I. Project Context

Country Context

1. Serbia in its first decade of transition (2000-2008) experienced dynamic, albeit unsustainable economic growth, and a significant reduction in poverty. The economy grew at an average rate of about 5 percent during this period, fueled by capital inflows and a credit boom. This led to a rapid expansion in the domestic demand which in turn resulted in high and increasing current account deficits. This consequently caused a significant build-up of debt throughout this period and peaking at about 80 percent of GDP in 2009. Poverty fell from 13.4 percent in 2002 to 6.1 percent in 2008, which translated into about half a million people (about 7 percent of the population) moving out of poverty.

2. Serbia’s economy was severely impacted by the 2008 global economic crisis. The global financial crisis ended capital inflows and access to easy credit, and significantly slowed down investment. In 2009, the Serbian economy entered recession; real GDP dropped by 3.5 percent and unemployment increased significantly to 22 percent. The economy’s growth in 2010 and 2011 was lackluster, averaging 1.3 percent. Consequently, poverty jumped back to 9.2 percent with around 230 thousand people falling back below the poverty line.

3. After low GDP growth in 2010 and 2011, Serbia is facing a double-dip recession. According to the latest estimates, GDP is estimated to have dropped by about 2 percent in 2012, but is expected
to grow at around 2 percent in 2013 and 3-4 percent per year over the medium term. Unemployment continues to be high reaching a peak level of 25.5 percent in April 2012. The main policy challenges are balancing growth-enhancing policies with fiscal consolidation. Therefore measures to improve the investment climate, including cutting red tape, implementing regulations to support the private sector, and making the labor market more flexible are expected to be policy priorities.

4. At the same time, Serbia has undergone a remarkable period of political change. The previous government was the first one to serve its full, four-year mandate. The direction taken by the new government elected in 2012 demonstrates the willingness to urgently address macroeconomic imbalances. The Serbian society has generally endorsed the Government of Serbia’s (GoS) actions which have not deviated from the agenda of EU accession, fiscal discipline and structural reform. Serbia gained European Union (EU) “candidate” status for membership in March 2012. This landmark event reflects the significant progress Serbia has made thus far in its reforms. Going forward, Serbia needs to develop trade beyond Europe and to make the most of EU accession increasing the economy’s export orientation.

II. Sectoral and Institutional Context

5. Serbia is at the crossroads of South East Europe; having an efficient transport network is essential for the country’s economic growth. The international roads and railways crossing Serbia represent the shortest link between Western and South Eastern Europe and Greece, Turkey and further east. Corridor X of the Trans European Network (TEN-T) connects Austria/Hungary, Slovenia/Croatia, Serbia and Bulgaria/Macedonia/Greece. The Government and international financial institutions (IFIs) are financing the construction of several road segments on Corridor X through the on-going Corridor X Highway Project (CXHP). (See Project Appraisal Document June 12, 2009, Report No. 47069-YF.) The Bank Loan, US$388 million, is financing the completion of the Southern axes of the Serbian segment of Corridor X. The backbone of the Serbian rail network is also along the Corridor X corridor, about 870 km, with branches to the Hungarian and Bulgarian borders. GoS is in the process of upgrading the Corridor X rail line.

6. The road network is a major asset for Serbia but connectivity and road conditions need improvement to support economic growth. The road network, estimated to have an asset value of US$13 billion, extends 40,800 km, including about 9,500 km of national roads. Road transport is the dominant mode in Serbia, with a share of 80 percent of total cargo transport and about 74 percent of total passenger transport. Despite the importance of the road network, the quality of road infrastructure appears to have declined in the past few years. While a 2010 survey of the National Road Network indicated that 48 percent of the network was in good condition, the 2012-2013 Global Competitiveness Report (GCR) ranked Serbia 122nd out of 144 countries on road quality. While this represents an improvement from its 131st position out of 142 countries in the 2011-2012 GCR, it is a significant drop from the 2008-2009 GCR ranking of 83rd out of 134 countries. The poor quality of roads manifests itself in high vehicle operating costs and inadequate road safety; and reduces Serbia’s overall trade competitiveness.

