staff during the project launch workshop and project implementation.	
Contract administration procedures may not be adequate to ensure efficient and timely contract implementation; contract amendments not processed diligently	H	More emphasis and training on appropriate contract management; regular compliance checks and quality control of the deliverables by the PPS.	S
Perceived **level of corruption** in the country is high.	H	Enforcement of public disclosure and transparency provisions of the Bank's Guidelines; publishing contract awards and progress reports from the implementing institutions on their respective websites; close Bank's implementation supervision.	S
OVERALL	**H**		**S**

Procurement Arrangements

33. *Procurement of goods and non-consulting services:* It is not likely that goods will be procured under the project. If any goods are procured, they could include minor IT hardware, software, office equipment, and others. In the unlikely event that large value contracts are identified procurement will be done using Bank Standard Bidding Documents under International Competitive Bidding (ICB) procedures. Goods contracts above US$1,000,000 equivalent will be procured under ICB procedures. The NCB method will be applicable for procurement of goods contract with an estimated budget of less than US$1,000,000. Goods and non-consulting services contracts below USD 100,000 may be procured through Shopping procedure in accordance with the provisions of paragraph 3.5 of the Procurement Guidelines. In the case of Shopping for IT systems, the PPS will follow the procedures set forth on the Bank website. When soliciting quotations, the PPS would include in the list the authorized suppliers (the list is available on the Bank's website). In addition, other suppliers or local dealers may be added to the list, upon checking their credentials with respective manufacturers. All ICB contracts are subject to the World Bank's prior review. In situations and circumstances that are in compliance with the provisions of paragraph 3.7 of the Guidelines, procurement under Direct Contracting method may be used with Bank's prior review. There will be no domestic preference in the procurements.

34. Procurement of consulting services: Consulting services under the project are of various size and complexity. These would include, inter alia: development of strategies, capacity strengthening, needs assessments, outreach and communication activities, monitoring and evaluation related assignments, project management, and others. Selection will be done using the Standard Request for Proposals. The employment of technical experts will be conducted through the selection of individual consultant in accordance with the provisions of the Section V of the Consultant Guidelines. Consulting firms will be selected using the following selection procedures: Quality- and Cost-Based Selection (QCBS); Quality-Based Selection (QBS); Selection under a Fixed Budget (FBS) and Least-Cost Selection (LCS). For the contracts below USD 300,000 equivalent Selection Based on Consultants' Qualification (CQS) method may be used in accordance with paragraph 3.7 of the Consultants' Guidelines. With justification satisfactory to the Bank, single-source selection can be used for hiring both firms (as in paragraphs 3.8–3.11) and individual consultants as described in paragraphs 5.1-5-6 of the Consultants' Guidelines.

35. Training activities to enhance the client's capacity may be funded under the project. The PPS, in coordination with the implementing institutions, will develop a Training Plan which will be prior reviewed by the Bank.

36. *Retroactive Financing*: The government is considering retroactive financing for several activities under the project. They are not expected to have procurement implications because the eligible expenditures will be for staff and researchers' salaries.

37. *Filing and records keeping*: Filing of procurement related documents, and records keeping under the project, will be done by the PPS and the respective implementing institutions. Procurement progress reports will be submitted to the Bank as part of the periodic financial management reports and annual progress reports by the PPS.

38. *Procurement Supervision*: Routine procurement reviews and supervision will be conducted by the Procurement Specialist. In addition, two supervision visit is expected to take place per year during which ex post reviews will be conducted. The Bank will post-review at least 10 percent of the contracts subject to post review. Procurement documents will be kept readily available for Bank's ex-post review during supervision missions or at any other point in time. A post review report will be prepared, shared with the implementation agencies and filed in the procurement post review system.

39. *Results-based financing (Part A)*: No procurement is expected under the results-based financing activities. The EEPs include staff compensation costs and researchers' salaries. If any procurement is foreseen under the selected budget lines, it will follow the Bank Procurement and Consultants Guidelines.

