Project Information Document (PID)

Concept Stage | Date Prepared/Updated: 22-Jan-2021 | Report No: PIDC31141

BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Parent Project ID (if any)	Project Name
Serbia	P174251		Serbia Local Infrastructure and Institutional Development Project (P174251)
Region	**Estimated Appraisal Date**	**Estimated Board Date**	**Practice Area (Lead)**
EUROPE AND CENTRAL ASIA	Sep 01, 2021	Dec 16, 2021	Transport
Financing Instrument	**Borrower(s)**	**Implementing Agency**	
Investment Project Financing	Republic of Serbia	Ministry of Construction, Transport, and Infrastructure	

Proposed Development Objective(s)

The Project Development Objective is to increase efficiency, inclusiveness, and sustainability of LSG infrastructure service delivery

PROJECT FINANCING DATA (US$, Millions)

SUMMARY

Total Project Cost	100.00
Total Financing	100.00
of which IBRD/IDA	100.00
Financing Gap	0.00

DETAILS

World Bank Group Financing

International Bank for Reconstruction and Development (IBRD)	100.00

Environmental and Social Risk Classification	Concept Review Decision
Moderate	Track II-The review did authorize the preparation to continue

Other Decision (as needed)

B. Introduction and Context

Country Context

1. **Serbia is an upper middle-income country, and, with a gross domestic product (GDP) in 2019 of US$ 52.7 billion, is one of the main economies in the Western Balkans.** In 2019, Serbia's economy grew by a solid 4.2 percent, with the service sector as the main driver of growth. Unemployment fell to an estimated 10.4 percent in 2019, and employment reached a record high of 49 percent. Average wages also went up by 10.6 percent in nominal terms. Serbia´s fiscal consolidation efforts resulted in surpluses in 2017 and 2018 and a strong fiscal position in 2019, with a small deficit of 0.2 percent of GDP. Despite this improved scenario, Serbia needs further sustained and accelerated growth to catch up with other European Union (EU) countries. Serbia started negotiations for EU accession in 2014 and much of Serbia's reform agenda is driven by the EU accession process.

2. **While economic growth has benefited rural and lower-income households, there are still large differences in the distribution of wealth across the country further deepening unequal regional development.** The income of Serbia's poorest 40 percent grew by an annualized average of 3.9 percent between 2013 and 2017, which compares favorably to income growth of 1.5 percent for the whole population. Although poverty (measured as those living on income under US$5.5/day in 2011 PPP terms, the standardized middle-income-country poverty line) declined from 25.8 percent in 2015 to 18.9 percent in 2019, poverty and inequality levels in Serbia are still significantly higher than in comparator countries, with disadvantaged groups and subnational regions persistently lagging the averages. The estimated share of households at risk of poverty (i.e., households living on less than 60 percent of the national median income) ranged from 4.8 percent in Novi Beograd in the Belgrade region to 66.1 percent in Tutin in the region of Šumadija and Western Serbia.[1]

3. **Serbia faces major environmental challenges, air pollution, and climate-related risks, and is prone to natural disasters such as floods and droughts, which can cause significant damage to infrastructure, the economy, and people's livelihoods, especially among vulnerable groups.** The 2014 floods affected 1.6 million people, caused several fatalities, and induced damage and losses estimated at EUR 1.55 billion. Meanwhile, low efficiency in energy, transport, water, waste management, and agricultural practices results in a high carbon footprint, significant losses of extracted water, and elevated levels of air pollution in major cities. Serbia GHG emissions grew 9 percent in the past 10 years, with energy and transport being the main contributors. Given observed trends of increased use of private vehicles and steadily growing motorization rate, it is expected that transport will further increase its GHG emission and impact on air pollution unless some firm actions are taken. Climate change may intensify the frequency and scale of natural disasters. Addressing environmental challenges and climate change is essential to sustain progress and ensure long-term economic development.

4. **Serbian economy is experiencing a recession due to the COVID-19 pandemic, and GDP is expected to drop by 2.0 percent in 2020.** Strict restrictions on mobility, commerce, and public gatherings aimed at containing the pandemic have had significant adverse impacts on economic activity. As a result, the Serbian economy is in recession. The 2020 fiscal deficit is expected to reach 8.9 percent of GDP (compared to a pre-crisis projection of 0.5 percent) due to a decline in revenues and spending for urgent goods and services. Public debt is projected to

[1] Serbia Systematic Country Diagnostic Update (SCD Update), WBG, April 2020

reach almost 60 percent of GDP by year-end and poverty (18.2 percent in 2019) is expected to increase by as much as 2 to 4 percentage points in 2020, wiping out the gains of the last four years. The negative impact of the pandemic is affecting manufacturing but is most pronounced in the services sectors, in particular transport and tourism. The government and the National Bank of Serbia have introduced several measures to mitigate the economic impact of the pandemic, including a massive fiscal stimulus package of about 13 percent of GDP during 2020. The fiscal package includes direct payments to businesses and individuals, soft loans, and guarantees. Additional measures, including wage subsidies (of 2/3 of minimum wage) to all employees and further deferral of social contributions and labor taxes, were announced in August. The World Bank has taken a number of actions aligned with the Approach Paper “Saving lives, Scaling-up Impact and Getting Back on Track” to support the Government of Serbia (GoS) in responding to the COVID-19 global pandemic crisis.

