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**ECONOMIC REFORM PROGRAMME**

**OF**

**SERBIA**  
**(2016-2018)**

**COMMISSION ASSESSMENT**

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## 1. EXECUTIVE SUMMARY

**Economic growth is expected to slowly gather pace.** The economy has recovered faster than envisaged, supported by increased confidence as a result of implemented reforms and low oil prices. A gradual acceleration of economic activity is forecast to be driven by robust investment and export growth. Employment is expected to pick up moderately. Price pressures are likely to remain low, although with the strengthening of domestic demand, inflation is forecast to return to the central bank target band. Further reductions of the current account deficit are expected to be marginal but foreign direct investment should fully cover the deficit.

**The macro-fiscal scenario is plausible and risks to it are clearly outlined.** The economy continues to be exposed to multiple external risks and remains highly sensitive to international capital flow reversals and fluctuations in oil prices. Potential relaxation in fiscal consolidation and structural reform efforts also remain significant internal risks, although these have been reduced as a result of recent policy measures.

The main challenges in these respects include the following:

- **The forecast medium-term budget deficit reduction is appropriate, although short-term adjustment efforts are less ambitious.** The authorities have not reassessed their target of achieving primary surplus only in 2017. The envisaged consolidation drive is planned to remain predominantly on the expenditure side and the overall deficit to fall to 1.8% of GDP in 2018. However, contrary to last year, the adjustment is deferred and the structural deficit is planned to decline marginally in 2016 before falling strongly in the year after.
- **The strong budget consolidation in 2015 masks delays in some reforms and deficiencies in budget planning and execution.** The restructuring of large publicly-owned enterprises has progressed unevenly and the public administration reform has encountered delays. Significant one-off revenue and expenditure have continued to influence the budgetary outcome. Strengthening the tax administration in a business-friendly manner is key to sustaining and further improving revenue collection.
- **Implementing planned reforms should strengthen financial sector resilience.** Macroeconomic stabilisation has already brought down borrowing costs and led to an easing of credit standards. However, the banking system still faces important challenges, like a particularly high level of non-performing loans, and bank lending, especially to corporates, remains muted. The oversight over majority state-owned financial institutions is being strengthened and there are ongoing efforts to prepare the privatisation of some of them.
- **Under-execution of capital expenditure remains an issue.** It curtails a much needed contribution from the public sector to growth. Weak physical networks and inefficient markets in the energy and transport sectors are slowing down economic integration with the EU and the region.
- **Although improving, the business environment remains weak, in particular for SMEs.** Private investment is restricted, among other reasons, by a costly, unpredictable and non-transparent system of para-fiscal charges, difficult access to finance and red tape. Credit growth is limited in the absence of guarantee instruments or a well-functioning cadastre.

- **The level of state aid is too high and granted to a large extent to unprofitable public companies or to non-transparent FDI projects.** Investment aid is not granted on the basis of clear predefined criteria. The level of public and private sector investment in research, development and innovation is low and below the needs of the economy. There is significant room to increase competitiveness in agriculture; however, the potential of the sector is held back by land fragmentation and low productivity due to outdated technologies.
- **Despite a recent slight increase in employment, high youth and long-term unemployment, as well as low female participation and a high prevalence of informal work, remain considerable labour market challenges.** Reforms in the education and training system at all levels are needed in order to ensure a better match of skills supply with future labour demands. The reform measures for responding to these challenges focus on strengthening labour market institutions, in particular employment services and initiating longer-term reforms in the education system.
- **Over recent years, poverty rates have increased, with children, the unemployed and large households being most at risk.** Along with policies for boosting growth and employment, policies aim at maintaining the level of social protection for the most vulnerable segments of society. Social benefits have been expanded but with little effect so far on alleviating poverty. A key challenge in this respect is to improve the adequacy and targeting of social assistance for addressing poverty.

**The macroeconomic and fiscal framework of the ERP is sufficiently comprehensive and coherent, providing a good basis for policy discussions, while the structural reform section has improved considerably compared to last year.** The description of each reform measure is detailed enough in order to follow up annually. However, the programme would have benefitted from a more market oriented approach. Implementing the envisaged reform agenda remains key to reducing economic imbalances, improving competitiveness, and supporting sustainable growth.

**The authorities have undertaken steps to address last year's policy guidance.** Strong measures contributed to a significant structural adjustment, bringing the budget deficit down to 3.8% of GDP. Fiscal consolidation provided room for monetary policy relaxation. Despite delays, the restructuring and resolution of state-owned enterprises and the implementation of the public administration reform have advanced. The authorities, including the central bank, have designed and have been implementing a comprehensive resolution strategy and action plans to address the issue of high non-performing loans. However, the very slow implementation of public infrastructure projects has a negative impact on recovery. The reform of the construction permit system supported economic development, but access to finance remains expensive and undermines further expansion of private investment. The fight against the grey economy has been intensified with stricter inspections and improved tax collection, but does not yet comprehensively tackle informal employment.

## 2. ECONOMIC OUTLOOK AND RISKS

**Economic growth is forecast to slowly gather pace.** Despite a significant fiscal consolidation in 2015, increased confidence as a result of implemented reforms and low oil prices helped the economy recover faster than expected. The programme envisages a continuing, gradual acceleration of economic activity, driven mainly by robust investment and exports. The baseline growth path is broadly in line with the latest Commission forecast. Private consumption, after being a drag on growth for a number of years, is also seen rebounding marginally in the first two years of the programme, before picking-up in 2018. As fiscal consolidation efforts are envisaged to continue, public consumption is forecast to decline by an average of 0.6 % over the next three years.

**Investment is forecast to join exports in reshaping the economy's structure.** At the end of the programme period, a decade after the 2008 crisis, the economy is envisaged to be much more open. Following a continuously robust performance, exports' share is expected to reach more than half of GDP, nearly doubling in real terms in ten years. The basis for the still modest economic recovery is likely to be more solid, as investment is also forecast to increase by a cumulative 30 % since its trough in 2014 and to be more than 20 % of GDP in 2018. Investment growth has already been very strong in 2015, benefiting from reforms to improve the business environment, measures to reduce the budget deficit, and monetary easing. Maintaining the authorities' commitment to implementing the planned structural reforms would undoubtedly remain an important factor to sustain this growth momentum, increase the economy's potential, and underpin sustainable economic growth. Investment is seen as the main driver of domestic demand as both public and private consumption remain subdued.