Procurement method and prior review thresholds:

40. Considering the risk assessment rating the proposed prior review and procurement method thresholds for the project are provided in the tables below. In addition to the below, the Bank will prior-review the first three sub-grant applications under the MGF sub-component.

Goods, Works and Non-Consulting Services.

41. **Prior Review Threshold**: Procurement decisions subject to prior review by the Bank as stated in appendix 1 to the Procurement Guidelines.

	Procurement Method	Prior Review Threshold US$ equivalent
1	ICB (Goods) and ICB (Works) packages	*All contracts*
2.	NCB (Goods) packages < USD 1,000,000	*First contract irrespective of cost estimates*
3.	NCB (Works) packages < USD 5,000,000	*First contract irrespective of cost estimates*
4.	Shopping (Goods) packages < USD 100,000	*First contract*
5.	Shopping (Minor Works) packages < USD 200,000	*First contract*
6.	Direct contracting (Goods and Works)	*All contracts irrespective of cost estimates*

Selection of Consultants.

42. **Prior review Threshold:** Selection decisions subject to prior review by the Bank as stated in Appendix 1 of the Consultant Guidelines.

	Selection Method	Prior Review Threshold
1.	Competitive Methods (Firms) CQS Method	*>US$ 300,000* *First contract*
2.	Single Source (Firms)	*All contracts irrespective of cost estimates*
3.	Individual consultants (IC)	*> US$ 50,000*
4.	Single source selection (IC)	*All contracts irrespective of cost estimates*

43. **Short list comprising entirely of national consultants**. Short list of consultants for services estimated to cost less than US$300,000 equivalent per contract may comprise entirely of national consultants in accordance with the provisions of paragraph 2.7 of the Consultant Guidelines.

Table 11: Consultancy assignments with selection methods and time schedule

Ref. No.	Description of Assignment	Estimated Cost (US$ Millions)	Selection Method	Envisaged Start of Procurement Process	Review by Bank (Prior/Post)
2A.2.5	Sector policy development and value chain analysis	0.35	QCBS	2/01/2016	Prior
3A.3.3	Design and Deployment of RDI Sector external audit	1.15	QCBS	5/09/2016	Prior
4A.4.3	Evidence based program design of ALMPs	0.22	QCBS	3/07/2016	Prior

Environmental and Social (including safeguards)

44. As the key coordinating agency, the Public Policy Secretariat (PPS) will hold overall responsibility for monitoring implementation of environmental and social safeguards according

to the procedures described in the ESMF. The PPS will work in close collaboration with the line ministries, particularly the Ministry of Education, Science and Technological Development responsible for Component 2 and the Innovation Fund responsible for the Mini & Matching Grants Programs.

45. An Independent Environmental and Social Expert will be engaged through the Project, who will be responsible for screening sub-projects/grants selected for financing to ensure: (1) compliance with the World Bank Group (IFC) exclusion list, (2) that no sub-projects with significant impacts of a Category A type are supported, (3) that sub-projects/grants will not necessitate involuntary land acquisition or any form of resettlement, and (4) no World Bank Safeguard policies other than OP/BP 4.01 on Environmental Assessment are triggered. Any activities corresponding to the World Bank category B Projects will be required to have an Environmental Management Plan in place prior to approval that would identify potential environmental impacts and provide adequate mitigation measures.

46. In addition the Independent Environmental and Social Expert will be responsible to ensure that any Technical Assistance (TA) outputs supported under the Project are consistent with World Bank Safeguard policies.

47. The project does not anticipate any negative social impacts. The various components and sub-components of the project will not support reforms and/or grant and research financing that might result in displacement of assets or expropriation of property or land. The project does not anticipate any direct, indirect or induced negative social impacts as no construction or refurbishing of buildings is anticipated that may induce acquisition of land and/or temporary displacement of socio-economic activities. Hence, the social safeguards policies are not triggered.