Sectoral and Institutional Context

5. **In recent decades, cities and towns in Serbia have suffered from underinvestment, weak management of infrastructure, and environmental pollution.** This has led to deteriorating living conditions in many cities and towns, increased vulnerability and considerable variability in living standards across the country. Key challenges include addressing infrastructure challenges, including weak infrastructure connectivity, inadequate solid waste management, significant air, soil and water pollution, disaster risks from floods and other natural hazards, and an ageing infrastructure stock. Less than 25% of the population has access to safe water sanitation services, collection rates of household waste are low and even in Belgrade only 85% of households have waste collection services. Local roads need renewal and the building stock is energy and heating inefficient and the main source of air pollution. The upgrading and expansion of ageing infrastructure and public service delivery and improvement to accessibility to markets/jobs/services are crucial to increase the attractiveness of the cities, towns and lagging regions to businesses and residents and to drive economic growth. The “SERBIA 2025” investment program, presented recently by the President of Serbia, aims at investing around 14 billion euros over the next five years in various development projects, including for projects at the local level, which could assist in filling some of the investment gaps.

6. **LSGs in Serbia are struggling with increasing air pollution and high GHG emissions.** The Environmental Performance Index shows Serbia’s environmental health and ecosystem vitality scoring below most WB6 and comparator transition economies of Europe. Serbia’s CO_2 emissions per unit of GDP (in PPP terms) are about twice those of the EU average. Meanwhile, low efficiency in energy, transport, water, waste management, and agricultural practices results in a high carbon footprint, significant losses of extracted water, and elevated levels of air pollution in major cities. Energy productivity is low, at one fourth of the EU28 average according to Eurostat data. Transport is the second main contributor to GHG emission and also heavily contributes to air and noise pollution in cities and is a sector where emissions are growing the most. The adoption of the EC Green Agenda for the Western Balkans related to the Green Deal will have a profound impact on the way that LSGs plan for low carbon and clean growth. This operation will support the investments needed that will contribute to decarbonizing the economy particularly in energy and sustainable mobility. To increase the focus on the circular economy, addressing in particular waste and recycling, and in fighting pollution of air, water and soil.

7. **Climate adaptation is also a key priority for LSGs. Serbia is prone to natural hazards with significant potential impacts on people and infrastructure.** Frequent droughts and floods have already led to a high adverse impact on livelihoods with an estimated population of 200,000 being affected by flooding annually at an estimated cost of $1 billion[2]. Following the extraordinary floods in May 2014 which pushed around 125,000 people into poverty, a post-disaster assessment reported that more than 2,000 landslides were activated along state roads and

[2] The Global Facility for Disaster Reduction and Recovery (GFDRR), WBG, Europe and Central Asia (ECA) Risk Profiles

more than 3,000 along local roads. Estimated damage was equivalent to 2.7 percent of GDP and losses were equivalent to 2 percent. Most of the damage occurred at the LSG level, with reconstruction costs that were far above the budget of local authorities. Similar extreme weather conditions, though more localized, repeated across the country in 2015, 2016, 2019 and in 2020. Serbia has taken initial steps in establishing an effective institutional framework for climate response, but there is limited capacity and awareness about climate change adaptation. Funding mechanisms to support the integration of climate change adaptation measures into key economic sectors and infrastructure investment planning are not well defined nor readily available. Addressing climate change adaptation will be a key component for this operation, both in terms of the financing and technical assistance.

8. **Serbia is organized as a unitary country, with a dominant central government level and characterized by significant regional inequalities.** Subnational government levels consist of autonomous provinces and LSGs**.** According to the *Law of Territorial Organization of the Republic of Serbia*, the territory of Serbia[3] consists of 145 LSGs: 117 municipalities, 27 cities and the capital city (Belgrade). Although operations of the City of Belgrade are regulated by the *Law on the Capital City*, statutory powers and functions of the City of Belgrade, as defined by that law, are rather like those of other LSGs[4]. LSGs are grouped in a total of 25 regions. 13 of these regions are "lagging regions,"[5] of which 4 regions (Zaječar, Pomoravlje, Jablanica, and West Bačka) are not only among the poorest in Serbia but in recent years their relative poverty has also been worsening[6]. Most responsibilities are shared between the central government and the LSGs. Regions mostly play a coordinating role with limited functions, but there are efforts of the GoS and LSGs to create intermunicipal cooperation bodies.

