

DRAFT PROGRAMME
AN INTIAL SUPPORT PROGRAMME FOR SERBIA IN 2001

1. IDENTIFICATION

Beneficiary state:	SERBIA - The Federal Republic of Yugoslavia
Programme:	Council Regulation (EC) No.2666/2000
Year:	2001
Cost:	€143.5 million
Expiry date:	31.12.2003 contracting 31.12.2004 disbursements
Sector:	AA
Group:	M
Budget line:	B7-542
Implementing Body:	European Agency for Reconstruction

2. SUMMARY

This proposal is the first tranche of assistance for Serbia for 2001. It represents the first step away from an emergency programme toward longer-term development assistance. Serbia emerged from a long period of economic decline compounded by conflict and international isolation and significant support from international institutions and the EU is needed to support the transition to a fully fledged market economy. The programme takes into account the need to provide support in key sectors of fundamental economic and social importance, in particular with a view to strengthen institutional development and create the basis for long term investments.

This proposal consists of:

- **Energy - €80 million (+/-20%).** Supply of essential spare parts for the electricity generation and supply systems, together with technical assistance on setting tariffs and advice on management reforms at EPS (see annex 1).
- **Agriculture - €20 million (+/- 20%).** Supply of key inputs (mainly fertilisers and animal feed); provision of institutional capacity building for Ministry of Agriculture and related regulatory bodies (see annex 2)
- **Enterprise Development - €10 million (+/- 20%).** Support to SMEs through technical assistance and training together with establishing a credit line (see annex 3).
- **Health - €26.5 million (+/- 20%).** Improve availability of pharmaceuticals and the supply of essential drugs; improve drug supply monitoring, storage and distribution; provide advice on drug pricing and legislation and establishing a drug agency; support the local pharmaceutical industry (see annex 4).
- **Policy and Legal Advice Centre - €5 million (+/- 20%).** To provide advice to the government on key issues – e.g. transition to a market economy, regulatory framework, harmonisation of legislation and WTO accession – in a consistent and accessible form (see annex 5).

- **A Technical Expertise Facility - €2 million (+/- 20%).** To provide short term technical expertise in project preparation, evaluation of highly specialised aspects of bids, audits, etc (see annex 6).

Maximum available: €143.5 Million

3. GENERAL BACKGROUND

3.1. Past EC Funding

Past EC funding has been focused on emergency assistance, media support and humanitarian aid. It consists of:

PROGRAMME	SUM	DESCRIPTION
Energy for Democracy	€ 4.4 m	Procurement of oil for district heating systems in municipalities opposed to the then Milosevic regime, together with a media campaign and monitoring/ audit and evaluation.
Energy for Democracy II	€ 4.4 m	Same as above but extended to further municipalities who opposed the previous regime.
Schools for a Democratic Serbia	€ 3.8 m	Consumables and repairs to schools in municipalities that opposed the previous regime.
Support for an Independent Media; Media in Crisis	€ 7.6 m	Creation of an independent media house and small project funding to support independent media survival needs.
ECHO Humanitarian Programmes	€73.0 m	Assistance to refugees, internally displaced people and "social cases".
Emergency Assistance	€180.0 m	Subsidies for Key Foodstuffs; Health (pharmaceutical supplies); Energy (fuel, spare parts and electricity imports); Municipalities (support for repairs to schools and other key municipal facilities); Media Support; Advice and Assessments for the New Government; Studies/Consultancies; Agency's starting up costs.

The €180 million emergency assistance programme outlined above, has proved to be a crucial factor in helping to stabilise an emergency situation. The programme got underway within days of the Commission Decision in early November. The practical benefits of the programme are being widely felt across Serbia – e.g. heating oil for some 1,000 schools and hospitals and for district heating systems in municipalities that cover some 80% of the population; electricity imports thus avoiding major power cuts; the supply of essential drugs (e.g. insulin); and food commodities (sugar, cooking oil). Implementation of the main elements of most of the programme will be completed by April.

3.2 Socio-economic issues

The break up of the former Yugoslavia, the ensuing armed conflicts and economic mismanagement resulted in hyperinflation and a ruined economy. Established

markets were lost, traditional production relations were disrupted and the international community imposed sanctions. Household foreign exchange banking assets were frozen, a number of private banks collapsed and in early 1994 there was hyperinflation resulting in a virtual collapse of industrial output. By 1994 GDP had dropped to 44% of its 1990 level.