48. Gender and excluded groups**.** The project is fully gender-informed and addresses all three of the WBG's gender tags, including:

- *Gender analysis and/or consultation on gender related issues*. To ensure that the project neither continues nor exacerbates gender inequality in employment, gender analysis will be incorporated in component 4.C, aligning incentives toward formal employment.
- *Specific actions to address the distinct needs of women and girls, or men and boys, or positive impacts on gender gaps*. Analysis of and recommendations on the active labor market programs ALMP's under component 3.B will take into account beneficiary characteristics, including gender indicators.
- *Mechanisms to facilitate monitoring and/or evaluation of gender impacts*. Sex disaggregated statistics where applicable, such as for owners of enterprises and startups in (component 3.A) and NES job placements that are female (component 4.A) will be monitored.

49. Citizen engagement plays a central role in increasing project impacts and it enhances development outcomes**.** Engagement with key stakeholder groups, such as the Serbia Chamber of Commerce, is expected to continue during project implementation. Engagement will also continue through periodic beneficiary surveys of innovation matching grant recipients and users of the National Employment Service (both of which are included as citizen engagement indicators).

Monitoring & Evaluation

50. Results monitoring and evaluation will be a key part of the project through the piloting of a competitiveness and jobs policy planning, monitoring, and coordination (PPMC) system, within the general framework that will be set formally by the PPS (policy evaluation and monitoring methodologies, processes, criteria). Results monitoring is expected to take place on a semi-annual basis and be managed by an inter-ministerial working group with official representatives of the PPS and each of the line ministries. It is expected that this results monitoring system will become institutionalized within the PPS and line ministries through the PPMC system. If successful, this could be a prelude to a results-based management system that is rolled out in the future to other government entities. The PPS will coordinate the results monitoring and provide guidance on evaluations of select programs that will be undertaken by the line ministries. Examples of expected evaluations include select MoE (e.g. SIEPA) and MoLESVA (ALMPs) programs.

Role of Partners

51. The Bank is coordinating closely with the EU Delegation in Serbia and the Serbia European Integration Office (which coordinates EU funding). The EU is supporting a range of policies and programs related to competitiveness and jobs through the Instrument for Pre-Accession (IPA) funds. The Bank's support will be fully complementary with and leverage the budget support and technical assistance provided through IPA funds (e.g. IPA funds are used to provide support to PPS for developing general framework of policy coordination, while the project will provide targeted support on policies related to competitiveness and jobs). Moreover, the Bank is leveraging work done by other donors, such as USAID on the reform of investment and export promotion agencies and on the implementation of program budgeting.

Annex 5: Implementation Support Plan

SERBIA: Competitiveness and Jobs

Strategy and Approach for Implementation Support

1. The Implementation Support Plan (ISP) articulates the Bank's approach to help Serbia achieve the expected project results based on the project's nature and risk profile. It identifies the inputs and actions required to facilitate better risk management, better results, and increased institutional development, while ensuring compliance with the Legal Agreements to meet the Bank's fiduciary obligations. Resources have been identified keeping in mind the need for (a) monitoring and evaluating results on the ground; (b) facilitating the timely implementation of the risk management measures, and (c) providing the necessary technical advice to the implementing institutions to build capacity.

2. The project is expected to have a co-TTL based in headquarters and a co-TTL based in the Belgrade office. It will also have a mix of local and international technical experts assigned the components. The procurement and financial management specialists are expected to be based in Belgrade. The environmental and social specialists will likely be based outside of Serbia, but expected to travel periodically to the region. This blend of staffing will ensure an appropriate balance between local knowledge and responsiveness and global expertise.

3. Implementation support will include periodic supervision missions and a detailed midterm review roughly 1.5 years after project effectiveness. The midterm review will, among other things, analyze progress toward achieving all of the results indicators and DLIs and determine where adjustments are needed. In cases where not enough information was available at the time of project approval to establish indicator baselines and realistic targets, these will be determined during the midterm review.