9. **Main functions of LSGs in Serbia are in the area of services delivery, management of existing assets, and implementation of local investments, often through local public service companies owned by the LSGs.** Main roles and functions of LSGs[7] are to support local economic development, develop, maintain and manage local roads and other public infrastructure, and provide local services including for waste, water, public transportation, education and health facilities and other services important for local development. In terms of infrastructure provision, LSGs are mainly focused on maintenance and rehabilitation/reconstruction of existing assets and service delivery. The LSGs are seldom implementing major capital infrastructure investments and because of capacity constraints this is often delegated to the national level. For example, the central government is supporting, through public companies or dedicated national programs, rehabilitation of local roads, energy efficiency programs, wastewater and solid waste treatment projects. There is a need to fully clarify the roles and mandates of the different levels of government and to ensure that governments have the capacity (technical, financial) to provide the necessary services under their responsibility.

10. **The regulatory framework for managing local government finances is relatively well developed, but its implementation has fallen short.** LSG financing, budgeting and public finance management are regulated by means of several laws, the most important being the *Law on Budget System*, the *Law on LSG Financing* and the *Public Debt Law*. The Ministry of Finance (MoF) provides guidelines for preparation of budgets but LSGs have autonomy in terms of expenditures and their design, amount and structure. The level of LSG financing has remained below legally prescribed levels, particularly with respect to non-earmarked funds, and the criteria for allocation have not been specified. Generally, allocations have been frozen since 2013, leading to a drop in un-earmarked funds from 0.87 per cent in 2013 to 0.65 per cent of GDP by 2019. Reporting occurs at a fairly aggregate level,

[3] The data on Serbia disclosed here refers to the territory of the Republic of Serbia as per the UN Security Council Resolution 1244
[4] Belgrade is regarded as one local government, divided into 17 municipalities, which do not have the same powers as other LSGs, which is why they are not included in the count of municipalities. Therefore, from the point of view of LSGs classification, the City of Belgrade considered one LSG.
[5] Identified as in the EU cohesion policy's "Lagging Regions Initiative", regions are divided into four categories in line with the "Lagging regions initiative": (i) leading regions; (ii) "low growth" lagging regions (iii) "low income", converging lagging regions and (iv) 'low income', diverging lagging regions.
[6] Western Balkans and Croatia Urbanization and Territorial Review (2019)
[7] Law on Local Self-Government, "Official Gazette of the Republic of Serbia", no. 129/2007

limiting the MoF's ability to analyse in detail the efficiency and efficacy of local government finances. Oversight and control of the local government public finance management, transparency and accountability is performed by the State Audit Institution, which audits certain number of LSGs every year in line with its capacity.

11. **The distribution of per capita revenues and expenditures across LSGs indicates relatively high inequality favoring more developed and richer LSGs.** Inequality in revenue distribution is then translated into inequality in expenditure distribution, including inequality in local public investment. There is a positive correlation between the total population of LSGs and their per capita (public) spending implying that larger LSGs have more funds available for spending than smaller LSGs. Additional resources that might be obtained from the central government are usually used by LSGs with more capacities, while the lagging ones usually do not even propose projects for funding.

12. **Recognizing the need for boosting local economic and urban development, the GoS adopted the Sustainable Urban Development Strategy (SUDS)[8], relevant for all LSGs, on June 13, 2019.** The Ministry for Construction, Transport and Infrastructure (MCTI) is the institution responsible for SUDS and it has established a unit within the ministry for its implementation. SUDS represents an integrated program until 2030 for tackling the next stage of the development of Serbia's cities and municipalities. The new strategy will contribute to Serbia's EU accession process and help harmonize its urban development policy and approach with the objectives of the EU Urban Agenda, the EU Green Deal, the New Urban Agenda adopted at the Habitat III United Nations (UN) Conference in 2016 in Quito, and the number 11 of the UN's Sustainable Development Goals: *"Make cities and human settlements inclusive, safe, resilient, and sustainable."* The SUDS applies to all LSGs and recognizes that among main weaknesses at the LSG level are (i) insufficient and unstable access to financing, (ii) outdated infrastructure, (iii) low accessibility, (iv) lack of participatory approach, (v) legacy and ineffective public utility companies and services, (vi) climate change and air pollution, and (vii) lack of sound asset and investment management frameworks. At the same time, the Strategy recognizes that opportunities are in improvement of these aspects.

13. **Many donors and IFIs are active in the provision of support to LSGs mainly through capacity building activities and support in the development of planning documents.** Out of foreign sources of financing, the most significant at the local level are loans provided by foreign and domestic commercial and investment banks (IFC, EBRD, EIB), institutional and private investment funds, EC IPA instruments, as well as FDIs in the form of capital increase, strategic partnerships, concessions, leasing, franchises, etc. Grants from bilateral donors, GIZ, SECO, FAO, UNWTO, USAID and UNDP schemes, European funds aid, etc. were also used to support local economic development. Most of the donors are focused on capacity building in the development of regulatory framework and planning documents[9], while most foreign loans are dedicated to energy efficiency, education, and health.

