

**PROGRAM-FOR-RESULTS INFORMATION DOCUMENT (PID)  
APPRAISAL STAGE**

Report No.:PID0037090

<b>Program Name</b>	Program for Results on Modernization and Optimization of Public Administration
<b>Region</b>	East and Central Asia
<b>Country</b>	Serbia
<b>Sector</b>	Governance
<b>Lending Instrument</b>	Program for Results
<b>Program ID</b>	P155172
<b>Parent Program ID</b>	n/a
<b>Borrower(s)</b>	Republic of Serbia
<b>Implementing Agency</b>	Ministry of Public Administration and Local Self Government
<b>Date PID Prepared</b>	January 18, 2016
<b>Date of Appraisal Completion</b>	December 18, 2015
<b>Estimated Date of Board Approval</b>	March 18, 2016

**I. Country Context**

**1. The Republic of Serbia is an upper-middle-income country with a gross national income (GNI) per capita of US\$5,820 and a population of approximately seven million.** Serbia emerged from political realignments that followed the breakup of the former Yugoslavia in 1991. A political union with Montenegro lasted until 2006, when each country became a sovereign state, following a referendum in favor of Montenegro’s independence. During the final years of the union and the first few years of the new Serbian state (2001–2008), real gross domestic product (GDP) averaged 5 percent annually and poverty headcount declined from 14 percent in 2002 to 7 percent in 2007. However, the establishment of an independent Serbian state marked the beginning of a period of political uncertainty characterized by weak and fragmented political coalitions. Lack of political consensus hindered efforts to focus on critical economic and public sector reforms.

**2. In recent years, Serbia has faced significant economic challenges.** Since 2008, economic growth has stalled, reversing the progress made in earlier years. Average real growth dropped to zero and fiscal deficits averaged 6 percent of the GDP between 2009 and 2014. As a result, Serbia’s public debt more than doubled from 34 percent of the GDP in 2008 to 71 percent at the end of 2014. Subsidies and guarantees to public utilities, high levels of public sector employment, inefficient human resources management (HRM), and weaknesses in financial management (FM), have all contributed to Serbia’s fiscal challenges. With the economy in recession, the vulnerable poverty rate increased from 6 percent in 2008 to 9 percent in 2010, the latest year for which comparable data are available. Unemployment increased and by 2012 had reached a high of 24 percent.<sup>1</sup>

**3. In 2014, the government of Serbia (GoS) adopted an ambitious fiscal consolidation**

<sup>1</sup> Vulnerability to poverty measures the degree to which people are likely to be poorer in the next period.

**and structural reform program.** The program is supported by a 36-month standby arrangement with the International Monetary Fund (IMF), approved in 2014. In the short term, the program focuses on the control of aggregate wage and pension expenditures, improvements in tax administration, and reductions in subsidies to state-owned enterprises (SOEs). The government has also begun to address longer term structural problems in the administration of the public sector, focusing on public sector employment and restructuring to create opportunities for efficiency. As a result of these measures, total nominal government expenditures declined by 1.7 percent on account of major savings from wage and pension reforms (down by 11.4 and 3.5 percent, respectively) in 2014. The general government deficit over the first nine months of 2015 was 1.3 percent of full-year GDP, down from 3.9 percent in the same period of 2014. At the same time, the economy is starting to recover. Serbia moved out of recession in Q2 2015 with growth at 1 percent. It is expected to grow by 2 percent in Q3.

**4. Although the government remains committed to implementation of initiated reforms, there are significant risks to the macroeconomic framework.** These risks include (a) slower-than-expected economic recovery in the European Union (EU); (b) adverse shocks to capital inflows, relating to the normalization of U.S. interest rates or negative spillovers from other emerging economies; (c) a deterioration of the financial situation of foreign parent banks; and (d) implementation of the fiscal consolidation program. To mitigate these risks, the government is working closely with the IMF and the World Bank to ensure that key fiscal reforms in public administration, SOEs, and public utilities stay on track and generate the required fiscal savings.