Implementation Support Plan

Focus	Skills Needed	Resource Estimate (annual staff weeks)	Partner Role
Project coordination, client management, and overall technical and operational support	Co-TTLs	14	
M&E, technical and operational support to PPS	M&E/ Governance specialist	3	
Investment and export promotion: technical and operational support	Investment and export promotion specialists	3	
Innovation: technical and operational support	1 Int'l and 1 local innovation expert	5	Coordinate with EU IPA projects
Labor: technical and operational support	Int'l and 1 local labor and social protection expert	7	Coordinate with EU IPA projects
Financial management	FM specialist	2	

Procurement	Procurement specialist	3	
Environmental and social issues	Env. and social specialists	3	
Total		**40**	

Skills Mix Required

Skills Needed	Number of Staff Weeks (annual)	Number of Trips (annual)	Comments
Co-TTL (intl')	6	3	DC-based
Co-TTL (local)	8	0	Belgrade-based
M&E/ Governance specialist	3	2	
Investment and export promotion specialists	3	2	
Innovation specialist	3	2	Trips to be combined with parallel IPA project
Innovation STC (local)	2	0	Belgrade-based
Labor specialist 1	3	2	
Labor specialist 2	2	2	
Labor analyst (local)	2	0	Belgrade-based
FM specialist	2	0	Belgrade-based
Procurement specialist	3	0	Belgrade-based
Environmental safeguards specialist	1.5	1	
Social/gender specialist	1.5	1	
Total	**40**	**15**	

Partners

Name	Institution/Country	Role
EU Delegation	EU	Development partner
Serbia European Integration Office (SEIO)	Serbia	Coordinates EU IPA funds

Financial Management Implementation Support and Supervision Plan

4. During project implementation, the Bank will supervise the project's financial management arrangements in two main ways: (i) review the project's interim un-audited financial reports, as well as the annual audited financial statements and auditor's management letter; and (ii) perform on-site supervision with the frequency based on the assessed project's risk and performance (first supervision in 9 months after the assessment) and review the project's financial management and disbursement arrangements to ensure compliance with the World Bank's minimum requirements. The on-site supervision will include a review of the following areas of project's financial management: accounting and reporting, internal control procedures and external audits, planning and budgeting, funds flow and staffing arrangements. A sample transactions review will also be conducted. Implementation support and supervision will be performed by the Bank-accredited Financial Management Specialist.

Annex 6: Economic Analysis

SERBIA: Competitiveness and Jobs

1. The project will largely reimburse existing, ongoing government expenditures (Eligible Expenditure Programs), such as ministry and researcher salaries. These reimbursements will be conditioned on a series of policy and process reforms specified in the disbursement-linked indicators. Since the project is not supporting new expenditures and investments, with the exceptions of innovation-related expenditures noted below, the economic impact of the supported activities will be indirect, through improved efficiency of key public programs. The establishment of a pilot competitiveness and jobs inter-ministerial policy planning, monitoring, and coordination (PPMC) system will be an important step toward helping the government conduct better economic analyses of their programs in the future. The PPMC Working Group is expected to help with cost-benefit analyses, gap analyses, and evaluations of select competitiveness and jobs-related programs. This will be particularly important for the success of the investment and export promotion programs currently being redesigned by the Ministry of Economy. Moreover, project-supported reforms in the Ministry of Labor focus on better using statistical evidence and evaluations to improve the design and implementation of ALMPs. Details on the economic rationale and existing evidence related to the type of reforms that the project will support are included below.

Investment and export promotion

2. Specific data on economic returns to investment and export promotion activities in Serbia are not available due to the lack of monitoring, evaluation, and transparency discussed in previous sections. (This is one of the issues that the project aims to address.) However, cross-country analytical work has found the return on government investment in investment and export promotion activities to be largely positive on average. A recent cross-country University of Oxford study has shown that one dollar spent on **investment promotion** potentially increases FDI inflows by 189 dollars and that 78 dollars spent on investment promotion create on average an additional job by a foreign affiliate.[22] This estimated effect is of course an average, with the largest individual marginal effects occurring where investment promotion intermediaries (IPIs) start with the least funding. In a recent survey of executives with site selection responsibilities, 47 percent indicated a strong likelihood that they would use the IPI Web site, and 83 percent said they normally make direct inquiries with IPIs during the site selection process. In other words, successful investment promotion intermediaries, operating up to international best practice standards have the potential to play a significant role in persuading investors to decide in favor of locating in their countries.[23]