14. **The share of public funds assigned to LSGs (5.9 percent of GDP) is below the EU (9.9 percent of GDP) and OECD (15.9 percent of GDP) averages[10].** LSG revenues in Serbia account for 14 percent of consolidated government revenues, which is significantly below the EU-27 average (22 percent) and the new EU member states average (20.7). There are three main types of revenues at the LSG level: (i) own-source revenues (recurring property tax, local administrative and communal fees, etc.), (ii) assigned revenues (personal income tax, inheritance, gifts

[9] Some of the most prominent among those projects are: Municipal Infrastructure Support Programme, financed by the EU, and implemented by the EU Delegation to Serbia (focused on institutional and regulatory framework for municipal infrastructure services and support for local public utilities reforms), Local Finance Reform (RELOF) Project and Support for the Implementation of the Action Plan for the Reform of Public Administration - Reform of LSG 2016-2020, both funded by the Swiss Government, and the EXCHANGE Program, funded by the EU from IPA 2014, and implemented by the Ministry of State Administration and Local Self-Government (MDULS) and the MoF, and the Standing Conference of Cities and Municipalities (focused on local property management, planning and programatic budgeting)

[10] Network of Associations of Local Authorities of South- East Europe, NALAS (2019) Local Government Finance Indicators in South- East Europe. Statistical Brief

and property transfer taxes, etc.) and (iii) central government grants. Grants can be non-targeted and targeted, whereby the non-targeted grants are divided into: Equalization grant, General grant, Compensating grant, and Solidarity grant. The total amount of non-targeted grants is set out by the Law on Local Self-Government Financing, at 1.7 percent of GDP. The main revenue streams of LSGs in Serbia are wage tax (40 percent of total revenues), property tax (17 percent) and central government grants (15 percent), while all other revenues together provide 28 percent of total LSG revenues.

15. **Recent increases in allocation of resources to LSGs have not resulted in increased local investment.** The share of LSGs spending in total public investment was 40 percent in 2011 but it halved over the next decade. As a result, LSGs investment in Serbia is low, both as a share of GDP and as a share of total spending, with only 16 percent of LSG expenditure going for investment. This was despite significant increases in transfers and own source revenues over the past decade. Expenditures instead were used for goods and services. The average total LSG infrastructure investment in Serbia in 2018 and 2019 stood at EUR 450 million, equaling 1 percent of GDP, significantly below the EU-27 average (1.4 percent of GDP) and the CEE average (1.5 percent of GDP). Relatively low LSG public investment in Serbia in comparison with the other CEE countries may be, to some extent, explained by the low overall level of LSG public spending, although, as discussed above, LSGs are also allocating limited resources within their budgets to investment. In terms of sectors, LSG public investment is mostly oriented to community development (29 percent), roads construction and maintenance (26.9 percent), and general investments (18.9 percent) while investment in green transportation and environmental infrastructure is rather low. It should be noted that capital expenditures of Belgrade and Novi Sad (in total EUR 123 million) account for almost a third of the total capital expenditures of all LSGs in Serbia.

16. **Weaknesses in public financial management systems, poor public investment management, and lack of asset management systems contribute to underperformance in providing reliable local infrastructure and enabling economic development at the local level**[11]. Asset management frameworks and improved public investment management can improve the quality of public investment projects at the local level, strengthening all elements of the project life cycle from identification to the final ex-post evaluation of results. LSGs lack methodologies and tools to effectively implement all stages of the project lifecycle, and particularly for maintenance and rehabilitation of existing infrastructure, a key focus for LSG. They lack asset inventories, prioritization tools and systems for long term asset management. In addition, the LSGs lack the capacity to prepare high quality design and tender documentation which results in weak implementation performance, poor quality of works and/or cost overruns. The low capacity is also reflected in relatively low execution rates (60-63 percent of LSG investment plans). Efforts are also needed to continue to improve transparency (e.g. the continuation of the Open Data Initiative), procurement, and supervision.