7. The Ministry of Transport (MoT) is responsible for policy, while the Public Enterprise “Roads of Serbia” (PERS) is responsible for construction, maintenance, operation and management of national roads. Road sector institutions in Serbia have undergone major institutional reforms in the past few years. The Serbia Roads Directorate was transformed into a PERS in 2008, and the Ministry of Capital Investments into MoT. In early 2009, GoS established the Corridor X Company, a PERS subsidiary for construction of Corridor X. In 2010 the Company was transformed into Corridors of
Serbia (CoS) to manage road construction projects of national strategic importance.

8. MoT is initiating a National Road Network Rehabilitation Program (NRNRP) to improve the quality and safety on priority national roads thus improving connectivity of the entire road network. With the support of the EU, MoT has developed a Transport Strategy and Master Plan that envisage a €4.6 - €5.0 billion investment in maintenance and rehabilitation between 2009 and 2027. About 5,000 km of national roads (slightly over 50 percent of the National Road Network) have been identified as high priority; and financial support from several IFIs is being sought to implement the rehabilitation works. In the first phase, about 1,125 km will be rehabilitated incorporating safety considerations in the design.

9. Budgetary allocations to maintenance have dropped below annual requirements resulting in a large maintenance backlog. Annual maintenance expenditures averaged about €290 million between 2005 and 2011, but have been generally on a downward trend dropping from about €360 million in 2006, to €194 million in 2010 and further to €168 million in 2011. The reductions were a result of the financial crisis and the Government’s commitment to completing CXHP and the Belgrade bypass. Given the economic outlook in Serbia and the need for fiscal consolidation, a further reduction in road maintenance expenditures is likely. Current funding levels are insufficient to meet the annual needs, let alone address the maintenance backlog. Annual needs for routine, periodic and backlog maintenance for the period 2009 - 2011 were estimated at €500 million (of which €240 million is for routine and periodic maintenance).

10. Besides inadequate funding for the National Road Network, asset preservation management and contracting practices remain inefficient and in need of modernization. While the regional maintenance companies have been privatized, with the exception of two pilot hybrid Performance Based Maintenance Contracts (PBMC) financed under the Bank’s Transport Rehabilitation Project (TRP), competitive tendering of maintenance works is not used. All the companies still operate in the same region for which they were responsible (a total of about 26 regions) before privatization through annual extensions of their contracts. The contract model for road maintenance was developed in 1992 and is based on unit rates set by PERS. In addition, the road database and condition surveys are not used for maintenance planning.

11. The Bank-supported TRP financed road rehabilitation and strengthened rehabilitation and maintenance planning and management. The US$105 million loan for TRP financed the rehabilitation of over 200 km of national roads. In addition, TRP supported hybrid PBMC for 1,100 km on the National Road Network in the Macva and Kolubara regions which resulted in significant savings in comparison to unit price approach and demonstrated the potential of this contracting approach. TRP also supported better planning by helping establish the road asset database, and introducing systematic maintenance planning and programming based on sound economic efficiency criteria (using the Highway Development and Management Model—HDM4). In addition, condition surveys for the entire National Road Network were conducted under TRP in 2008 and were used in the preparation of NRNRP and the Road Rehabilitation and Safety Project (RRSP).

12. Serbian authorities are improving road safety but the social cost of traffic accidents remains high. The level of injuries and fatalities caused by traffic accidents is a growing social and economic cost for the country. Between 2001 and 2010, there were about 9,000 fatalities and 190,000 injuries resulting from road traffic crashes in Serbia. While road fatalities have dropped significantly from 1,275 in 2001 to 656 in 2010, injuries have only dropped slightly over the same period from 20,000
to 19,300. According to the latest data of the World Health Organization (2009), the number of traffic fatalities per 100,000 of population in Serbia is about 9 which is high compared to EU countries such as the Netherlands, Germany and France where traffic fatalities are in the 3 to 6 range. While there is no official estimate of the socioeconomic costs of road accidents in Serbia, some estimates suggest a cost as high as 2.0 percent of GDP.