3. The economic justification for government involvement in **export promotion** is based on the theory of asymmetric information and other market failures.[24] There are important externalities

[22] Torfinn Harding and Beata S. Javorcik (2011). "Roll out the Red Carpet and They Will Come: Investment Promotion and FDI Inflows," The Economic Journal, vol. 121, issue 557.
[23] World Bank Group (2012) Global Investment Promotion Best Practices 2012.
[24] Lederman, Olarreaga, and Payton (2009). Export Promotion Agencies Revisited. World Bank Policy Research Working Paper 5125.

associated with the gathering of foreign market information related to consumer preferences, business opportunities, quality and technical requirements, etc. Private firms alone will not provide foreign market information, as companies hesitate to incur research and marketing costs that can also benefit competitors. The same applies to pioneer exporters, who make a considerable investment in attempts to open foreign markets, cultivating contacts, establish distribution chains and other costly activities that can be used by their rivals.[25] According to a cross-country econometric analysis done by Lederman et al (2009), export promotion agencies are effective in terms of having an impact on national exports. Their estimates suggest that 10 percent increase in export promotion agency budgets at the mean leads to a 0.6 to 1 percent increase in exports.

4. The project would be expected to help Serbia achieve the aforementioned or higher returns through the implementation of good international practice in their investment and export support programs.

5. **Investment incentives** are another area that fall under the Ministry of Economy's agency restructuring. A nuanced approach needs to be applied to assess the effectiveness of incentive policies. The effectiveness of incentives in reaching the desired policy objectives tends to vary by the type of investment (i.e. resource seeking, market seeking, efficiency seeking), or even by the sector in which investment is taking place. Every investment incentive policy has potential costs and benefits. The benefits arise from: i) higher revenue from possibly increased investment; and ii) social benefits—such as jobs, technology transfers, spillovers, positive externalities, and signaling effects—from this increased investment. The costs are due to: i) revenue losses from investments that would have been made even without the incentives; ii) indirect costs such as economic distortions and administrative and leakage costs. At the least, the incentives should be narrowly targeted and awarded with as little discretion and as much transparency as possible.[26]

Innovation

6. **The economic rationale for investing in science, technology, and innovation lies in the long term implications for economic growth.** A society's capability to use, produce and commercialize scientific research is critical for gains in productivity and ultimately its global competitiveness. Emerging economies that have invested in human capital, technology and R&D—and where other conditions such as market incentives and strong institutions were present—have developed economies with a strong capacity to innovate and convert knowledge into wealth.

7. The proposed project seeks to develop and implement public instruments that address key market failures associated with innovation, specifically underinvestment in R&D by the enterprise sector, which is associated with information asymmetries that stem from the inappropriability of knowledge (via enterprise R&D matching grant programs), and key coordination failures that exist between the Serbian research and enterprise sectors (by support to

[25] Hausmann and Rodrik (2003). "Economic Development as Self Discovery", *Journal of Development Economics* 72(2), 603-633.

[26] James, Sebastian (2009). Incentives and Investments: Evidence and Policy Implications. World Bank Group.

technology transfer activities), as well as at the institutional level (support to MoESTD for RDI sector reform).

8. ***Matching grants:*** Owing to the aforementioned market failures related to information asymmetries, there is a clear case to provide access to finance especially for young enterprises engaging in R&D and innovation. New technology-based start-up firms are especially vulnerable during the R&D phase as they're unable to generate revenues to sustain their operations, but also face very high levels of technology risk. Furthermore, some of the most important barriers in business access to finance for innovation are: the lack of both credit history and experience in working with financial institutions, high collateral requirements, unclear long-term vision for business development, and a complete lack of appetite for technology risk or understanding of technology company trajectories among traditional financiers. The consequences of the economic crisis are also an important factor.[27] Matching grants have been among the most common tools for direct support for business R&D used by governments around the world. They have proven to be a very effective instrument to increase investment in R&D by firms. Moreover, impact evaluation studies of several programs have shown that the matching grant programs can create important additionality effects.[28]