17. **The LSGs lack (financial and technical) capacity to prepare and execute numerous strategic planning documents and budgets necessary for successful infrastructure service delivery.** As part of the EU accession process, Serbia has improved the links between investment planning and budget execution, but further efforts are needed. According to the new *Law on the Planning System*, LSGs are now required to adopt and implement a set of planning procedures and practices that include a Long-Term Development Plan (not less than 7 years) and a Medium-Term Plan (for 3 years) as the main LSG operational document[12]. In addition to this, the LSGs are obliged to prepare line and programmatic budgets, although implementation of program budgeting is still at an early stage. In addition, although local budgets should list all LSG's capital projects, only investments above 5 million EUR are required to apply a newly defined and more rigorous framework to appraise, select, prioritize and implement

[11] Ministry of Construction, Transport and Infrastructure, 2018, Sustainable and Urban Development Strategy of the Republic of Serbia until 2030
[12] The establishment of the new planning system in Serbia has just stared at all levels of government, so development planning documents at the national and provincial level - RS Development Plan, AP Development Plan and RS Investment Plan - are not going to be available in the initial phase of preparation of LSGs Development Plans.

investment projects. This threshold effectively excludes most capital infrastructures at the LSG level from this more rigorous public investment framework, and leaves them without preparation and implementation guidance, and IT support. The legislative framework for the main planning documents seems to be well developed (*2009 Law on Regional Development, Spatial Plan of the Republic of Serbia 2010–20, Law on the Planning System 2018, and Law on Planning and Construction*), but the outcome will ultimately depend on local capacity which is, as mentioned, relatively low.

18. **The provision of infrastructure related services is not keeping up with the changing demands from the environment, citizens and land purposes.** Insufficient financial investment in infrastructure maintenance and provision of equipment for public services' facilities are contributing to faster deterioration of infrastructure and services unadjusted to changing users' needs. Supervision is limited and relies on historical contracts with infrastructure providers. Citizens provide limited input to the investment planning and selection process [13]. A recent survey suggests that 85 percent of citizens report not to be consulted or aware of planned infrastructure investments. Consequently, limited resources are often not used for issues that citizens consider as the most urgent and investments fail to include the user needs in the design stage. Such an approach significantly reduces the potential impact of the scarce public investment resources. Although the regulatory environment for a participatory approach to infrastructure investment planning exists (*Law on State Administration, Law on Local Self-Government and the Law on the Planning System*), there is still limited application in practice, partially due to the lack of guidance and methodology for LSG on how to apply a participatory approach.

19. **Local SOEs have an important role in the provision of infrastructure services, but their operations are not modernized and adjusted to the changing citizen needs and technological advancements.** According to the data publicly available from the Business Registry, the Chamber of Commerce and line ministries, in Serbia there are 477 local-level SOEs with close to 60 thousand employees. Their total annual business revenues in 2019 amounted to almost EUR 1.9 billion, with total assets of more than EUR 5.2 billion. Local State-owned enterprises (SOEs) are often inefficient and are accumulating debts and liabilities. The total liabilities of local SOEs at the end of the year stood at approximately EUR 1.8 billion, out of which more than EUR 330 million relates to arrears. Fixed assets of local SOEs amount to more than EUR 4.3 billion, while annual depreciation costs amount to more than EUR 170 million. This means that local-level SOEs need to invest in fixed assets more than EUR 170 million every year only to preserve the capital base of their operations, while for further development and improvement of the quality of services, significantly larger investments are needed.

20. **Modern technologies are seldom used despite their high potential to improve the efficiency, effectiveness, quality, and accessibility of infrastructure in a cost-effective manner.** In Serbia, the penetration of smart phones is above 80 percent, and, on average, there are 1.2 mobile phones per citizen. The use of ICT has evolved with great popularity to the Smart concept - a series of initiatives that are integrated with broader LSGs efforts aided by technology to improve livability, competitiveness, and sustainability. For example, modern technologies can improve level of service provision, effectiveness of supervision, transparency, efficiency of public spending, etc. Despite the high ICT literacy and declining price of ICT equipment, in Serbia there is little utilization of ICT solutions in service provision and more efficient management of the available infrastructure.

21. **LSGs in Serbia face unprecedented economic, demographic, fiscal and environmental challenges that share an underlying need for the increase of local public investments into modern, efficient, reliable, and environmentally friendly infrastructure.** To promote local economic development, it is necessary to boost local public investment. Infrastructure enables trade, powers businesses, connects workers to their jobs and citizens to healthcare and education, creates opportunities for struggling communities and protects the nation from an

[13] World Bank Group (2020) Draft Serbia Systematic Country Diagnostic Update (SCD)

increasingly unpredictable natural environment. From private investment to publicly spending on transportation, water, buildings and parks, infrastructure is the backbone of a healthy economy. Local infrastructure investments can play a key role in this context. The post-COVID recovery phase offers a unique opportunity to build back a greener economy. LSGs have a key role to play in the pace and sustainability of Serbia's growth, but they seem to be falling short. Limited financing, weak public financial management systems at the local level, and weak capacities to plan and prioritize infrastructure investments and develop strategic plans, seem to be the main constraints for LSGs to play a more meaningful role in accordance with their responsibilities. This project will seek to address it by providing financing for local level infrastructure, equipping LSGs with asset management tools and strategic planning frameworks, strengthening capacities as well as the provision of incentives for improvements in implementation of public financial management systems at the local level.