Table 1:

### Macroeconomic developments and forecasts

|  | 2014 |      | 2015 |      | 2016 |      | 2017 |      | 2018 |      |
|--|------|------|------|------|------|------|------|------|------|------|
|  | COM  | ERP  |
| Real GDP (% change)                      | -1.8 | -1.8 | 0.8  | 0.75 | 1.6  | 1.75 | 2.5  | 2.2  | n.a. | 3.5  |
| <i>Contributions:</i>                    |      |      |      |      |      |      |      |      |      |      |
| - Final domestic demand                  | -1.7 | -1.8 | 0.6  | 0.7  | 1.8  | 1.6  | 2.7  | 1.5  | n.a. | 2.7  |
| - Change in inventories                  | 0.5  | 0.6  | 0.0  | 0.0  | 0.0  | 0.0  | 0.0  | 0.0  | n.a. | 0.0  |
| - External balance of goods and services | -0.6 | -0.6 | 0.2  | 0.1  | -0.1 | 0.1  | -0.2 | 0.8  | n.a. | 0.7  |
| Employment (% change)                    | 10.1 | 10.6 | 0.9  | 1.1  | 0.7  | 0.5  | 1.2  | 0.9  | n.a. | 1.5  |
| Unemployment rate (%)                    | 19.4 | 20.1 | 17.4 | 18.5 | 16.8 | 17.0 | 16.1 | 16.1 | n.a. | 14.6 |
| GDP deflator (% change)                  | 2.7  | 2.7  | 1.2  | 1.5  | 2.4  | 2.6  | 3.5  | 3.2  | n.a. | 3.7  |
| CPI inflation, annual average (%)        | 2.1  |      | 1.4  | 1.9  | 2.4  | 2.8  | 3.6  | 4.0  | n.a. | 4.0  |
| Current account balance (% of GDP)       | -6.0 | -6.0 | -5.1 | -4.6 | -4.9 | -4.5 | -4.9 | -4.1 | n.a. | -4.1 |
| Budget deficit (% of GDP)                | -6.6 | -6.6 | -3.8 | -4.1 | -3.7 | -3.9 | -3.5 | -2.6 | n.a. | -1.8 |
| Government debt (% of GDP)               | 70.4 | 71.8 | 76.2 | 76.0 | 79.9 | 79.1 | 81.8 | 78.6 | n.a. | 75.7 |

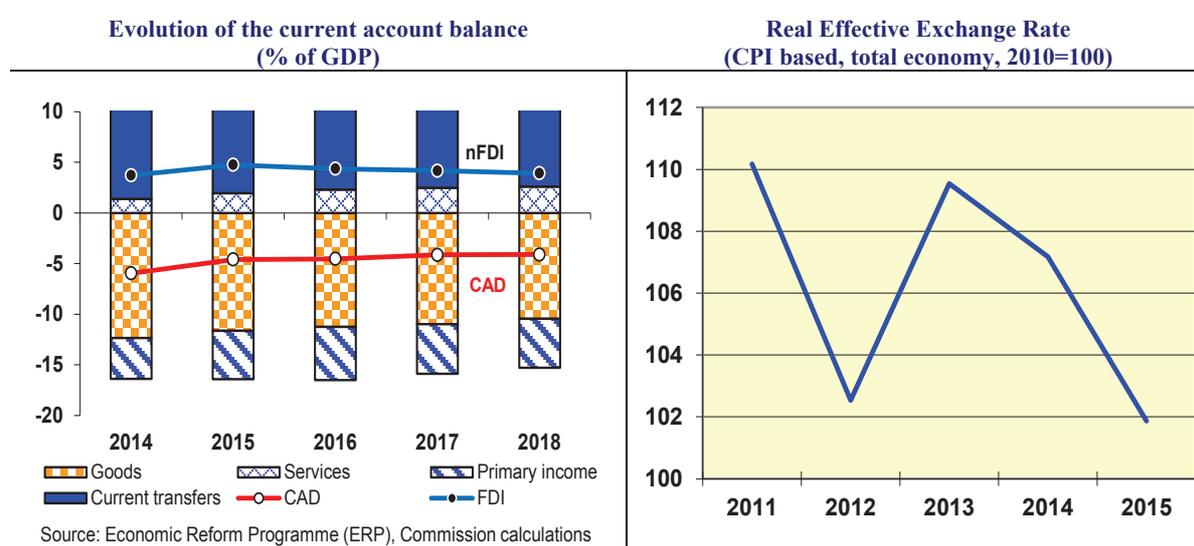
Sources: Economic Reform Programme (ERP) 2016; Commission Winter 2016 Forecast

**The macroeconomic scenario is plausible and risks to it are clearly identified.** The programme also presents an alternative, pessimistic scenario on the assumption that some of the identified risks materialise, envisaging lower cumulative real GDP growth of just 3.3 % in the period 2016-2018. The economy continues to be exposed to a multitude of external risks, stemming mainly from developments in the EU, which is its main export market and the source of most foreign investment. It also remains highly sensitive to international capital flow reversals and fluctuations in oil prices. In comparison with last

year's programme, the risk matrix has shifted to the external side, due to increased role of export and FDI to support growth and heightened geopolitical tensions. Nevertheless, although reduced as a result of recent policy measures, the programme also flags some key domestic risks, mainly related to potential delays in fiscal consolidation and structural reform efforts.

**Inflation is expected to return to the central bank target band but price pressures are likely to remain low.** Inflation has been persistently below the central bank target tolerance band in the last two years. The spell of subdued inflation has been due to low international prices, in particular of key commodities, restrictive fiscal policy, weak domestic demand and exchange rate stability. The long period of price moderation has helped anchor inflation expectations and provided room for significant monetary policy relaxation. The programme envisages that short-term price pressures remain low. Over the medium term inflation is forecast to gradually approach the 4 % target, pushed up by regulated price increases and as disinflationary effects from the international environment and aggregate demand start to wane. A steady implementation of the announced reform measures and continuing fiscal consolidation are key assumptions substantiating this inflationary path.

Graph 1: External competitiveness and the current account



**Further reductions of the current account deficit are forecast to be marginal.** The moderately high current account deficit reflects low income and savings levels and the still underdeveloped export potential. The programme envisages that the closing of the public savings-investment gap would be an important factor suppressing the current account deficit over the medium term. However, it is likely to be counterbalanced by growing private investment. Should this investment be channelled into tradable sectors, it would further expand the export base and sustain export growth. A number of reforms improving the business environment, implemented over the last few years, are already having a visible effect on external competitiveness. This is seen not only in overall export growth but also in the fact that Serbia has gained global market share. In addition, external competitiveness received a temporary boost last year due to the depreciation of the euro against the US dollar. As their effects decline, further improvements in competitiveness would require a continuation of domestic reforms and careful prioritisation of investments.

**Foreign direct investment is expected to cover the current account deficit.** Net FDI has increased markedly in 2015, covering 113 % of the current account deficit. The programme is relatively conservative in assuming a constant nominal level of net FDI

inflows, broadly at the level of the current account deficit in each of the years. Higher FDIs, along with currency revaluations, were one of the main factors for the continued deterioration in the international investment position (IIP). In view of the forecast external imbalances, the IIP is set to worsen further, although probably less so in its debt-driven components. However, a comfortable level of official foreign exchange reserves is likely to remain an important buffer against external risks. A continued steadfast implementation of the Stand-By Arrangement with the IMF should additionally anchor stability-oriented policies and provide reassurance in case of negative shocks.

