Program Information Document (PID)

Appraisal Stage | Date Prepared/Updated: 19-Jan-2023 | Report No: PIDA35160

BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Project Name	Parent Project ID (if any)
Serbia	P177410	First Serbia Green Transition Programmatic Development Policy Loan (P177410)	
Region	**Estimated Board Date**	**Practice Area (Lead)**	**Financing Instrument**
EUROPE AND CENTRAL ASIA	09-Mar-2023	Macroeconomics, Trade and Investment	Development Policy Financing
Borrower(s)	**Implementing Agency**		
Republic of Serbia	Ministry of Finance		

Proposed Development Objective(s)

The objective of the proposed programmatic Green Transition Development Policy Loan is to support the Government of Serbia's efforts to: 1) better align fiscal management with the climate-change agenda, 2) accelerate the clean energy transition, and 3) align with European Union standards on environment and climate action.

Financing (in US$, Millions)

SUMMARY

Total Financing	160.00

DETAILS

Total World Bank Group Financing	160.00
World Bank Lending	160.00

Decision

The review did authorize the team to appraise and negotiate

B. Introduction and Context

Country Context

The objective of the proposed Development Policy Loan (DPL) series is to support the Government of Serbia's efforts to: 1) better align fiscal management with the climate-change agenda, 2) accelerate the clean energy transition, and 3) align with European Union standards on environment and climate action. These objectives have become even more relevant as Serbia recovers from the COVID-19 pandemic and navigates the international energy crisis. The loan for US$ 160 million is the first in a programmatic series comprising two loans, that helps solidify a reform agenda initiated recently by the government. The French Development Agency (Agence Française de Développement, AFD) and German Development Bank (Kreditanstalt für Wiederaufbau, KfW) are financing the same policy matrix with two parallel loans worth up to Euro 135 million each.

The economy rebounded in 2021, with growth reaching 7.5 percent after the COVID-related recession in 2020. But the pandemic was followed by other shocks that have affected Serbia recently, several of them climate related. Firstly, the energy crisis which started in the latter part of 2021 and continued through 2022, coupled with degraded domestic generating capacity and the need to import electricity, coal and gas at exceptionally high prices has created large fiscal costs and pushed inflation upwards. Secondly, drought has reduced domestic agricultural output two years in a row (2021 and 2022) at a time when international food prices are also rising sharply. While the macroeconomic framework is adequate, and the macroeconomic risk is still assessed as moderate, there are some risks due to external developments (i.e. the global economic recovery and international prices) which might have an impact on FDI, exports and terms of trade.

Relationship to CPF

The proposed DPL series underpins the overarching objective of the Serbia Country Partnership Framework (FY22-26) on fostering growth that is sustainable across generations. The DPL series directly supports CPF Higher Level Outcome – 1: Growth that is greener and more resilient, specifically objectives 1.1 (structural reforms for greener growth) and 1.2 (green investments and just transition). The three pillars of the DPL series aim to ensure that Serbia achieves a robust recovery from the impact of COVID-19 with higher and resilient growth and broadly shared prosperity. The need to address environmental and climate vulnerabilities has been identified as development priority for the country and a transition away from coal is recognized as unavoidable if Serbia wants to continue accessing international finance from public and private sources.

C. Proposed Development Objective(s)

The objective of the proposed First Serbia Green Transition Programmatic Development Policy Loan is to support the Government of Serbia's efforts to: 1) better align fiscal management with the climate-change agenda, 2) accelerate the clean energy transition, and 3) align with European Union standards on environment and climate action.

Key Results

Reforms supported under Pillar I of this loan (in-year reporting on budget execution, fiscal impact estimates of different risks and prioritization of environment and climate-friendly projects within the public investment management framework) will help the authorities to increase transparency of budget expenditures, to prepare better for situations when some fiscal risks materialize and to increase investment from budget in projects that address environmental and climate concerns. Reforms supported under Pillar II of this operation (in the fields of energy efficiency, renewable energy, corporate reform and financial stabilization of utilities, and protection of energy vulnerable households) should promote greater investment in renewable energy and energy efficiency projects, make the renewable energy market more dynamic and ensure financial sustainability of the national electricity utility PE “Elektroprivreda Srbije” (EPS) while protecting the most vulnerable consumers. Reforms supported under Pillar III relate to the environment and climate change (introduction of the monitoring and reporting system related to GHG emissions, better management of municipal solid waste, and strengthening of efforts to improve air quality) should provide a basis for better reporting on meeting GHG emission targets, increase the share of waste being managed and stimulate introduction of a broad set of measures aimed at reducing air pollution.

D. Project Description

The programmatic series’ objective is to support the Government of Serbia’s efforts to: 1) better align fiscal management with the climate-change agenda, 2) accelerate the clean energy transition, and 3) align with the European Union on environment and climate action. To maintain a stable macro-fiscal framework and promote climate smart fiscal policy is a necessity, especially in the context of renewed fiscal constraints due to the pandemic and the ongoing energy crisis. The proposed operation supports reforms in the first pillar that comprise: Prior Action #1: in-year reporting on the budget execution to increase transparency on budgetary spending including on environment and climate-related activities; Prior Action #2: the fiscal risks assessment methodology to take into account the potential impact on public finances caused by natural disasters, and Prior Action #3: the public investment management system to take into account environment and climate-related criteria. The second pillar supports the GoS’s efforts to speed up a sustainable transformation of the energy sector, which includes: PA#4: increase the share of renewable energy, PA#5: efforts to improve residential energy efficiency, PA#6: accelerate energy market reforms, and PA#7: ensure financial sustainability of the EPS and strengthen the support for energy-vulnerable consumers. Finally, under the third pillar, the operation aims to support the alignment of domestic legislation with European Union legislation to reduce GHG emissions, improve waste management and enhance air quality by: Prior Action#8: adopting regulation related to monitoring and reporting on GHG emissions; Prior Action#9: amending the waste management legislation and Prior Action #10: adoption the National Air Protection Program.