Relationship to CPF

22. **The Systematic Country Diagnostic (SCD) Update was completed in April 2020 and emphasized the continued need to improve governance, efficiency and accountability across all levels of government, including at the subnational level.** The SCD Update highlights the need to start addressing the "next generation" of reforms related to environmental challenges to protect quality of life; strengthening climate resilience and supporting a low-carbon transition, and focusing on the specific needs of lagging regions. This will require improving urban economic performance; investing more in public services; upgrading urban infrastructure; making municipal administrators more accountable; and promoting resilience. The Serbia SCD Update states that improving infrastructure connectivity and institutional and governance structures at the local level can accelerate local development. It also argues that there is a need to increase transparency and effectiveness at the subnational government level. Local level capacities and governance and institutional weaknesses remain key constraints for progress across sectors. The country's governance challenges also impact the country's ability to reduce inequality, address environmental challenges, and demonstrate progress on EU accession-related reforms. The proposed project will support LSGs in assessing infrastructure needs, prioritizing, and effective project implementation, taking into account different needs and capacity between developed and lagging regions.

23. **While a new Country Partnership Framework (CPF) is planned for next year, the current CPF identifies infrastructure as one of the top priority areas.** The proposed Project is aligned with CPF *objective 2d -P5 enhanced infrastructure networks*. According to the CPF, improved efficiency in spending and better-quality maintenance of infrastructure are both critical, as well as improved prioritization of public investments and facilitation of private sector investment. The CPF consultation process brought out the criticality of the connection to infrastructure networks for the development of small cities, rural areas and communities. It showed the direct impact of infrastructure connections on rural economic development, as municipalities that lack access to infrastructure have experienced a much deeper economic decline accompanied with a greater number of people falling back into poverty[14]. Although the WBG has been heavily engaged in infrastructure development, both through investment support to transport (roads and railways) and energy sectors, further support to planning and management of infrastructure is needed.

24. **The proposed Project supports Serbia's greenhouse gas emissions (GHG) reduction goals and contributes to the CPF's and SCD's cross cutting theme of responding to climate change through mitigation efforts.** Serbia has committed to reduce its GHG by 9.8 percent by 2030, compared to 1990 levels. Optimizing the usage of infrastructure and maintenance cycles supports a more efficient use of resources. Ensuring stable financing and improving asset and investment management systems, will enable cities to more effectively use available resources

[14] WBG, 2015, Country Partnership Framework FY16- FY20

and focus toward investments that will increase infrastructure resilience and reduce environmental footprint. Through the establishment of eligibility criteria to access funding (to be further defined during project preparation), the project will support only projects that improve resilience and reduce the environmental footprint.

C. Proposed Development Objective(s)

The Project Development Objective is to increase efficiency, inclusiveness, and sustainability of LSG infrastructure service delivery

Key Results (From PCN)

Key output indicators:

- Implemented number of green and resilient **infrastructure investments**, disaggregated per sector (number)
- Number of **communities consulted** on infrastructure investment plans (number)
- MoUs signed between LSGs and central government including commitments for PFM improvements to be implemented during project implementation (number)
- Development and adoption of **asset management** framework (yes/no)
- Reform action plan for **fiscal decentralization** developed (yes/no)

Outcomes:

- Strengthened **financial sustainability** of LSGs infrastructure investments - measured as execution rate of LSG infrastructure investments (percentage)
- Improved **public funds management efficiency** - measured as share of infrastructure plans and budgets at the LSG level informed by the asset management framework to be developed (percentage)
- Improved **infrastructure service delivery** - measured as increase of citizens reporting satisfaction with infrastructure service delivery (by before and after surveys and gender disaggregated) (number)
- Enhanced **greening of infrastructure** - measured as percentage of subprojects at local level supporting low carbon, reduced pollution and/or climate resilient action (percentage)

Intermediate Outcomes:

- Improved **maintenance** of the infrastructure - measured as number of LSGs that are using the asset management tool for development of maintenance and rehabilitation plans (number)
- Increase **procurement transparency** and competitiveness - measured by percentage of cases where the procurement process has been followed according to the approved procedures (percentage)
- Support in **jobs creation** - measured by the number of people directly or indirectly engaged through the project, disaggregated by gender (number)
- Increased **capacity** - measured as number of trained officials at the LSG level, disaggregated by gender and age groups (number)
- Enhanced **citizen engagement** - measured by the share of participating LSGs that have used citizen consultations or deliberative polling to inform annual and multi-annual local investment plans, with women making up at least 40% of participants (percentage)