**Implementing planned reforms should strengthen financial sector resilience and facilitate a revival of credit activity.** Commercial bank lending, especially to corporates, remains muted. However, macroeconomic stabilisation has already brought down borrowing costs and led to an easing of credit standards. Although the banking system still faces important challenges, such as a particularly high level of non-performing loans (NPLs), a number of policy initiatives have been undertaken to address them. The authorities, including the central bank, have designed a comprehensive NPL resolution strategy and action plans. The central bank implemented a special diagnostic study, covering most of the system, which did not identify capital shortfalls for any of the participating banks and has led to a limited decrease of the aggregate capital adequacy ratio by 176 basis points to 18.45 %. Steps have been taken as well to further develop micro- and macro-prudential policy frameworks. The oversight of majority state-owned financial institutions is being strengthened and there are ongoing efforts to prepare the privatisation of some of them.

Table 2:

**Financial sector indicators**

|  | 2011   | 2012   | 2013   | 2014   | 2015     |
|--|--------|--------|--------|--------|----------|
| Total assets of the banking system, mEUR     | 36 015 | 35 163 | 34 836 | 35 696 | 35 938   |
| Credit growth                                | 5.5    | 12.9   | -6.5   | 6.7    | 7.7      |
| Deposit growth                               | 9.2    | 10.4   | 3.3    | 8.1    | 6.5      |
| Loan to deposit ratio                        | 1.3    | 1.4    | 1.2    | 1.2    | 1.2      |
| <b>Financial soundness indicators</b>        |        |        |        |        |          |
| — non-performing loans                       | 19.0   | 18.6   | 21.4   | 21.5   | 22.0 Q3  |
| — total provisions to gross NPLs             | 121.4  | 120.7  | 113.8  | 114.5  | 115.0 Q3 |
| — regulatory capital to risk weighted assets | 19.1   | 19.9   | 20.9   | 20.0   | 21.2 Q3  |
| — liquid to total assets                     | 37.8   | 34.5   | 38.5   | 37.1   | 35.9 Q3  |
| — return on equity                           | 0.2    | 2.1    | -0.4   | 0.6    | 5.6 Q3   |
| — forex loans to total loans*                | 69.0   | 73.1   | 70.9   | 70.0   | 70.6 Q3  |

Sources: Economic Reform Programme (ERP), National Central Bank, DataInsight.

\* Includes both denominated and indexed positions.

### 3. PUBLIC FINANCE

**Strong consolidation measures have reduced the budget deficit to 3.8 % of GDP<sup>1</sup> in 2015.** Public wage and pension cuts, implemented at the end of 2014, and better collection of tax revenue have contributed the most to a significant (2.5 % of GDP) structural adjustment. The structural measures to limit fiscal imbalances also included an extension of the attrition rule on new hiring in the public administration, the introduction of a gas transit fee and a 7.5 % excise duty on electricity. In addition, as in previous years, significant one-off revenue and expenditure have influenced the budgetary outcome. Although the deficit turned out much lower than initially planned mainly due to an over-performance on the revenue side, the consolidation was still predominantly expenditure-driven. The better than expected budget performance led to a marked downward revision of the initial 5.8 % of GDP deficit target and allowed for accommodation of a partial reversal of the wage and pension cuts<sup>2</sup> and unplanned one-off payments<sup>3</sup> by the end of the year.

Table 3:

Composition of the budgetary adjustment (% of GDP)

|   | 2014 | 2015 | 2016 | 2017 | 2018 | Change:<br>2015-18 |
|---|------|------|------|------|------|--------------------|
| <b>Revenues</b>                           | 41.5 | 41.9 | 41.0 | 40.1 | 39.0 | 2.9                |
| — Taxes and social security contributions | 36.8 | 36.3 | 36.3 | 35.5 | 34.7 | 1.7                |
| — Other (residual)                        | 4.7  | 5.5  | 4.8  | 4.5  | 4.3  | 1.2                |
| <b>Expenditure</b>                        | 48.1 | 45.9 | 45.0 | 42.7 | 40.8 | 5.1                |
| - Primary expenditure                     | 45.1 | 42.6 | 41.5 | 39.2 | 37.4 | 5.1                |
| <i>of which:</i>                          |      |      |      |      |      |                    |
| Gross fixed capital formation             | 2.5  | 2.6  | 2.9  | 2.9  | 3.1  | -0.5               |
| Consumption                               | 18.3 | 16.9 | 16.9 | 15.6 | 14.6 | 2.3                |
| Transfers & subsidies                     | 20.8 | 21.2 | 19.8 | 19.0 | 18.3 | 2.9                |
| Other (residual)                          | 3.5  | 1.9  | 1.9  | 1.7  | 1.4  | 0.5                |
| — Interest payments                       | 2.9  | 3.4  | 3.5  | 3.5  | 3.4  | -0.1               |
| <b>Budget balance</b>                     | -6.6 | -4.1 | -3.9 | -2.6 | -1.8 | -2.2               |
| — Cyclically adjusted                     | -6.3 | -3.7 | -3.6 | -2.3 | -1.7 | -1.9               |
| <b>Primary balance</b>                    | -3.7 | -0.7 | -0.4 | 0.9  | 1.6  | -2.3               |
| <b>Gross debt level</b>                   | 71.8 | 76.0 | 79.1 | 78.6 | 75.7 | 0.3                |

Sources: Economic Reform Programme (ERP), Commission calculations.

**The impressive consolidation masks delays in some reforms and deficiencies in budget planning and execution.** The restructuring of large state-owned enterprises has been progressing unevenly and slowly and the reform of the public administration has encountered delays. Although resulting in short-term savings in severance payments and

<sup>1</sup> The text comments on the actual execution data for 2015, which differ from those in the ERP.

<sup>2</sup> Pensions were increased by 1.25 %. There was also a wage indexation of 4 % for employees in primary and secondary schools, 3 % for employees in health and social protection institutions, up to 2 % for employees in higher education institutions, and 2 % for police and army employees. Both wage and pension indexations became effective as of January 2016.

<sup>3</sup> The one-off payments included pension liabilities of close to RSD 10 billion, following a Constitutional Court ruling in favour of military pensioners, RSD 23.4 billion in takeover of Srbijagas debt to NIS (majority-owned by Gazprom), RSD 9.6 billion in agricultural subsidies, and RSD 1 billion in bonus payments to employees in the education sector.

unemployment benefits, the slower than initially envisaged pace of these reforms leads to long-term costs which at the end are covered by the budget. Significant, and sometimes unbudgeted, one-off revenue and expenditure have continued distorting the underlying budgetary performance, reducing transparency and undermining proper allocation of public resources. Persistent under-execution of capital expenditure also remains an issue despite a marked increase in spending in comparison to the previous year.

**The forecast medium-term budget deficit reduction is appropriate, although short-term adjustment efforts are less ambitious.** The unexpectedly strong and upfront deficit reduction in 2015 has not led to a re-evaluation of the authorities' target of achieving a primary surplus only in 2017. The programme envisages the consolidation drive remaining predominantly on the expenditure side and the overall deficit falling by 2.3 percentage points to 1.8 % of GDP in 2018. However, contrary to last year, the planned adjustment is back-loaded and the structural deficit is planned to decline marginally in 2016 before falling again strongly in the following year.