## **II. Sectoral and Institutional Context**

**5. The GoS has launched an ambitious program of public sector reforms that seek to enhance efficiency in the public sector.** The government's overall framework for reforming public sector administration is set out in a Public Administration Reform (PAR) Strategy adopted in 2014. Together with the Action Plan for the Implementation of the Public Sector Reform Strategy (2015–2017) adopted in 2015, the strategy sets out the immediate priorities of the GoS with respect to key reforms in public administration. Both the PAR Strategy and the action plan cover five major areas of reform: (a) improvement of the organization and functioning of the public administration systems; (b) strengthening of HRM; (c) improvement of public finance and public procurement management; (d) increased transparency and enhancement of ethical standards; and (e) strengthening the government's supervision capacities. The PAR Strategy complements and incorporates elements of other strategic planning instruments, notably, the procurement strategy (2014), the public financial management reform program (PFMRP) (2015), and the action plan for open government partnership (2014). The Bank's engagement supports these reforms in the core systems of HRM, public financial management (PFM), and public procurement. These reforms are addressed in turn below with a focus on HRM, which in many respects, is the most challenging part of the reform agenda.

**6. Serbia faces significant challenges in HRM and related expenditure in the context of shrinking fiscal space.** Serbia's public sector wage bill increased from 9 percent of the GDP in 2002 to approximately 11 percent in 2008. Across the board staffing reductions and hiring freezes have helped contain the wage bill at an average of 11 percent of the GDP from 2009 to

2014. In recent years, the government has scaled down the formula tying wage adjustments to inflation, imposed a solidarity tax (in effect, a wage cut) on public employees earning more than RSD 60,000, and imposed a ceiling on individual public salaries. More recently, the government imposed an additional across the board 10 percent pay cut (as of November 2014) and modified the Budget Law to suspend wage indexation altogether in years in which the share of general government salaries (excluding severance pay) is expected to exceed 7 percent of the GDP. The government has also taken measures to reduce the number of staff, imposing a hiring freeze, and a cap on replacements (for example, for every 5 employees leaving, only one may be replaced), and sought to reduce overall government operational costs by 5 percent every year for three successive years beginning in 2015.

**7. To make further progress in containing the overall wage bill growth, the government will need to undertake fundamental reforms in the HRM system.** There is evidence of overstaffing in health, judiciary, police, and to some extent, in education sectors. There are also underlying problems in the structure of compensation. At present, the pay and grading system includes 2,200 job titles, 71 different elements of remuneration, 5 different base salaries, 900 different job coefficients, 19 laws, and a plethora of bylaws that regulate salary levels. Compensation rates are above market levels in low- skilled positions and below market levels for high-level positions (IPSOS, 2015). The complex and arbitrary nature of the compensation system undermines staff morale and renders the system vulnerable to ad hoc pressure from public sector unions.

**8. Deficiencies in the human resource information systems have undermined the ability of the government to control employment numbers.** Recent efforts by the government have led to the establishment of the first comprehensive registry of public employees since 2003. The current registry, however, has several shortcomings. Data on the total number of employees is inaccurate because participation by individual ministries is voluntary. The lack of strong information systems at the sector level to monitor staffing and employment data has undermined the ability of the government to control the wage bill in various sectors—the Ministry of Education, for instance, does not have accurate data on the number of teachers. There is no mechanism to link the various systems operating at the sector-level ministries with the large public administration payroll systems to monitor staff numbers, increase in staff complement over time, and total employment cost. This makes it difficult for the government to control staffing and wage bill management across the public sector. While the new Law on Registry is helpful, effective implementation requires a comprehensive human resource information system both at the sector level and at the central level.

**9. The government intends to revise the regulatory framework for public sector employment to enable further reforms.** The National Assembly has passed the Law on Ceilings on the Number of Employees in the public sector and the Law on Registry of Public Employees, and is in the process of finalizing the passage of the Law on Public Sector Salaries. Together, these laws and their associated bylaws will strengthen the legal and policy framework for managing the wage bill and employment practices across the public sector.

**10. The government will restructure the pay and grading system based on a comprehensive job evaluation and grading exercise.** The new structure will cover all public service employees including those in education, health, social protection, culture, tourism, and

sports (local government, police, defense, members of parliament, judiciary, and state agencies will have their own pay scheme). Under the proposal, all positions will be graded according to common criteria. Pay scales will be established for each grade, reflecting current market conditions and the government's fiscal constraints. Once this process is completed, new regulations governing the new pay and grading will be issued and the new pay system will be implemented.

**11. Finally, the government intends to rationalize staffing levels in a structured manner.**

To begin this process, the government is strengthening its registry of public employment by making it mandatory rather than voluntary and linking it to the payroll system to ensure that staff who are not recorded in the registry are not paid. At the same time, the government will launch a targeted staff reduction program. This rightsizing program seeks to improve the organization of the public sector, assign competencies among tiers of government, and organize work processes within institutions. Ministries are expected to simplify administrative procedures, eliminate redundant tasks, and eliminate or restructure departments with duplicate functions, thereby reducing the need for staff. To implement staffing reductions, the government has begun undertaking specific reviews of staffing needs in particular sectors and agencies. Following consultations with stakeholders, a retrenchment plan will be prepared and submitted to the cabinet. This will then be implemented through a combination of attrition, reassignments, and dismissals. The government will offer severance payments to staff occupying positions that are found to be redundant. These positions will then be eliminated.