E. Implementation

Institutional and Implementation Arrangements

The Ministry of Finance (MoF) coordinates the overall implementation of the DPL program of reforms. The MoF is the main counterpart for this operation and coordinates the preparation and implementation of supported reforms with all line ministries and institutions involved in the DPL. The line ministries and institutions report on the prior actions and result indicators to the MoF as and when requested. The Ministry of Finance is responsible for reforms under Pillar I in close coordination with the Ministry of Environmental Protection (MoEP), while reforms under Pillar II are the responsibility of the Ministry of Mining and Energy (MoME) and the state-owned energy companies (PE EPS and EDS Ltd). Some PAs under this pillar need to be coordinated with the MoF since there are budgetary implications (for instance for PA#7 related to protection of energy vulnerable consumers). Pillar III is almost entirely responsibility of the MoEP, and like for Pillar II there is a need for close coordination with the MoF. In addition, the team consults and coordinates with the offices of the Prime Minister and the President as some decisions require their input and coordination. In general, government agencies have the capacity to provide good and timely data. Available data are generally reliable, with Serbian institutions increasingly producing data in line with international standards (Eurostat in particular).

F. Poverty and Social Impacts, and Environmental, Forests, and Other Natural Resource Aspects

Poverty and Social Impacts

The program supported by this DPL series is expected to lead to welfare improvements in the medium term through supporting a green, resilient economic recovery, though some of the actions are expected to have mixed social and distributional impacts in the short term. Under Pillar I, Prior Action #1 on fiscal transparency is not expected to have major poverty or social impacts. But to the extent that this may contribute to further spending and investment on targeted social programs and to mitigate climate change and address environmental concerns, Prior Action #1 may benefit poor and vulnerable populations in the medium term. Prior Action #2 is expected to deliver poverty and social benefits by setting up a budgetary reserve dedicated to addressing natural disasters. Prior Action #3 with prioritization of environment and climate change-related public investment projects is also expected to benefit poor and vulnerable populations, who often suffer more from environmental hazards and the negative impacts of climate change. The proposed set of measures under Pillar II is expected to have mainly positive poverty and social impacts. In Prior Action #4, the secondary legislations to expand renewables are not expected to impact electricity tariffs or have significant adverse poverty or social impacts on consumers, while enabling expansion of the prosumers program might have a positive impact. Prior Action #5 is expected to have positive social and distributional impacts since the new EEA will support households with grants for energy efficiency investments that will help to reduce their energy bills and improve the living conditions, including air quality. The EEA is envisioned to run a scaled-up subsidy program that targets larger grants to poorer municipalities and lower-income households. Prior action #6 is not expected to have negative social impacts from the human resource unbundling of the distribution company EDS Ltd: the process of transferring employees from the old integrated company to the newly spin-off distribution company was conducted in a fair, transparent and voluntary manner in consultations with unions and workers. Prior Action #7 is expected to have mixed poverty and social impacts. The new tariff increases supported by this DPL in 2022 and 2023 are expected to have only a moderate impact on purchasing power and result in a 0.5 percentage point increase in the poverty rate and the share of electricity spending in the total household budget. In addition, the expansion of the benefits for energy-vulnerable consumers under Prior Action #7(i), with a three-fold increase of households eligible for the energy vulnerable protection program will likely further limit the poverty and social impacts. The proposed set of measures under Pillar III is expected to improve livelihoods by reducing air pollution and unmanaged solid waste in the near term. In particular, positive social and poverty implications are expected from Prior Action #10 (National Air Protection Program), given that low-income households and marginalized groups are more adversely impacted by low air quality, due to higher exposure to pollutants where they live and lower access to protection measures and healthcare.

Environmental, Forests, and Other Natural Resource Aspects

Given the overall green aim of the operation, all PAs are likely to have positive environmental impacts, to some extent, and no significant adverse impacts on environment, forests and natural resources are expected. Significant positive environmental effects are expected under the proposed prior actions in Pillar II (Accelerating the clean energy transition) and Pillar III (Aligning with the European Union on environment and climate action), by delivering reductions in GHG emissions, emissions of other air pollutants as well as reductions in insufficiently managed solid waste, while possible adverse impacts on the environment (in terms of generation of electrical waste, used batteries and used solar panels, etc.) are expected to be moderate to negligible. More indirect but similarly positive environmental effects are expected under the proposed prior actions in Pillar I (Better align fiscal management with the climate-change agenda), delivering improved climate change related budget management.

G. Risks and Mitigation

The overall risk for this operation is moderate since all risk categories are assessed either as moderate or low risk. Nevertheless, a number of mitigating measures have been taken during the course of preparation of this DPL series. For instance, the quality of governance has been stagnating or deteriorating recently, as assessed by several international institutions, including the Bank's Worldwide Governance Indicators. This operation will help improve the governance through increased fiscal transparency (PA#1). Similarly, the macroeconomic risk is rated moderate even though the global economic environment is uncertain and subject to further shocks caused by the international energy crisis, increase in interest rates on international financial markets, and a slower-than-expected pace of recovery among Serbia's main trading partners. However, this DPL series supports reforms aimed at better budget management, assessment of fiscal risks and prioritization of capital expenditures (PAs 1-3 in the first Pillar). In addition, the government reached a staff-level agreement on a new arrangement with the IMF (approved in December 2022), which will help ensure macro-fiscal stability and further mitigate possible risks mentioned above.

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APPROVAL

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