**Box: The 2016 budget**

The National Assembly adopted the 2016 republican budget on 12 December 2015.

The general government balance target is RSD 163.4 billion (3.9 % of GDP). The envisaged consolidation measures are moderately dominated by expenditure cuts. The main adjustment is planned to come from reducing employment in the public sector and a wage and pension freeze, following their indexation in the beginning of the year. Increases in excise duties on oil products and the full impact of the excise duty on electricity, introduced in 2015, are the sole measures on the revenue side.

Table: Main measures in the 2016 budget\*

| Revenue measures   |                       | Expenditure measures   |                        |
|--|-----------------------|--|------------------------|
| • 7.5 % electricity excise duty, introduced August 2015 (0.3 % of GDP) |                       | • Reducing agriculture subsidies (-0.2 % of GDP)                       |                        |
| • Increase in excise duties on oil products (0.1 % of GDP)             |                       | • Reducing subsidies for public broadcasting companies (-0.1 % of GDP) |                        |
|  |                       | • Lower pension and wage bill (-0.6 % of GDP)                          |                        |
| <b>Total revenue effect</b>  | <b>(0.4 % of GDP)</b> | <b>Total expenditure effect</b>  | <b>(-0.9 % of GDP)</b> |

\* Estimated impact on general government revenue and expenditure.

Source: ERP

**The programme targets a broadly unchanged budget deficit in 2016.** Both total revenue and expenditure are expected to fall by 0.9 % of GDP. Mandatory expenditure cuts are planned to continue, although rising interest payments, higher capital expenditure, and pension and wage indexations adopted at the end of 2015 are likely to offset their effects. The attrition rule for new employment in the public sector is being maintained and its application extended to cover state-owned enterprises. Targeted reduction of government employment, by implementing legislation on the maximum number of public sector employees and continuing the public administration reform on the basis of functional review studies, is expected to result in a lower wage bill. Additional savings are envisaged from reducing agriculture subsidies and cuts of transfers to public broadcasting companies. With the exception of increases in excise duties on oil products and the full impact of the excise duty on electricity, introduced in August 2015, major tax rates are planned to remain unchanged. However, there is a

non-negligible risk that significant and unbudgeted one-off items could continue influencing revenue and expenditure performance.<sup>4</sup>

**The fiscal scenario faces a number of risks.** The programme acknowledges them and outlines an alternative fiscal scenario, based on a pessimistic macroeconomic scenario. The public administration reform and the restructuring of state-owned enterprises remain the two pillars for a sustainable reduction of fiscal imbalances. Therefore, further delays in their implementation, in view also of the early parliamentary elections called in the spring 2016, are a key risk to the forecast budgetary developments. However, the better than envisaged revenue outturn last year, not only in comparison to the initial budget but also to revised estimates, represents an upside risk to the budget execution. Although the programme fails to capitalise on the better outcome in 2015, any gains on the revenue or expenditure side, including one-offs, should be used exclusively to further reduce the deficit. In addition, elevated uncertainties and still growing government debt also call for a careful evaluation before underwriting new expenditure commitments.

**Steps are being taken to improve budgetary processes and institutions.** The programme recognises the importance of strengthening the institutional framework. It outlines wide-ranging measures to address identified issues: aligning statistical coverage of the general government sector with ESA 2010 requirements, further developing programme budgeting and advancing the tax administration reform in a business-friendly manner. As part of the drive to improve performance and effectiveness of the public administration, the salary system is planned to be simplified to ensure fairness, reduce inequalities, strengthen budget checks and increase transparency. In addition, fiscal impact analysis and monitoring of state-owned enterprises are being enhanced and there is a commitment to the policy of strictly limiting the issuance of new state guarantees.

**The deficit path is consistent with plans to reverse government debt growth in 2017.** However, the planned structural adjustment after 2016 is almost exclusively dependent on continuation of the wage and pension freeze and further cuts in public sector employment, which will be increasingly difficult to implement. Government debt is forecast to peak at just below 80 % of GDP in 2016 and the primary balance is expected to turn to surplus in the following year. Importantly, interest expenditure would remain significant, stabilising at around 3.5 % of GDP throughout the programme horizon. Stock-flow adjustments are also likely to remain a major debt-increasing factor in the short-term, although the programme sees them diminishing afterwards.

**Risks to the envisaged debt scenario are significant.** Budget deficit and debt levels are still very high. Despite recent strong consolidation efforts, fiscal slippages are not excluded, especially if reforms are delayed or commitments to curbing mandatory expenditure are not respected. The poor financial situation in some large state-owned enterprises, in particular, remains a source of implicit liabilities for the budget. As most of the debt is denominated in foreign currencies, debt dynamics remain sensitive to exchange rate fluctuations. A 1 % depreciation of the dinar against a basket of currencies could lead to a 0.6 % of GDP increase in the debt-to-GDP ratio. Refinancing risks also loom large as gross financing needs are expected to increase to 20 % of GDP next year. In view of the elevated risks, reversing the trend of rising government debt remains a significant challenge that would require sustained efforts.

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<sup>4</sup> In January 2016, the budget received RSD 12.7 billion from a ten-year concession for the use of several frequencies.

**Box: Debt dynamics**

Table 4:

**Composition of changes in the debt ratio (% of GDP)**

|                                 | 2014        | 2015        | 2016        | 2017        | 2018        |
|---------------------------------|-------------|-------------|-------------|-------------|-------------|
| <b>Gross debt ratio [1]</b>     | <b>71.8</b> | <b>76.0</b> | <b>79.1</b> | <b>78.6</b> | <b>75.7</b> |
| Change in the ratio             | 10.7        | 4.2         | 3.1         | -0.5        | -2.9        |
| <i>Contributions [2]:</i>       |             |             |             |             |             |
| <b>1. Primary balance</b>       | <b>3.7</b>  | <b>0.7</b>  | <b>0.4</b>  | <b>-0.9</b> | <b>-1.6</b> |
| <b>2. 'Snow-ball' effect</b>    | <b>2.4</b>  | <b>1.8</b>  | <b>0.3</b>  | <b>-0.5</b> | <b>-1.8</b> |
| <i>Of which:</i>                |             |             |             |             |             |
| Interest expenditure            | 2.9         | 3.4         | 3.5         | 3.5         | 3.4         |
| Growth effect                   | 1.1         | -0.5        | -1.3        | -1.7        | -2.6        |
| Inflation effect                | -1.6        | -1.0        | -1.9        | -2.4        | -2.7        |
| <b>3. Stock-flow adjustment</b> | <b>4.7</b>  | <b>1.7</b>  | <b>2.3</b>  | <b>1.0</b>  | <b>0.6</b>  |

[1] End of period. In accordance with the Budget System Law, includes all government-guaranteed debt and non-guaranteed local government debt. Differs from government debt according to the national methodology (Public Debt Law), which does not include non-guaranteed local government debt.