A stabilisation programme was introduced in January 1994 leading to some financial stability and growth. Restrictive macro economic policies reduced inflation to an average of 43% during this period. By 1998 GDP was estimated to have recovered to 56% of the 1990 level. However, the Government's inconsistent application of those stabilisation policies inhibited further recovery.

The Kosovo crisis in 1999 resulted in a second severe economic set back. The IMF estimated that GDP dropped by 20% in 1999 alone, its lowest level in a decade. The economy was placed on a war footing. The government introduced price controls, rationing, special taxes, etc. Internal as well as external imbalances continued to mount. Foreign exchange shortages by 1999 resulted in steadily increasing gaps between the official and parallel market exchange rates. Inevitably public finances were badly affected. The decline in public revenues has led to a rapid increase in arrears in Government and quasi Government bodies.

Today, the macro-economic environment remains fragile. Output has recovered partly from the economic dislocation caused by the Kosovo war. Nevertheless it is still estimated to be at about 40% of the 1990 level. The external debt to GDP ratio is estimated to be about 140% and rising in the absence of debt servicing. This is clearly unsustainable and rescheduling by the Paris and London Clubs will be necessary. Unemployment (official and involuntary) is about 50% of the labour force.

The country's infrastructure is in a state of disrepair due to a combination of poor maintenance, a lack of investment and the NATO bombing campaign. A detailed EC/World Bank overall needs assessment is underway and the results will be available in a few months time. However, estimates prepared by the G17 indicate that Serbia suffered US\$ 3.8 billion in damages to its infrastructure and industrial facilities such as oil refineries; auto, chemical, electrical and machine building plants; bridges, power system; and telecommunication facilities.

About 900,000 refugees and internally displaced persons live in the Federal Republic of Yugoslavia in very difficult conditions. The United Nations estimate that over one-third of the population of Serbia lives in absolute poverty; defined as a monthly income of DEM 100 or less.

Although GDP is thought to have risen a little during 2000 largely due to the ending of sanctions (which were lifted in October), key sectors remain in crisis. For example, agricultural output is expected to decline by over 15% due to the severe drought in 2000 and the lack of inputs (fertiliser, seeds and animal feed). Due to price liberalisation by the outgoing Government in October, retail price inflation is estimated to be about 110% for 2000. As a consequence the real value of wages continues to be eroded. The IMF does not currently have an up to date figure for GDP in FRY – the most authoritative recent estimate is US\$ 1,150 (per capita) for 1999 (from the Economist Intelligence Unit).

3.3 Socio-Political issues

The Federal Republic of Yugoslavia was established in 1992 as a federation of the republics of Serbia and Montenegro after the four other republics of the Socialist Federal Republic of Yugoslavia became independent states. The total population of the current Federal Republic is approximately 10.5 million.

In May 1992 the UN Security Council imposed economic sanctions on Yugoslavia for its involvement in the civil war in Bosnia and Herzegovina and Croatia. After the Dayton agreement the sanctions were suspended in November 1995 and lifted in October 1996. Nevertheless many western industrial nations continued with some form of sanctions, such as those affecting Yugoslavia's membership of the International Financial Institutions, until the country eased concerns about human rights in Kosovo and began to cooperate with the war crimes tribunal. Increased tensions in Kosovo caused the EU and US to re-impose bans on foreign investment and on financial transactions by Yugoslav institutions. Continued escalation of tensions in Kosovo culminated in the NATO bombing campaign of 1999.

Federal Presidential elections were held in September 2000 and a new Government was formed following massive demonstrations against attempts by the Milosevic regime to remain in power despite the election results. The Democratic Opposition parties, which won a clear majority of the votes, formed a coalition Federal Government headed by Mr. Kostunica.

In Serbia, the old socialist led Government resigned under heavy popular pressure and new republican elections were quickly organised. They were held on December 23 and a new Government was finally formed in late January 2001. The normalisation of international relations followed quickly. Most major nations resumed diplomatic relations. Yugoslavia resumed membership in the UN, OSCE, IMF and EBRD. Membership of the World Bank is still pending until the issue of the payment of arrears (US\$1.7 billion) is settled.