9. ***Technology Transfer Facility:*** Transforming national R&D capabilities into an engine of innovation and growth not only requires appropriate public research sector framework and research capacities, but also requires highly specialized tools and capabilities that often reside at technology transfer facilities (TTFs). In most advanced and transition economies, universities and research institutes are among the greatest generators of invention pipelines, followed by innovative industries and businesses, however coordination failures among these two communities are not atypical even in the most advanced economies. Therefore, in Serbia the TTF's role would not be limited to supporting commercialization of the intellectual property (IP) generated by the research community. Rather the TTF would be critical in: addressing coordination failures between two currently estranged communities – enterprise and research sector - establishing relationships (e.g. TTF brings global knowledge to academic researchers and local users who may be unaware of certain technologies due to severe information asymmetries); providing assistance with regard to entrepreneurship and IP; facilitating the formation of university-connected companies utilizing a public research organization's technology (start-up) and/or a university's human resources (spin-off) to enhance prospects of further development; generating net royalties for the public research organizations and

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[27] OECD (2014) OECD Science, Technology and Industry Outlook, OECD Publishing, Paris

The World Bank (2011): Igniting Innovation Rethinking the Role of Government in Emerging Europe and Central Asia. Europe and Central Asia Region Knowledge Economy Report Innovation Policy Platform, R&D grants, available online at https://www.innovationpolicyplatform.org/search/site/matching%20grants?f[0]=bundle:document&f[1]=bundle:contentpage

[28] Crespi G., Maffioli A., Melendez M. (2011) Public Support to Innovation: the Colombian COLCIENCIAS' Experience. Inter-American Development Bank.

Aerts, Kris and Dirk Czarnitzki (2006). The Impact of Public R&D–Funding in Flanders, IWT Study Bd. No. 54, Brussels.

PACEC (2011) Evaluation of the Collaborative Research and Development Programmes Final Report. UK Technology Strategy Board.

collaborating partners. Establishment of effective technology transfer practices and a technology commercialization system is a long process with considerable initial and continued costs and resource commitments but with significant advantages in the long term including supporting the critical culture of entrepreneurship and commercialization among the public research community. Income generation is not systematic in any early stage technology transfer facility and cannot be relied upon as the only basis for financing technology transfer activities and thus must be viewed as a medium to long term public commitment.

10. ***Rationale for RDI sector reforms****:* In recent years, particularly since the financial crisis in 2008, governments across the OECD have strongly emphasized quality, efficiency, prioritization and concentration of resources. Universities and public RDIs faced with global competition were challenged to increase critical mass and enhance systemic efficiency. Consequently, restructuring of applied research activities in particular has taken place via mergers of institutes, better co-ordination across research units, and the introduction of new performance management approaches in universities and RDIs to reinforce autonomy, accountability and business-like operational models. In addition, evaluation has taken on greater importance (e.g. the Academy of Finland started to prepare an international review of the state of scientific research in 2012, and all the science, technology and innovation institutions were evaluated)[29].

11. In contrast, the case studies of RDIs from several transition countries (Russia, Ukraine, Croatia, Serbia, Poland, and Bulgaria)[30] showed that many RDIs continue to operate as standalone entities, with very limited progress in creating critical mass in research, improving quality or in intensifying interactions with the innovation system overall. RDIs in transition economies also lag significantly in the range of services provided to industry, knowledge management, licensing, incentives structures, staffing, etc. In this context, given the budgetary constraints for public R&D spending and the global trends, Serbia’s public research sector system calls for systematic reforms that would foster the relevance of RDIs for achieving national priorities, enhance their performance and relevance to the economy and society at large by creating incentives at the individual, institutional and sector levels.

Labor

12. This component aims at improving the services offered by the NES to firms and jobseekers alike, and to improve the work incentives faced by a specific subset of jobseekers, namely work-able social assistance beneficiaries. The rationale for the provision of public employment services is twofold: first, public employment services (PES) enhance the efficiency of the labor market by increasing the speed and quality of job matches; second, efficient PES improve the employability and job opportunities of the unemployed in general and the most disadvantaged segments of the workforce in particular by providing active labor market programs (ALMPs) to them. With regard to work disincentives the aim is to balance the poverty-reducing effects of last-resort social assistance with sufficient incentives for beneficiaries to search and accept (formal) work, as the main sustainable way to achieve poverty reduction.