[2] The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences between cash and accrual data.

Source: Economic Reform Programme (ERP) 2016, Commission calculations.

Government debt is forecast to peak in 2016. Debt-reducing effects from real GDP growth and inflation are set to increase, while interest payments stabilise at a relatively high level. Consolidation efforts are expected to turn the primary deficit into a small surplus only in 2017. Stock-flow adjustments are envisaged to decline, due to the forecast exchange rate stability and restricted issuance of new government guarantees. Restitution-related debt of up to EUR 2 billion (to be issued in 2018) and potential privatisation inflows from the sale of large state-owned enterprises are not included in this scenario but could potentially and temporarily impact debt dynamics as well.

#### 4. STRUCTURAL REFORMS

**The ongoing economic recovery indicates improvements in competitiveness, but structural bottlenecks persist.** The recovery is largely based on increased private investment and continuously growing exports. However, only a small part of the economy is internationally competitive and more efforts should be made to expand the growth potential across sectors. There is no transparent support to attract FDI, which is only slowly expanding beyond a few sectors of the economy. The business environment is generally unstable and characterised by high para-fiscal charges and burdensome procedures. Private companies, in particular SMEs, suffer from expensive access to finance. The large informal sector, estimated at around 30 % of GDP, creates unfair competition and a dual labour market. Serbia remains competitive in terms of wage costs, but productive capacities and new job openings are scarce due to still low public and private investment. Unemployment remains very high, especially among young people.

**The structural reform policy guidance of the Economic and Financial Dialogue of May 2015 was partially addressed.** Limited progress was achieved in the restructuring of state-owned enterprises, most importantly of large utilities. These restructurings were accompanied by some social policies. However, sustainable reintegration of redundant workers into the labour market remains hampered given the limited job creation. Introducing corporate governance in public utilities still needs to be effectively

implemented. The development of energy and transport infrastructure continued but at a slower pace than planned and needed. The share of expenditure as part of GDP for these investments did not increase significantly. Private investment is on the rise in part due to higher FDI and the implementation of the new system of construction permits. The fight against the informal economy intensified, with stricter inspections and improved tax collection. There were no attempts to better regulate para-fiscal charges or to re-launch the ‘regulatory guillotine.’ Some measures were taken to limit the under-execution of capital expenditure.

**The Economic Reform Programme correctly identifies the key areas of structural reforms in the period 2016-2018.** The reforms have clear timelines of activities that are sequenced and budgeted for. However, some of the reforms are not ambitious enough, given the challenges faced by the economy. They are limited to measures implemented by a single institution, while cooperation between various actors is not promoted. In the preparation of the ERP, the external stakeholders were consulted, but their influence and input was limited as the consultation came too late in the process. Most measures would have benefitted from a more elaborate analysis of the expected impact on competitiveness and long-term growth, as well as a better analysis of potential implementation risks and actions envisaged to mitigate these.

### *Public finance management*

**A comprehensive Public Finance Management (PFM) reform programme for 2016-2020 has been recently adopted and needs to be implemented in order to support fiscal consolidation efforts.** There are weaknesses in the preparation and execution of the budget. The execution targets are often missed. Financial management control and managerial accountability are not well understood. Without proper management of public funds, the economy will be negatively affected, with adverse effects on the business climate. Corruption also thrives where PFM is weak, creating obscure and unfair market conditions. It is essential that all measures in the PFM reform programme are implemented according to the adopted timetable.

**Transforming the tax administration is of high priority in order to bring systemic gains in revenue collection and improve the business environment.** This reform should be driven by the implementation of the programme for the transformation of the tax administration, adopted in 2015. It aims in particular at strengthening the tax administration’s capacity and providing financial means to reorganise it and upgrade its IT equipment. The reform should have a continuous positive impact on tax collection, and thus on the fight against the grey economy. It should result in better and quicker services to taxpayers, such as online filing of declarations, improved transparency of internal procedures and predictability of administrative decisions.

**Better planning of budget expenditure and improved management of capital investment are needed.** The reform envisages improved management of capital investment plans by putting in place a platform for planning and prioritising capital projects and investments on the basis of a cost-benefit analysis. It should strengthen the current weak governance of public investment projects. However, these efforts should build upon existing structures, namely the National Investment Committee and the Single Project Pipeline.

### *Infrastructure*

**Persistently low levels of investment in physical infrastructure hamper economic development and regional integration.** This affects the government’s capacity to provide services to businesses and the public and negatively affects the business

environment and, therefore, overall competitiveness. Underdeveloped infrastructure, weak connections with neighbours in the region and the EU and non-harmonised regulation of the energy and transport sectors are slowing down economic development and integration with the EU and the other CEFTA economies. Only 55 % of households have broadband access to internet. The amount of public services offered via e-government is limited.

**There are delays in building new infrastructure and reorganising the existing one.** The policy guidance to increase public investment and improve the implementation of public projects has been only partially addressed: there is progress on investment projects on corridor X, while corridor VII, though mentioned in the recommendation, is not covered. The recommendation to improve governance of energy firms, regulation of the network and the construction of gas interconnectors has been partially addressed: the restructuring of the energy public utilities is still ongoing but the gas utility remains to be un-bundled. The construction of the Serbia-Bulgaria gas interconnector will not start before 2018, much later than initially planned.

**The transport and energy sectors would benefit from swift implementation of a number of soft measures.** The envisaged construction or modernisation of seven segments of physical infrastructure in the transport and energy sectors is too wide to be considered just one priority. Moreover, these investment projects do not necessarily reform the transport or energy sectors. Therefore, any public investment in transport and energy has to be accompanied by restructuring of public utilities. Equally important is the implementation of the obligations under the Energy Community Treaty as well as the so-called soft measures as agreed at the Western Balkans 6 summit in Vienna in August 2015. The programme would have benefitted from further emphasis on measures such as traffic management, road safety and maintenance in the transport system and the establishing of a regional electricity market rather than solely on the construction of new infrastructure. In order to reform the energy sector, more focus should be directed towards demand management, particularly energy efficiency, and measures to reduce energy intensity.

**Developing and improving the national broadband communication infrastructure is important but its timing should be accelerated.** In 2016, only the adoption of a law on broadband access is contemplated. This law is planned to set up a comprehensive new regulatory framework. It remains undefined in terms of requirements for network operators to coordinate their civil engineering and sharing the infrastructure. At this stage, it does not specify the conditions for granting aid and rules of access to subsidised infrastructure. EUR 116 million is planned in 2017-2018 for the roll-out of the broadband network, without detailed information on various costs.

### *Sector development*

#### *Agricultural sector development*

**Agriculture remains of key importance for economic growth, employment and trade.** It accounts for around 10 % of GDP, employs half a million people (significant portion of which works in grey area) or 20 % of total employment, and generates significant foreign trade surpluses. However, the sector's potential is weighed down by land fragmentation, low productivity due to outdated technologies, small economic size and low utilisation of agricultural land per farm compared to the EU average. Further alignment of phytosanitary regulations with EU standards and border control procedures would also facilitate increases in exports.

