PROJECT INFORMATION DOCUMENT

29989

Country Name:	Serbia and Montenegro (SaM)
Project Name:	Serbia—Second Structural Adjustment Credit (SAC II)
Region:	Europe and Central Asia
Sector:	Economic Management
Project ID:	PE-P078457
Borrower:	Government of Serbia and Montenegro
Implementing Agency:	Ministry of Finance of the Republic of Serbia (MOF)
Environment Category:	C
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Country Background

1. Under the present federal structure of SaM, the two republics—Republic of Serbia and Republic of Montenegro—are macroeconomically autonomous and are responsible for nearly all aspects of economic policy. The proposed operation will focus on Serbia, the larger of the two republics.

2. The 1990s was a lost decade for Serbia. Although the country started the period relatively well integrated with the world economy and with higher standards of living compared to many other transition economies, the Serbian economy was devastated as a result of armed conflicts, international sanctions, and trade shocks stemming from the break-up of the SFRY during the 1990s.

3. In January 2001, the new Government in Serbia launched an ambitious economic program with the objective to reverse the trends of the past—through ensuring a rapid transition to an open market economy and normalizing relations with international financial markets—and to integrate the economy with the European Union. More specifically, the economic program, which was supported by the IMF, World Bank, and other donors, contained four pillars: (i) implementation of prudent fiscal and monetary policies to achieve macroeconomic stability; (ii) rapid liberalization of most prices, removal of most quantitative restrictions on foreign trade, and rationalization of import tariffs; (iii) policy actions to establish effective institutions of macroeconomic policy; and (iv) implementation of a set structural reform measures in the labor market, trade policy, tax policy, bank restructuring, pension and social policy reform, public administration, judicial system, privatization—all of which aimed at improving the efficiency and flexibility of the economy.

4. The implementation of the economic program has been successful in establishing macroeconomic stability: Retail price inflation declined from 113.5 percent in 2000 to 14.8 percent in 2002 and further to 7.8 percent in 2003. As a result of higher oil prices, more flexible exchange rate policy, rise in the electricity prices, and increase in excise taxes, the inflation rate is projected to be between 8-9 percent in 2004. Serbia's GDP has

recovered from a sharp contraction of about 18 percent in 1999 owing mainly to the Kosovo conflict, growing by around 4 percent in 2002 and 3 percent in 2003. Real GDP growth in 2004 is expected to be around 4.5 percent. The performance on the fiscal side (gauged by meeting the program targets under the IMF supported economic program) to date has also been favorable.

5. The Government has also made significant progress in the implementation of structural reform measures, but not evenly across all areas. More specifically, there has been considerable progress in opening the economy, restructuring the banking sector, and adopting legislation in many areas aimed at harmonization with the European Union. In many areas, however, the reforms are still incomplete, and in several areas the reform process has hardly initiated. In this respect, the following policy areas should receive priority: (i) improving the private sector incentive framework; (ii) strengthening the productive, financial, and infrastructure sectors; and (iii) reforming the public sector—an area, which is crucial in the context of the implementation of the overall reform agenda.

6. The authorities realize the significance of the satisfactory progress in these policy areas for placing the country on a sustainable growth path and are determined to collaborate with international financial institutions towards successful implementation of their reform agenda. To this end, the Government in cooperation with the IMF and the World Bank has formulated a medium-term stabilization and reform program for 2002-05, which has been supported by a three-year Extended Arrangement approved in May 2002. Attaining sustainable growth and improved living standards, low inflation, and a viable external position constitute the main objectives of the program. As was envisioned in the Transitional Support Strategy agreed with the Government, the proposed operation will focus on key medium-term structural and institutional reforms and complement the macroeconomic program supported by the IMF.

Objectives

7. This operation aims to assist the Government of Serbia to undertake the structural reforms necessary to lay the foundation for enduring growth and to maintain macroeconomic stabilization over the medium-term.

Description

8. The operation supports economy-wide structural reforms aimed at promoting sustainable economic growth. The program will also contain reform measures to strengthen fiscal discipline, social protection, and public administration.

Financing

9. It is anticipated that the operation will be in the amount of around US$40 million disbursed in single tranche.

Implementation

10. As a result of the highly devolved nature of SAM and the different staring points, needs and pace of reforms in the two republics, the proposed operation will focus on the Republic of

Serbia. The Serbian Ministry of Finance will serve as the main Government counterpart which will ensure the overall coordination among several other agencies involved in the program: Ministry of Social Affairs, Ministry of Mining and Energy, the Electric Power Industry of Serbia (EPS), Ministry of Economy and Privatization, and Privatization Agency. Reforms to be supported under the Bank operation will be implemented through a variety of mechanisms, including inter-agency working groups and on-going technical assistance operations. Bank experts will assist the relevant officials and working groups.

Sustainability

11. Key to the sustainability of the proposed operation will be strong progress on the overall structural reform agenda and maintenance of macroeconomic stability. Both of these are supported under the proposed SAC.

Poverty Category

12. The operation will support immediate and longer-term poverty reduction through several channels. Its support for macroeconomic stability will reduce the risk of shocks, which can adversely affect the living standards of the poor. Its support for measures aimed at strengthening social protection will mitigate social costs of the reforms and safeguard people who are already disadvantaged. These measures will be accompanied by those directed at improving the targeting and transparency of energy benefits.

Environmental Aspects

13. The Loan would have no direct impact on the environment and (in line with operational OD4.02 and 8.60) has been placed in category C, which does not require an environmental assessment.

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