D. Concept Description

25. **The objective of the project is to improve LSGs' operational performance, financial sustainability and capacity to plan and deliver green and resilient infrastructure service.** The Project will be a mixture of

investment and technical assistance to boost green and inclusive infrastructure development and infrastructure service provision at the local level, including the implementation of the relevant chapters of SUDS, in particular measures 4 and 5[15]. The project will focus on strengthening capacities and technical approaches to implement existing regulatory and legal framework. The first component of the project will finance local infrastructure with a clear focus on greening infrastructure investments and service provision at the local level. The second component will focus on enhancing systems and strategic planning that should lead to improved local public financial management and infrastructure investment management. The third component will strengthen project management and LSG's capacity for infrastructure service provision. During implementation the team will discuss and scope out with counterparts a medium term operational support program in this respect that is informed by key LSG needs identified as well as findings and recommendations emerging from the SECO MDTF. The following principles are followed in the design of the operation:

a. The project is designed to open a path for a long term engagement in support of LSGs in Serbia. It will support the development of a policy and investment framework that can be strengthened over time, allow other development partners[16] to contribute and ultimately support EU accession and improved absorption of funds.
b. All LSGs will be eligible to participate subject to a signed MoU setting out performance expectations and compliance with government procedures. Maximum grant amounts will be set in accordance with an agreed formula (based on population, size, development gap)
c. The project will follow existing government systems (e-procurement, FM, planning and execution) where possible. The objective is to build implementation capacity and implement at decentralized level.
d. Infrastructure investment will be supported by improved asset management and concepts of building back better, resilience, decarbonization of the economy and creating a cleaner living environment.

26. **To incentivize change, the LSGs will receive grant transfers from the central level for infrastructure investments, and will sign an MoU with the central government, which will include a set of commitments to improve public financial and asset management at the local level.** The MoU will define the accountabilities and commitments of LSGs to improve strategic planning, infrastructure management, and financial performance. The financing for infrastructure to be provided by the project should be additional, and not substitute for existing infrastructure spending by LSGs. The project goal of supporting sustainable local infrastructure and enhanced capacities for local infrastructure investments will be achieved through implementation of the following three components: (i) Rebuilding better; (ii) Strengthening PFM and asset management systems; and (iii) Project management and capacity building.

a. **Component 1- Rebuilding Back Better:** The objective of this component is to promote infrastructure investment paradigm shift toward greening of infrastructure and improved infrastructure service delivery. This will be achieved by financing targeted infrastructure investments and modernization of service delivery. Each LSG will be eligible for grants for infrastructure investments up to a value determined per predefined formula, but the award of a grant will be subject to compliance with agreed eligibility criteria and commitment to improve infrastructure management practices as per the recommendations from the project. In addition to grant transfers, this component will finance technical assistance and selected pilots in the field of smart and efficient service delivery. Under the component the following will be financed: (i) Greening of Infrastructure; and (ii) Improved service delivery.

[15] Specifically, the component 1 will support measure 4.1.2; component 2 will support measures 5.2.2, 5.3.2, and Component 3 will support measures 5.1.1. and 5.1.5 from the SUDS

[16] In addition to the financing to be provided by this project, earlier discussions with development partners suggest that additional financing of EUR 70-80 million may be available to finance eligible investments, bringing the total available financing to EUR 140 million. Given that the LSGs annual expenditures on infrastructure are EUR 450 million, the amount envisaged under the component will raise infrastructure investments by LSGs by around 8 percent during a 4-year period. A limited increase will ensure that the LSGs absorption capacity is not overwhelmed.

b. **Component 2 – Strengthening PFM and Asset Management Systems:** The objective of this component is to improve the effectiveness and sustainability of infrastructure investments at the local level through strengthening LSGs' capacity for management of public finances and assets. The component will finance a mixture of technical assistance and development of tools to strengthen and equip LSGs with objective infrastructure investments planning and decision-making frameworks, with the focus on infrastructure maintenance and rehabilitation. In addition, the component will finance technical assistance to enhance the policy framework for financing infrastructure at the LSG level, with a focus on the fiscal decentralization framework and the ability of LSGs to raise commercial financing for infrastructure. To this end, the component will finance activities to: (i) enhance the policy framework for financing infrastructure at the LSG level; and (ii) strengthen public financial and asset management at the LSG level.

c. **Component 3 – Project Management and Capacity Building:** The objective of this component is to establish institutional set up that will enable successful implementation of the project and equipping LSGs with capacities to perform their infrastructure related functions in a sustainable manner. The PIU will be responsible for overall project implementation. Beside regular tasks, they will have a strong focus on providing a close support to LSGs during projects prioritization, preparation, procurement, and supervision, to ensure the project yields long term results. The component will also finance relevant capacity building activities and knowledge exchanges. To this end, the component will finance (i) project management and (ii) capacity building.