**12. While the government has made progress in strengthening its PFM, the 2015 Public Expenditure and Financial Accountability (PEFA) assessment identified important weaknesses in the control framework and its coverage.**

The PEFA assessment period 2011–2013 was dominated by the aftermath of the global economic recession which affected macro-fiscal performances and posed particular challenges for PFM. In spite of these challenges, the PEFA assessment observed improvements in relation to the previous assessment in 2010 in the legislative framework for the budget process, budget classification, multiyear fiscal planning, procurement, and external audit. The assessment also noted significant weaknesses in the composition of expenditure out turn compared with the originally approved budget, expenditure arrears, oversight of fiscal risk and predictability in the availability of funds, application of public sector accounting standards, and the legislative scrutiny of annual budget law and final accounts. Building on the PEFA assessment, the Ministry of Finance (MoF) has prepared a PFMRP, aligned with the broader PAR, which sets priority actions in the short, medium, and long term.

**13. The immediate priority of the government's PFM reforms is to strengthen expenditure control and prevent the accumulation of expenditure arrears.**

Accumulation of expenditure arrears emerged as a significant problem during the economic crisis. In June 2013, the FMIS system reported arrears amounting to RSD 84,942 million (US\$1,003 million) equivalent to six percent of total expenditures in that year. During 2013, the government negotiated payment plans and conversion to public debt, reducing outstanding payment arrears to RSD 8.26 billion (USD 74 million). Action was also taken to curb accumulation of arrears, including a Law on Deadlines for Payments in Commercial Transactions which mandates a timetable for the payment of arrears and fines for government officials who fail to pay on time. An electronic Registry of Settlements of Pecuniary Commitments (RINO) was established to

monitor arrears. The RINO data indicates that payment arrears amounted to RSD 9 billion (US\$79 million) at the end of 2015. However, the RINO data should be interpreted with caution because the data submitted by budget beneficiaries is still not verified.

**14. Further reforms seek to address the systemic problems that have weakened expenditure controls and allow arrears to accumulate.** The government intends to strengthen the MoF budget department, increasing its staff's ability to prepare realistic forward estimates of revenues and expenditures, monitor budget execution, and improve cash planning. Budget entities will be required to submit quarterly reports on arrears and strengthen internal controls over contractual commitments to ensure comprehensive reporting. The MoF will also systematically roll out the Financial Management Information System (FMIS) to Indirect Budget Beneficiaries (IBBs) who are responsible for the bulk of the stock of expenditure arrears. Courts will be integrated into the FMIS by January 1, 2016; prisons and cultural institutions by January 2017; and social welfare centers by January 2018. This will leave only education institutions outside the FMIS in the beginning of 2018. Integrating these institutions into the FMIS will take more time due to their large numbers.

**15. The Public Procurement Law (PPL) of 2013 and its amendment in 2015 have significantly strengthened the legal framework for public procurement in Serbia.** The PPL provides for the decentralization of procurement activity to budget entities whilst streamlining procedures, creating a single register of bidders and reducing the scope for arbitrarily rejection of bids. It ensures transparency in the public procurement processes and requires the publication of a wide range of procurement related information through a public procurement portal. The PPL also sets out the competences of the two core agencies responsible for the public procurement systems. The Public Procurement Office (PPO) participates in the drafting of procurement regulations, manages the public procurement portal, prepares reports on public procurements, and provides technical assistance to contracting authorities and bidders. The Republic Commission for the Protection of Rights in Public Procurement Procedures (RC) is an autonomous and independent body of the Republic of Serbia which provides for grievance redress and tackles fraud and corruption (F&C) in public procurement. The commission reports directly to the parliament.

**16. While a robust legal framework for public procurement is in place, capacity constraints have undermined implementation.** The PPO currently lacks the capacity to fully discharge its functions and the RC lacks the capacity to handle appeals in a timely manner. Procurement is largely decentralized with about 4,900 registered contracting authorities, of which about 166 are central government entities. Contracting authorities are often familiar with procurement procedures. This has caused delays—it now takes about 120 days to complete a procurement procedure—and has also led to the purchase of inferior goods and services as tenders are inadequately specified and contracts are awarded solely on the basis of price.