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[29] OECD (2014) OECD Science, Technology and Industry Outlook, OECD Publishing, Paris
[30] World Bank (2009) Restructuring RDI Institutes in Europe and Central Asia. ECA KE Study III.

13. Enhancing the institutional capacity of NES is a key factor in improving the efficiency of the Serbian labor market. Every labor market needs a place where employers and jobseekers can meet—and the better that market place is organized, the more efficient the labor market will be. The professional level of NES staff as well as the ratio of staff to the unemployed are key ingredients to improving employability of the unemployed and the quality and speed of job matches. A high caseload per case worker—as it is the case in Serbia—has various negative implications. Jobseekers are unable to see their counselors to get advice or referrals to employers or ALMPs on a regular basis; counselors cannot monitor job search efforts of the unemployed and do not have enough time to reach out to employers to collect vacancies.[31] Currently, the NES has an average case load per case worker of about 1,200. In high-income OECD countries, this ratio is usually below 100.[32] Hence, decreasing the caseload to a more manageable number is a key priority. Experience from other countries shows that this does not have to be achieved only through an expansion of case workers. For example, narrowing the concept of who is unemployed to "active jobseeker" can help focus the case work on those who truly are looking for work, therefore lowering the case load to fewer—and better motivated—beneficiaries.[33] In Serbia, there seems to be considerable potential to narrow the concept of unemployed because according to the labor force survey, less than 50 percent of registered unemployed are actually active jobseekers. Instead, many of the unemployed are not looking for work or already work in the informal economy. Asking NES case workers to focus on non-active jobseekers, in a highly constrained context, is a waste of precious resources, while focusing them on the active jobseekers will greatly enhance the quality of their case work and free them from unnecessary administrate work.

14. In addition, a re-assessment of organizational structures towards better front-line engagement with clients (unemployed and employers) will also help to improve the quality of the case work. A modern NES will have to develop mechanisms to re-allocate caseworkers between branch offices to those municipalities where there is more need and comprehensive certification and training programs for case workers.[34]

15. Enhanced capacity of the NES will not only lead to better job matching, but it will also improve the targeting, design, and implementation of ALMPs, and hence the employability of beneficiaries. With a more manageable case load and better trained case workers, NES will be in a position to more adequately profile active job seekers and group them into various risk groups.[35] This, in turn, will guide case workers in their case management, separating the harder-

[31] See Gligorov et al. (2011): Assessment of the Labour Market in Serbia. Wiiw Research Report 371.
[32] See Kuddo, A. (2012): *Public Employment Services, and Activation Policies*. Social Protection and Labor. World Bank Discussion Paper No. 1215.
[33] For an overview of differing caseloads per concept (e.g. job seeker, long-term unemployed or market integration clients) in different countries, see Manoudi et al. (2014): *Small Scale Study on PES Business Models*. Report by the European Commission.
[34] See Duell, N. (2014): *Roadmap Serbia. Contribution to the section on: increasing capacity of the National Employment Service and active labor market programmes*. Mimeo.
[35]Current NES jobseeker profiling categories can be obtained from: Kavanagh, F. (2010): *A Review of the Public Employment Service in Serbia*. Conducted within the Promotion of Youth Employment and Management of Migration Joint Programme in Serbia. In addition, the effects and roles of profiling in PES are shown in: Weber, T. (2011): *Profiling Systems for Effective Labour Market Integration*. The European Commission Mutual Learning Programme for Public Employment Services.