E. Implementation

Institutional and Implementation Arrangements

27. **The Project will be managed by the MCTI through a PIU, supported by the CFU in the MoF, and supported by employees in the municipalities officially assigned to the project.** The MCTI's PIU has already been established to manage the Serbian part of the WB Trade and Transport Facilitation Project and Railway Modernization Project MPA, and the same PIU will serve as the anchor point to establish the Serbia LIID PIU team. The already existent PIU in the MCTI will be extended with the team to implement the project, and strengthened with appropriate managerial and technical capacity to enable it to carry out (i) day-to-day implementation of project activities directly under its responsibility and (ii) support municipalities participating in the Project. It is envisaged that the PIU will be strengthened with the minimum of 9 highly skilled engineers that will support municipalities in project preparation and will review the quality of the submitted projects against the best practices and eligibility criteria. The CFU will be responsible for fiduciary issues like financial management and support to LSGs to implement procurements. The CFU will be strengthened with minimum 3 procurement specialists whose main task will be to raise procurement capacities of LSGs and guide the procurement of projects under the Loan. Municipalities will have their dedicated employee(s) in charge of managing the projects financed by the loan, including activities related to procurement, project preparation, and the introduction of improved policies and planning and management frameworks. Each beneficiary municipality will sign a MoU with the MCTI where mutual responsibility and obligations are defined. MoU will be defined in a Project Operational Manual. Among possible obligations of municipalities are to implement through the project proposed simplified asset management systems, planning and budgeting approaches, procurement as per the country procurement procedures and Bank clauses, preparation of individual project(s), data delivery, open data platforms, additional supervision of works, improved planning documents, etc.

Legal Operational Policies	Triggered?
Projects on International Waterways OP 7.50	No
Projects in Disputed Areas OP 7.60	No

Summary of Screening of Environmental and Social Risks and Impacts

The project will have long-term positive impacts, given its aimed green and sustainable footprint, but there is a number of potential short-term risks that need to be considered, mostly related to infrastructure investments under Component 1. The scope and exact locations of these interventions are yet to be determined, but all works are envisaged to be carried out within the scope of existing infrastructural facilities. In this regard, the potential environmental risks that could be identified are (i) impacts on ground and surface water, soil and air contamination (dust and noise); (ii) occupational health and safety (OHS) and access to work sites; (iii) improper waste management. To mitigate these risks the Environmental and Social Management Framework (ESMF) will be prepared, as the guiding instrument in addressing and mitigating community, environmental, and OHS risks in Project implementation. Components 2 and 3 should have no significant environmental impacts as they are focusing on strengthening policies and practices and project management and capacity building. The ESMF will include, but not limited to, gaps and responsibilities for ESF implementation and mitigation measures, a methodology for environmental and social risks and impact screening, as well as a list of non-eligible activities. The ESMF will also set forth a screening mechanism to ensure no substantial or high-risk activities are financed under the Project. The ESMF will also include provisions for the avoidance of any sensitive environments or protected areas, guidance for pollution prevention, waste management, and environmentally sound resource use under ESS3, and any guidance on cultural heritage or chance finds as stipulated under ESS8. The ESMF will include Labor-Management Procedures (LMP) and sections on Environment Health and Safety (EHS) which will set out the way OHS will be managed in accordance with the requirements of national law and ESS2. The site-specific ESMPs, as stipulated under the ESMF, will include provisions on traffic management, and other components on community safety in line with ESS4. Furthermore, a Grant Operation Manual (GOM) will be prepared in order to provide in a more detailed manner a list of eligible activities, selection process, and tools for environmental screening in line with the provisions of the ESMF.
Given the nation-wide scope and multisectoral character of the Project, the community engagement process will be two dimensional: (I) Presentation of Project and sector and sub-project selection and (ii) sub-project-specific community engagement. The first dimension of community engagement will focus on informing the public about the Project, Project objective, eligibility criteria for grants, etc. Once the sub-project is selected, the second dimension of engagement will present to the public the site specific impacts, opportunities, and challenges of the sub-project. In order to ensure timely and precise stakeholder identification a Project level Stakeholder Engagement Plan (SEP), acceptable to the Bank will be developed, disclosed, and consulted by the Borrower prior to Project Appraisal.
Considering the nature of the project, it can be presumed that the interventions will not cause large land take impacts. Mostly, small scale impacts for spot widening in urban areas are expected. Furthermore, minor impacts on livelihood are possible (e.g. relocation of kiosks or formal or informal stands). Resettlement resulting from Project activities is not expected. In order to address the aforementioned risks, the borrower will prepare a Resettlement Policy Framework (RPF) to establish resettlement principles, organizational arrangements, and design criteria to be applied to subprojects, and to mitigate potential resettlement impacts. Moreover, the RPF shall set out guidance for a detailed Social Analysis and screening procedure to assess the potential scale and scope of the loss of private assets and determine the potential relevance of the ESS5 for each selected sub-project. The RPF, satisfactory to the Bank will be prepared, disclosed, and consulted prior to Project appraisal.

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