**17. To address these problems, the government's Procurement Reform Strategy of 2013 identified priority reforms in three areas—capacity building, process improvements, and performance measurement.** The procurement capacity building program has sought to ensure that individual contracting authorities have adequately qualified procurement staff by implementing a large-scale training and certification process for public procurement officers. The government will extend its capacity building to encompass potential bidders in public

procurement. Improvements in procurement processes seek to gradually expand the use of centralized public procurement at the central and local levels through framework contracts. This will lower costs through bulk purchasing. Special attention will be paid to minimizing the adverse impact of centralized procurement on small and medium-sized enterprises. The PPO will prepare model tender dossiers and reach out to contracting authorities to bring more awareness. Finally, the government intends to develop a systematic approach for measuring procurement performance to inform ongoing policy reforms and its operational support.

### III. Program Scope

**18. The proposed PforR on Modernization and Optimization of Public Administration supports the implementation of two out of the five objectives of the Action Plan for Implementation of Public Administration Strategy (government's program).** These are, respectively, the establishment of a public service system based on merits and promotions of HRM and improvement of public finances and public procurement management. This selective approach is deliberate. The three key areas of the Program namely, improving human resource management, improving financial management and improving procurement management, are not only the focus of the government's action plan, but are also directly linked with the immediate concerns of the government's fiscal consolidation agenda supported by the IMF. It enhances synergy with operations financed by other DPs, notably the EU's Sector Budget Support. It also reflects the key areas where there has been sustained engagement by the Bank through operational and knowledge products.

### IV. Program Development Objective(s)

**19. The Program Development Objective (PDO) is to improve efficiency in public sector employment and finances.** In this context, efficiency is the reduction in the cost of doing government business. This will be achieved by addressing systemic weaknesses in allocation of employees and their remuneration, streamlining and rationalizing public procurement, and strengthening controls over public expenditure.

**20. Progress toward the achievement of the objective will be measured using the following outcome indicators:**

- **PDO Indicator 1:** Share of public administration employees assigned to new pay grades according to the Public Sector Wage Law (percentage);
- **PDO Indicator 2:** Total number of public administration employees at or under the annual ceiling prescribed by the Law on Maximum Number of Employees (yes/no);
- **PDO Indicator 3:** Share of redundant public administration employees receiving redundancy payments (percentage);
- **PDO Indicator 4:** Share of public administration procurement over RSD 5 million in value, awarded in the fiscal year, within a duration of 90 days or less between

issuance of bidding documents and award of contract (percentage);

- **PDO Indicator 5:** Value of public procurement contracts awarded through Framework Agreements (RSD);
- **PDO Indicator 6:** Share of payments for commercial transactions in Budget Execution System (BES) which are based on previously reported commitments in line with legislation (percentage).

## V. Environmental and Social Effects

**21. An environment and social safeguards assessment (ESSA) was carried out in September 2015 in consultation with the MPALSG.** Formal consultations with key stakeholders on the draft ESSA were held in November 2015. The assessment draws on interviews with key stakeholders supplemented with a desk review of the various laws and regulations. See annex 6 for a detailed summary of the assessment.

**22. The ESSA determined that the Program poses no major environmental risks but identified social risks related to potential retrenchment of public sector employees.** The program will support policy measures that seek to improve efficiency in HRM. These measures are expected to include reductions in staffing numbers and retrenchment. The numbers of affected employees will be determined during program implementation. The government has communicated on multiple occasions, in media, that cost reductions and staffing cuts in the public sector are necessary as a part of fiscal consolidation measures, arguing that these measures will create an enabling environment for investments and job creation in the long term.

**23. The ESSA concludes that adequate arrangements are in place to deal with the social impacts arising from the Program.** Serbia has a relatively well-developed policy and legal framework on labor relations and retrenchment, along with an institutional system that is generally adequate. The Ministry of Labor and the NES have acquired solid experience and the skills needed to manage large retrenchment during the privatization of SOEs, which occurred over the past fifteen years. The NES, as an implementer of the employment policy, has specific programs targeting support for retrenched workers, women, and vulnerable groups.