4. PROGRAMMING CONTEXT

4.1 The current situation

Serbia has many of the characteristics and problems found in other Central and South-Eastern European countries at the outset of transition. But Serbia is coming to these issues much later than its neighbours. And it is burdened by additional factors, most notably the legacy of prolonged isolation, sanctions, a series of armed conflicts and large numbers of refugees/internally displaced people. The public's expectations are high and people are impatient for improvements in their standard of living. Major economic, legislative and institutional reform is obviously essential, and will require substantial assistance from the international community. The IMF opened negotiations on a standby loan in January 2001 and is expecting to conclude a standby arrangement by spring 2001. But most of the assistance, particularly

assistance in the form of an Extended Financing Facility from the IMF and loans from the World Bank, are unlikely to be available until next autumn/winter.

The need for urgent assistance in Serbia has meant that this programme has had to be prepared in advance of the presentation of a formal strategy paper and multi-annual programme by the Commission. However, the programme is based on an analysis of the key priorities following intensive discussions with the Federal and Republican levels of Government. From that has flowed the programme rationale and criteria set out below.

4.2 The programme rationale

This programme for 2001 aims to balance the need to address some of the more immediate crucial non-emergency requirements with the need to undertake some of the groundwork to prepare for the essential reforms. In essence the programme is designed as a steppingstone to help Serbia be in a position to take on the process of reform over the coming period.

4.3 The programming criteria

The main criteria are:

- To concentrate resources on a limited number of fields crucial to economic and social stability and recovery;
- To ensure a sense of local “ownership” of the programme, and in particular that it accords with the Federal and Republican level Governments’ priorities;
- To provide assistance that can be absorbed quickly;
- To intervene in ways that will help to begin the process of institutional and economic reform;
- To work closely with other donors;

4.4 The choice of sectors

The four sectors, together with the policy and legal advice centre, were selected following detailed consultations with the Federal and Republican level authorities. The proposed programme also takes into account the plans of other major donors so far as they are already established.

Three of the sectors – energy, agriculture and health – are vital in sustaining the economic and social fabric of the country and will be crucial in the reform process. All are in need of substantial reform, but they are also in imminent danger of collapse before the results of those reforms can bear fruit. If they are allowed to collapse over the coming months the process of reform will be much harder. For example virtually all economic activity will be affected if the reliability of electricity supplies deteriorates sharply during 2001; and social unrest and populist resistance to reforms could become a real threat if the supply of key pharmaceuticals dries up whilst unemployment continues to rise.

The other two sectors – enterprise development and a policy/legal advice centre – have been selected because of their importance, in practical terms, in stimulating the economy and the reform process.

5. IMPLEMENTATION

This programme will be implemented under the responsibility of the European Agency for Reconstruction that will sign all necessary contracts with service providers and suppliers. Selection of contractors will be carried out in conformity with the CARDS Regulations, with maximum emphasis placed on local tendering to the extent permitted by the regulation.

Implementation of projects will be carried out in close co-ordination and consultation with the FRY and Serbian authorities and those international agencies and donors that are active in the various fields of the programme.

6. INDICATIVE DISBURSEMENT SCHEDULE (M€ACCUMULATED)

Sector	Dec 2001	June 2002	Dec 2002	June 2003	Dec 2003
Energy	50	70	75	80	80
Agriculture	12	15	17	20	20
Enterprise Development	4	6	8	10	10
Health	17	20	23	26.5	26.5
Policy and Legal Advice Centre	1	2	3	4	5
Technical and Administrative Assistance Facility	1.5	0.5	2	2	2
TOTAL	85.5	113.5	128	142.5	143.5

7. MONITORING, EVALUATION AND AUDIT

This programme will be monitored and supervised by the European Agency for Reconstruction who shall:

- a) monitor the implementation of the programme on the basis of regular reports;
- b) carry out regular monitoring and evaluations to follow the progress of the programme and its components as well as ex-post evaluations after the completion of the programme.

The accounts and operations of the programme components will be checked at intervals by an outside auditor contracted by the Commission without prejudice to the responsibilities of the European Commission, including the European Antifraud Office (OLAF) and the European Union's Court of Auditors.