to-employ from others. The former group can then be more efficiently linked to the best-fitting ALMPs, like training programs, start-up support, wage subsidies, or, as a last resort, public works. As for the design and implementation of ALMPs, NES is already collecting vast amount of data and generates the necessary evidence to monitor the impact of these programs. For example, the "Severance to job" program has been shown to have significant positive effects on core labor market outcomes, such as probability of employment. Nevertheless, the program has been stopped for lack of funding and recommendations for a re-design and further improvement were not implemented.[36] Therefore, one goal of the NES should be to improve its long-term capacity to plan, implement and monitor nation-wide ALMP's to enhance their accountability. However, ALMP's so far are underfunded and need structural revisions. What needs to be improved is how this evidence is fed into re-design of programs, and possibly performance-based contracting of program providers. Especially the latter has shown interesting results in OECD countries.[37]

16. Not only individuals will benefit from the enhanced capacity of the NES, firms will benefit as well. Vacancy services offered by the NES are key, especially for small and medium enterprises (SMEs) who cannot afford private recruitment services, to ensure an efficient and fast filling of job vacancies. This is particularly important for jobseekers of the bottom 40 percent, as they are most likely to work in SMEs.[38] In addition, the improvement of job matches through the enlargement of the pool of jobseekers available to a firm is likely to make a positive contribution to firms' productivity.[39]

17. Finally, social assistance beneficiaries face a specific barrier that prevents them from participating in formal employment, namely benefit disincentives.[40] The design of social assistance benefits and its interaction with the tax system strongly discourage recipients from taking up formal employment. In essence, the current design of social assistance benefits results in very high average effective tax rates and marginal effective tax rates, often in access of 100 percent.[41] In other words, for every dinar that beneficiaries earn from formal jobs they lose a dinar in benefits or taxes, hence providing no incentive to accept formal work. Such high work disincentives have been shown to be associated with higher levels of informality.[42]

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[36] See Nojkovic, A. Vujic, S. and Arandarenko, M. (2010): *Evaluation of the Active Labor Market Policy in Serbia: "Severance to Job"*. Presentation at Conference: Western Balkans – Poverty and Inclusions, Dec. 2010, Brussels.
[37] See Finn, D. (2011): *Sub-Contracting in Public Employment Services. Review of Research Findings and Literature on Recent Trends and Business Models*. The European Commission Mutual Learning Programme for Public Employment Services.
[38] See forthcoming World Bank: *Systematic Country Diagnostic for Serbia*.
[39] See Cedefop (2010): T*he Skill Matching Challenge – Analysing Skill Mismatch and Policy Implications*. Belman, D. and Heywod, J. (1997): *Sheepskin Effects by Cohort: Implications of Job Matching in a Signaling Model*. Oxford Economic Papers 49, 623-637.
[40] See World Bank (2013): *Activation and Smart Safety Nets in Serbia: Constraints in Beneficiary Profile, Benefit Design, and Institutional Capacity*. Part of the Western Balkans Activation and Smart Safety Nets analytical and advisory services.
[41] See Koettl, J. (2012): *Does Formal Work Pay in Serbia? The Role of Labor Taxes and Social Benefit Design in Providing Disincentives for Formal Work*. In Caterina Ruggeri Laderchi and Sara Savastano (eds.) *Poverty and Exclusion in the Western Balkans. New Directions in Measurement and Policy*, Volume 8. Springer. 2012.
[42] See Koettl, J. and M. Weber (2012): *Does Formal Work Pay? The Role of Labor Taxation and Social Benefit Design in the New EU Member States*. Research in Labor Economics, Vol. 34. 2012.

18. The proposed project aims at achieving the aforementioned improvements through functional reforms, better use of data for decision-making, and changes in incentives, which are largely budget neutral. Additional investment is marginal compared to the size of the loan and compared to the budget of the NES and ALMPs in place. One of the expected results of the project will be to enable the NES management to make better decisions on which ALMPs to finance and to whom they are more likely to work. This is likely to yield efficiency gains, since meta-analyses on active labor market measures suggest that in several occasions costs of these measures, especially if not well designed, may outweigh benefits.[43]

[43] See Betcherman et al. (2004): I*mpacts of Active Labor Market Programs: New Evidence from Evaluations with Particular Attention to Developing and Transition Countries*. Social Protection Discussion Paper Series No. 0402.