**24. The government has included specific measures to mitigate any adverse effects associated with retrenchment in the action plan.** The Bank will collaborate with the authorities during the implementation phase and will provide support necessary for implementing the actions recommended by the ESSA. The government has agreed to undertake the following measures related to mitigating social risks for the affected people:

- Ensure that the MPALSG has staff assigned to coordinate, monitor, and report on the rightsizing process and its effects
- Improve consultations with workers and workers organizations
- Ensure that the criteria for selection of those employees who will be categorized as

redundant are based on the principles of transparency and nondiscrimination, and that, the criteria is applied consistently, with employees having adequate appeals procedures;

- Employers in the public sector will prepare retrenchment plans
- Work closely with the NES to develop an action plan for supporting employees who have been separated, including training plans
- Ensure documentation of the profiles of those retrenched in terms of age, education, and disability
- Prepare active employment measures for retrenched women
- Monitor severance payment disbursement and status of retrenched workers

**25. Communities and individuals who believe that they are adversely affected as a result of a Bank supported PforR operation, as defined by the applicable policy and procedures, may submit complaints to the existing program grievance redress mechanism or the Bank's Grievance Redress Service (GRS).** The GRS ensures that complaints received are promptly reviewed to address pertinent concerns. Affected communities and individuals may submit their complaint to the Bank's independent Inspection Panel, which determines whether harm occurred or could occur, because of the Bank's noncompliance with its policies and procedures. Complaints may be submitted at any time after concerns have been brought directly to the Bank's attention and the Bank management has been given an opportunity to respond.

**26. Serbia's legal framework or the prohibition of discrimination and the anti-discriminatory policy is aligned with the EU conventions and harmonised with the three key EU directives.** These are the Council Directive 2000/43/EC implementing the principle of equal treatment between persons irrespective of racial or ethnic origin; Council Directive 2000/78/EC establishing a general framework for equal treatment in employment and occupation; and Directive 2006/54/EC on the implementation of the principle of equal opportunities and equal treatment of men and women in matters of employment and occupation. Serbia has a Law on the Prohibition of Discrimination and has adopted the National Antidiscrimination Strategy. In 2015, the action plan for the implementation of this strategy, supporting measures in a number of sectors of society, was adopted.

**27. A National Strategy for Improving Gender Equality 2016–2020 is currently being drafted.** An official report on gender equality in Serbia (men and women in Serbia), published by the Statistical Office of the Republic of Serbia in 2014, recorded a number of discrepancies in male and female participation in the labor market—activity rate of women aged 25 to 54 years is 14 percent lower than the employment rate of men of the same age. The public administration system in Serbia has more women than men. However, women account for only five percent of the Serbian government; less than 30 percent of members of parliament and around 25 percent of state secretaries. At the local government level, women comprise only five percent of municipal presidents and 29 percent of the membership of municipal councils and assemblies. This is in contrast to other segments of the public sector where women constitute the majority of



employees—in education (72 percent) and health and social work (80 percent), women represent a significant majority of employees. Women are likely to be the most affected by the proposed reduction in public sector employment.

**28. The Social Systems Assessment Program Action Plan proposes actions to reduce the burden of reforms on women.** This includes measures that reinforce protection of women in instances of retrenchment provided by the national legislation, such as protection of women on maternity leave, women-headed households, and mothers of children under the age of two. The criteria for selection of employees to be made redundant must be based on the principle of nondiscrimination. The retrenchment plans and requests for redundancy (severance) payment will include segregated information according to gender to monitor and identify possible adverse gender impacts. When identified, these impacts and remedial measures will be reviewed by the MPALSG and adjustments made in the retrenchment program where appropriate.

## VI. Financing

### PROGRAM FINANCING

(\$Million)		
Source	US\$	%
Government	166	69
IBRD	75	31
Other Development Partners	-	-
<b>Total Program Financing</b>	<b>242</b>	<b>100</b>

## VII. Program Institutional and Implementation Arrangements

**29. The Program will adopt the institutional coordination arrangement of the PAR Strategy.** The PAR Strategy outlines three levels of management. The PAR Council, chaired by the prime minister, sets policy and coordinates PARs. The Board of State Secretaries, comprising senior civil servants from all ministries, supports the PAR Council. An Inter-Ministerial Working Group comprising representatives of ministries is tasked with technical and operational coordination of the PAR implementation, including the development of strategies and action plans and adoption of reports on the implementation. Issues that cannot be resolved by the Working Group are submitted to the Board of State Secretaries.

**30. The MPALSG is the lead implementing agency.** The MPALSG oversees the day-to-day management of the program, including the coordination of results monitoring and reporting

in collaboration with other participating agencies. Additionally, the MPALSG, the TA, and the PPO are directly responsible for implementation of each of the result areas. The Public Policy Secretariat (PPS) will be responsible for coordinating data collection, verification of results, and reporting on program performance. Procurement and FM will be undertaken by individual agencies based on Serbian country systems. The Serbia State Audit Institution (SAI) will be responsible for auditing the program financing.

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