**There is significant room for increasing competitiveness in agriculture.** The expected increase in agricultural productivity needs to be substantiated by a stable subsidy policy, better integration and correlation with cross-cutting measures such as ring-fenced finance for specific problems of small and medium farms, land consolidation, the development of modern agricultural infrastructure (irrigation systems, cadastre management, rural planning, access roads, storage facilities, etc.), establishment and further consolidation of advisory, certification, testing and inspection/control systems, development of marketing standards, integration into the environmental framework, etc. The status of agricultural holdings is correctly identified as a priority but the use of Rural Development component of the Instrument for Pre-accession Assistance (IPARD) funds should not be seen as the only solution to the structural problems. The indicative financial allocation under IPARD of EUR 175 million by 2020 has the potential to contribute significantly to the modernisation and development of the sector. However, most benefits could be realised in the medium and long term and will be directly dependent on the IPARD institutional framework becoming fully functioning. The correct functioning of the Managing Authority, the IPARD Agency and the Advisory system depend not only on sufficient allocation of staff and resources, but also on long-term stability, transparency and retention of expertise.

### *Industry sector development*

**The deindustrialisation of the 1990s and 2000s has contributed to the unfavourable export structure.** Although the deindustrialisation appears to have stopped, the level of productivity in the sector remains very low (40 % below the one in Central and Eastern Europe). Sustained investment in industry and manufacturing is needed to safeguard and upgrade the skills, improve productivity and so ensure the integration of a larger number of firms into global value chains.

**The planned changes concerning industrial policy do not go far enough to constitute a substantial reform of the sector.** The level of state aid is very high, and too much aid is granted to unprofitable public companies or to non-transparent FDI projects. The envisaged policy measure boils down to the effective implementation of the recently adopted Law on Investments. The plan is to improve administrative capacity at local and central level to better manage subsidies, in particular towards priority industries identified in action plans. The scope and content of this measure could be better defined to ensure that less but better targeted and growth-inducing aid is granted. In addition, it should also ensure that investment aid is granted on the basis of clear criteria in line with the EU and SAA state aid rules, and according to fully transparent procedures.

### *Services sector development*

**Job gains in the services sector in the past decades have not been accompanied by major productivity gains.** Services are currently dominated by retail and administration, the latter including a high number of public administration employees. As in industry, Serbia enjoys good comparative advantages in some services sectors. The share of services in total exports is comparable to similar countries, information and communication technologies and transport being the two most important exports. Tourism is lagging behind, although there has been a revival in recent years, in particular in Belgrade. Overall, the sector will benefit from the general measures on the improvement of the business environment and the fight against the informal economy.

### *Business environment, corporate governance, and reduction of the informal economy*

**Business-friendly reforms have continued but there are still barriers to attract and facilitate private investment.** The recent adoption of simplified procedures for issuing construction permits was an important improvement. However, private investment remains hampered by *inter alia* a costly, unpredictable and non-transparent system of para-fiscal charges, difficult access to capital for smaller firms, and red tape. The very low inflation and reduced risk premia contributed to lowering interest rates. However, credit remains expensive due to the lack of collateral mechanisms such as guarantee schemes or mortgages and enforcement deficiencies. Competition remains distorted by state-owned enterprises and the large informal economy.

**The policy guidance to improve the business environment was partially addressed.** The simplified construction permit procedure and the new law of conversion of right of use of land into right of ownership are both expected to have a positive effect on business activity. Similarly, the fight against the informal economy was intensified with stricter inspections and tax collection. However, there were only limited attempts to better regulate para-fiscal charges and to re-launch the ‘regulatory guillotine.’ The privatisation and liquidation process of state-owned enterprises, in particular of large ones, and the restructuring of utility firms are still ongoing. The Law on Inspections still has to be effectively implemented.

**The measure on improving access to finance for SMEs addresses the main obstacle to SME development in Serbia.** However, it tackles a symptom rather than the underlying structural obstacles to affordable access to finance. A number of proposals to reduce the lending rate have been put forward, including a guarantee scheme, operated by the European Investment Bank. It is very much needed for SMEs that are unable to access commercial loans at affordable rates, especially considering that the implementation of this scheme has been delayed for over two years. However, more structural obstacles to access to finance have not been addressed. For example, the mismatch between demand and supply of sufficient collateral is a key obstacle to credit expansion.

**Implementing the reform of public enterprises is a key challenge.** The Law on Public Enterprises, adopted in February 2016, provides the basis for introducing corporate governance in public utilities. It is still uncertain how it will be implemented to achieve an effective de-politicisation of management. As regards the three large public utilities – for railways, gas and electricity — plans for corporate and financial restructuring are now underway but obstacles to their effective restructuring remain very high. There is resistance, given the high direct costs, immediate and longer-term social impact, and limited perspectives to find new employment for redundant staff. Therefore, in order to facilitate these reforms, efforts to mitigate their negative repercussions should be given special attention.

**The planned reform of para-fiscal charges targets simplifying procedures and reducing the overall administrative burden for businesses.** The mapping of administrative procedures and listing of existing fees and charges should improve transparency and predictability for businesses. However, this system should also effectively target a simplification of existing administrative procedures and a reduction of the level of fees and para-fiscal charges. To that end, the implementation of the Law on Fees planned to be adopted at the end of 2016 should be closely monitored. The link to the ‘regulatory guillotine’ seems obvious, although not mentioned in the programme.

**A common information platform for all inspections (e-inspection) is expected to contribute to combating the informal economy.** The measure establishes an electronic information system for planning, coordinating and conducting inspections. It is foreseen

to have positive results on reducing the informal economy, while relieving compliant companies from the cost of unnecessary and frequent inspections.

### *Technological absorption and innovation*

**Serbia has a good scientific base but cooperation between the public and private sector is weak and not systemically supported.** The level of investment in research is 0.8 % of GDP in 2014, while 0.5% of the workforce was R&D personnel in 2013. The main focus of the ERP is on strengthening cooperation between public and private sector. The measures aim to promote better application of basic science in industry, inter alia through the ‘Technological Development Programme’ and an increase of activities of the Innovation Fund. The budget commitment is substantial (EUR 130 million for the period of 2016-2018). However, there is insufficient information about which measures this amount will cover, except that it should serve for the salaries of 6 000 researchers. It is important that the reform commit the government to work directly with the private sector as an equal partner. At the moment, public financing of research in the private sector is only possible via the Innovation Fund, while ministries and public agencies cannot directly support research activities implemented by companies. Serbia has considerable needs for sustainable support to RDI infrastructure such as a technology park, incubators, clusters, etc., which can directly benefit SMEs, as well as for addressing the brain drain of the most technologically skilled people. Increased support to these could complement already planned actions in this area.

### *Trade integration*

**The trade deficit remains high, although it has declined over recent years.** Total exports of goods and services are only 47 % of GDP, which is below the average for countries of similar size and geographic location. The export base is still heavily concentrated within few companies and sectors. Despite a strong increase in 2015, net FDIs are still only two-thirds of their level before the global crisis in 2008.