13. The Bank through TRP and CXHP has been supporting road safety initiatives in Serbia since 2004. TRP financed the removal of 18 blackspots and improvement of road safety design practices, and CXHP is financing and supporting the implementation of a comprehensive road safety program, involving all affected stakeholders. In 2009, CXHP helped establish the Road Traffic Safety Agency (RTSA) and is now helping build its capacity. CXHP-financed activities also include developing a National Road Safety Strategy, developing a road accident database, undertaking road safety audits and developing awareness campaigns and capacity building activities for the different stakeholders. During the past few years, GoS has also been earnest in road safety institutional and policy reforms. The Road Safety Law (RSL), adopted on May 29, 2009, represents the first major update in legislation since the 1980s and addresses many aspects of the EU Transport Acquis Communautaire and the recommendations given in the Road Safety Capacity Review funded by the WB Global Road Safety Facility. In 2009, GoS passed legislation mandating the incorporation of an independent safety audit by an accredited road safety auditor in road design.

14. The Project is a part of a larger IFI effort to rehabilitate the Serbian national roads. EBRD and EIB are also supporting the development of the transport sector and the National Road Network in Serbia. Nearly half of EIB’s total lending to Serbia between 2001 and 2010 period has been to upgrade the road network. EBRD has been the country’s second largest investor since 2001 with transport infrastructure being a main focus area. RRSP will build on the achievements and the strong engagement of the IFIs in the sector over the past decade.

III. Project Development Objectives
The proposed PDO is to improve the condition and safety of the National Road Network for road users by supporting the Republic of Serbia in the implementation of the first phase of its National Road Network Rehabilitation Program.

IV. Project Description
Component Name
15. Road Rehabilitation & Safety Investments will finance periodic maintenance & rehab works, partial pavement widening, works concerning traffic signalization improvement & structure renewal.
16. Institutional Strengthening, consists of 3 subcomponents: (i) Support to Road Safety; (ii) Strengthen Road Rehabilitation and Planning Processes; and (iii) Strengthening Maintenance Management.
17. Project Detailed Design, Supervision, Management & Monitoring consists of 3 subcomponents: (i) Design and Supervision; (ii) Project Management Support; and (iii) Project Audits.

V. Financing (in USD Million)
For Loans/Credits/Others Amount
Borrower 150.48
International Bank for Reconstruction and Development 100.00
EC European Investment Bank 131.83
VI. Implementation

18. The Project Implementation Team (PIT) within PERS will be responsible for day to day project implementation. The PIT is staffed with financial management and procurement specialists familiar with Bank procedures. The capacity of the PIT was assessed and deemed adequate to prepare and implement activities for the first 18-month of the Project. However, given the size of the first phase of the NRNRP and the innovative features of linking disbursement to preset indicators, the Project will finance consultants to provide project management support to the PIT during project implementation when necessary.

19. Enhanced implementation arrangements for the Project’s road safety interventions. Implementation arrangements for the road safety interventions will be coordinated with the National Road Traffic Safety Coordination Body (NRTSC) through the Road Traffic Safety Department in MoT which acts as the Secretariat of NRTSC. NRTSC was established by the 2010 Road Traffic Safety Law to harmonize, as well as initiate and oversee road safety efforts. It is composed of the ministers of transport, interior, health, labor, justice, education, and trade, and chaired by the Minister of Transport. NRTSC has seven working groups each covering a specific functional area of road safety.

20. At the working level a member of the each of the three workings groups dealing directly with the project’s activities (road safety infrastructure, enforcement by traffic police, and children’s traffic safety) will be part of PERS’s PIT to strengthen implementation of the enforcement and awareness/education activities.

VII. Safeguard Policies (including public consultation)

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VIII. Contact point

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