**Improving the national quality infrastructure (QI) system is an important but not the only component of boosting trade performance.** The efforts to reach international recognition of the national QI system should be accompanied by a thorough review of all legislation, technical regulations and standards, as well as the removal of distortive non-tariff barriers to trade that do not derive from the use of certificates of conformity, standards or other technical requirements. The reform measure is supported by an adequate budget allocation and the associated risks are correctly identified.

**Foreign and domestic investors need an appropriate set of public services to support their exports.** In particular, better services could be offered to support the internationalisation of companies, in particular SMEs, through consultancy, international fairs and projects bringing domestic and foreign companies together. At the same time, more should be done to facilitate both exports and imports through improved procedures at the border and beyond. The ambitious efforts on trade facilitation that are pursued within CEFTA also need to be implemented in time.

### *Employment and labour markets*

**Low employment rates, high youth and long-term unemployment are still key challenges for the labour market, despite some improvements.** The employment rate reached 53.2 % in 2015 and is particularly low for women (45.8 %), while the youth (15-24) unemployment rate is still over 40 %; one in five young persons is not in employment, education or training. Two thirds of all unemployed are long term unemployed. New and considerable inflows into unemployment are expected in 2016

resulting from the dissolution process of state-owned enterprises and the "rightsizing" of the public administration. Obstacles to the creation of formal jobs such as the high taxation on labour are not identified. A refined diagnosis of structural problems, in particular informal work (close to 20 % in 2015) and identification of the characteristics of the unemployed (age, skills) is mostly lacking. Around 60 % of unemployed have completed upper secondary education, pointing to considerable gaps between skills and labour market demand.

**The policy guidance on finalising the National Qualifications Framework (NQF) and adopting a comprehensive and well-targeted set of active labour market policies has been partially addressed.** On the basis of existing qualification frameworks for vocational and higher education, an integrated NQF has been developed which is under consultation with relevant national bodies. The budget and coverage of active labour market measures increased in 2015, compared to very low levels in previous years, but remained modest. Out of around 120 000 beneficiaries, the vast majority benefitted from active job search training and job fairs. Reforms in the National Employment Service continued in 2015 with focus on developing a client-centred approach and improving the caseload distribution.

**The NQF and active labour market policies are the focus of the reform measures envisaged in 2016-18 but stronger links should be established with other reform priorities.** It will also be important to stick to the schedule of reform steps outlined in the programme. The identified risk of inadequate support from social partners in the course of adoption of the NQF and the necessary establishment of sector councils requires further work by the government to involve the social partners in order to ensure progress. No indication is given how the risks mentioned about establishing the Qualifications Agency could be addressed early on in the process. Finalisation of the NQF is presented mainly as an objective in itself and not linked with steps for a progressive reform of the education system at all levels, including expanding pre-primary education, improving the level of basic skills to be acquired by all students, and strengthening teacher training in order to improve the outcomes and relevance of the system for the labour market.

**Improving the effectiveness and scope of active labour market policies with special emphasis on young people, redundant workers and the long-term unemployed clearly responds to the social and economic needs.** The identification of target groups is adequate, but the planned number of beneficiaries does not yet match the needs. A more robust approach for supporting the labour market reintegration of workers becoming redundant in 2016 and beyond due to the state-owned enterprises resolution process and the public administration reform could be developed within the framework of this measure, and would have to be reflected in next year's budget. The ongoing reform of the National Employment Service provides the framework for increasing its capacity to roll out support measures to larger numbers of beneficiaries.

#### *Fostering social inclusion, combating poverty and promoting equal opportunities*

**Social protection of the most vulnerable segments of the society is envisaged to be preserved.** However, the current system of financial assistance does not lift beneficiaries out of poverty and does not systematically cover people living below poverty thresholds.

**A key challenge is to improve the effectiveness of social assistance for addressing poverty.** Foreseen changes in social protection are adequate in terms of objectives (improving adequacy, quality and targeting) but lack focus on spending efficiency. The main pillars of the measure are amendments to the Social Welfare Act of 2011 and new legislation on financial support to families with children. From the information provided

about the substance of these legal initiatives they appear to be of rather technical nature. In addition, it is planned to interlink different information systems on the disbursement of benefits in order to improve allocation mechanisms.

**It remains unclear how the stipulated objective of moving recipients of social benefits closer to the poverty threshold would be reached.** The reform does not sufficiently address the issues of adequacy, targeting and coverage. The budget for this measure indicates an increase by 25 % of social spending in the period 2016-2018, but since the new legislation is not yet in place, it is not clear on which basis this increase is projected. A comprehensive approach to tackling poverty and social exclusion, which would link providing social protection for poverty alleviation to activating policies across relevant sectors such as employment and education and take into account the needs of particularly vulnerable groups is not yet developed.

## 5. ANNEX 1: OVERALL ASSESSMENT OF PROGRAMME REQUIREMENTS

The government adopted the Economic Reform Programme on 3 March 2016 and formally submitted it to the European Commission on 11 March 2016.<sup>5</sup> The programme is in line with the medium-term fiscal strategy and the 2016 budget and covers the period 2016-2018. In conformity with the new approach to economic governance, the programme includes an enhanced description of structural reform priorities. However, the programme's structure does not always fully follow the guidance provided by the Commission.

### *Ownership and internal coordination*

The preparation of the programme was centrally coordinated by the Ministry of Finance, which established an ERP working group. Several consultations with ERP coordinators of line ministries and other relevant institutions (the National Bank of Serbia, the National Employment Service, and the Statistical Office of the Republic of Serbia) were carried out.

### *Stakeholder consultation*

Two public consultations were held to give social partners, civil society and all relevant stakeholders an opportunity to contribute, especially to the drafting of chapter 4 on structural reforms.

### *Macro framework*

The programme presents a clear and concise picture of past developments. It also covers all relevant data at the time of drafting it. The macroeconomic framework is sufficiently comprehensive and coherent. The macroeconomic scenario is plausible and major uncertainties and risks are clearly outlined and recognised. The programme also presents an alternative macro-fiscal scenario, envisaging a lower growth path, slower narrowing of the budget deficit and higher debt levels.

### *Fiscal framework*

The fiscal framework is based on the presented medium-term macroeconomic scenario and is coherent, consistent, sufficiently comprehensive and integrated with the overall policy objectives. Most revenue and expenditure measures backing the programme consolidation scenario are well explained, although some are subject to higher uncertainty or would require additional specification. In view of the high government indebtedness and better than expected performance in 2015, the objective of achieving a primary surplus in 2017 could have been more ambitious and brought forward. The programme does not present long-term projections of population trends and of the implications of an aging population on the labour market and public finances, in particular on health and pension systems. As Serbia has only started submitting unofficial fiscal notification data to Eurostat, significant further efforts would be needed to ensure ESA 2010 compatibility of fiscal data.

### *Structural reforms*

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<sup>5</sup> The authorities submitted the programme to the European Commission informally on 2 February 2016.

The structural reform priorities section follows broadly the guidance note and presents in general a credible diagnostic per area as well as reports on the implementation of the recommendations of the Economic and Financial Dialogue of May 2015. Chapter 4 includes 23 structural reform priorities and measures. In general, the reform measures correspond well to the key obstacles to growth and competitiveness identified in the diagnostics and by and large to last year's recommendations. In spite of the difficult budgetary situation, the programme presents costly infrastructure projects. The programme would have benefitted from more market economy oriented reforms, which may not have significant funding needs but might improve the overall economic framework and socioeconomic outcomes. The description of each reform measure is detailed enough in terms of specific actions, timeline and budgetary impact in order to follow-up annually in the coming three years. However, the authorities should consider a more specific analysis of priority measures' expected impact on competitiveness.

**6. ANNEX 2: IMPLEMENTATION OF THE POLICY GUIDANCE ADOPTED AT THE ECONOMIC AND FINANCIAL DIALOGUE IN 2015**

| 2015 policy guidance (PG) for Serbia   | Summary assessment   |
|--|--|
| <p><b>PG 1:</b> Strengthen fiscal consolidation by using any excesses revenue and current expenditure savings to further reduce budget deficits in 2015 and the following years. Underpin the medium-term consolidation path by implementing the planned structural reforms.</p>   | <p>Serbia has partially addressed policy guidance 1:</p> <ul style="list-style-type: none"> <li>• The 2015 deficit was lower than expected. Significant one-off revenues have been used to cover one-off expenditures. Part of the budgetary over-performance was channelled to limited pension increases and targeted wage indexation. Implementation of key reforms is ongoing but has encountered delays.</li> </ul>  |
| <p><b>PG 2:</b> Advance the restructuring and privatisation of state-owned enterprises, prioritising the biggest companies. Introduce better corporate governance and advance, as planned, the organisational and financial restructuring of large, loss-making utilities. Review the efficiency of all forms of state aid and take steps to reduce it. Proceed to revisit public sector employment in a sustainable manner by implementing the Action plan on public administration reform.</p> | <p>Serbia has partially addressed policy guidance 2:</p> <ul style="list-style-type: none"> <li>• Privatisation and bankruptcy procedures have been initiated for companies in the portfolio of the Privatisation agency and the agency was closed in early 2016. Deadlines for finding a sustainable resolution for 17 of the largest state-owned companies have been extended to May 2016.</li> <li>• The restructuring of the large utilities (EPS, railways and Srbijagas) is ongoing, but not yet completed. Corporate and financial restructuring plans were adopted or are in the pipeline. More needs to be done to reduce state aid and review its efficiency. Introducing corporate governance in companies under public ownership remains to be launched. It is part of the 2016 ERP.</li> <li>• Steps are being taken to reduce public employment in a sustainable manner, although this reform is also facing implementation delays.</li> </ul> |
| <p><b>PG 3:</b> Further strengthen public finance management, notably by improving the budgetary process and the capacity of the tax administration. Compile and start submitting to Eurostat excessive deficit procedure notification tables before the end of 2015.</p>  | <p>Serbia has partially addressed policy guidance 3:</p> <ul style="list-style-type: none"> <li>• A public finance management reform programme and a tax administration transformation programme until 2020 were adopted last year. Their implementation is envisaged to significantly improve budgetary processes and the work of the tax administration.</li> <li>• Serbia has submitted an unofficial notification in 2015 and is working on a plan to start compiling and submitting official excessive deficit procedure notifications.</li> </ul>  |
| <p><b>PG 4:</b> Advance with the rebalancing of macro-economic policies with fiscal consolidation as a precondition for a more accommodative monetary policy stance, with a view to fostering a pick-up in the pace of credit extension. In this context, increased efforts to address the high burden of non-performing loans on banks' balance sheets, involving all key stakeholders including the central bank as necessary, also appear warranted.</p>                                      | <p>Serbia has fully addressed policy guidance 4:</p> <ul style="list-style-type: none"> <li>• The strong fiscal consolidation in 2015 provided room for significant monetary policy relaxation. There are some signs of easing credit standards and a pick-up in lending activity.</li> <li>• Non-performing loans remain very high. However, the authorities, including the central bank, have designed a comprehensive resolution strategy and action plans. As part of the efforts to address the problem, the central bank implemented a special diagnostic study.</li> </ul>  |
| <p><b>PG 5:</b> Improve the business environment and tackle the grey economy, notably by better regulating para-fiscal charges, business inspections, and leasing of labour. Take steps to further simplify the regulatory environment by re-launching the</p>   | <p>Serbia has partially addressed policy guidance 5:</p> <ul style="list-style-type: none"> <li>• Several measures were adopted to improve the business environment (e.g. full implementation on simplified construction permit procedures, the law of conversion of right of use of land into</li> </ul>  |

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|--|---|
| <p>"regulatory guillotine".</p>  | <p>right of ownership). The fight against the grey economy has been intensified with stricter inspections and tax collection. However, the business environment remains unpredictable.</p> <ul style="list-style-type: none"> <li>• There has been no attempt to better regulate para-fiscal charges, though this is covered (with limitations) in the 2016 ERP.</li> <li>• There was no progress to re-launch the 'regulatory guillotine.'</li> <li>• Serbia has not addressed the guidance of leasing of labour.</li> </ul>   |
| <p><b>PG 6:</b> Adopt a comprehensive and well-targeted set of active labour market policies, with a focus on youth and the long term unemployed, as well as dedicated skills upgrade programmes. The finalisation of the national qualifications framework should be the first step in a progressive reform of the education system, aimed at improving the outcomes of the system, thereby enhancing the human capital productivity.</p>   | <p>Serbia has partially addressed policy guidance 6:</p> <ul style="list-style-type: none"> <li>• Employment policies targeted workers who lost jobs in the restructuring of state-owned companies.</li> <li>• Active labour market measures were stepped up in 2015, with young people as a main target group.</li> <li>• Further steps were taken for establishing the National Qualifications Framework, but it has not been finalised yet.</li> </ul>   |
| <p><b>PG 7:</b> Stimulate private investment, for example by establishing public schemes to support lending to SMEs and research activities in companies. To increase public investment, improve preparation and speed up the implementation of public projects. Step up the works on corridors VII and X in line with the regional core network. Improve energy production and transmission, most notably by better governance of energy firms, regulation of the network and the construction of gas inter-connectors.</p> | <p>Serbia has partially addressed policy guidance 7:</p> <ul style="list-style-type: none"> <li>• Financial instruments for SMEs, including most innovative ones, remain underfunded and new schemes take long to be established.</li> <li>• A programme to improve the management of public investment is introduced as part of the public finance management reform. However, in 2015 government capital expenditure underperformed again.</li> <li>• The infrastructure and energy projects listed in the 2016 ERP aim at improving corridor X and interconnection in the field of gas and electricity. The ongoing restructuring of EPS and Srbijagas should also improve in principle their governance.</li> </ul> |