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ECONOMIC REFORM PROGRAMME

OF

SERBIA
(2018-2020)

COMMISSION ASSESSMENT

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Contents

1. EXECUTIVE SUMMARY

Economic growth is forecast to pick up markedly. Weather-related supply shocks trimmed growth to just below 2 % in 2017, well under initial expectations. However, economic expansion gathered pace in the second half of the year, supported by stronger investment. Economic expansion is expected to continue in the following years, mainly on the back of recovering private and public consumption. Although growing aggregate demand would drive prices up, inflation is forecast to stay close to the central bank target. Foreign direct investment is expected to remain large and to fully cover the current account deficit. Financial sector indicators improved but there are still pockets of vulnerability, in particular in some state-owned banks.

Fiscal policy is projected to turn expansionary. In the 4 years from 2014 to 2017, the general government budget moved from a very high deficit to a surplus. The 2018 budget is conservative and contains significant buffers but could have been more ambitious in addressing some legacy issues from the crisis. The medium-term budget deficit target of 0.5 % of GDP is sufficient to ensure fiscal sustainability and further reduction of government debt, which is still relatively high at above 60 % of GDP. Total expenditure is set to decline further but its composition is expected to become more supportive of growth. The success of budget consolidation, however, masks an unfinished reform agenda for the public sector.

The main challenges in these respects include the following.

- **Maintaining a proper macroeconomic policy mix and continuing difficult structural reforms remain demanding.** The baseline macro-fiscal scenario is premised on continuing economic reforms that should reduce fiscal risks and further support both public and private investment. Striking the right policy mix may be more difficult now that the programme with the International Monetary Fund (IMF) has expired.

- **Weak fiscal rules and incomplete reforms do not sufficiently support debt sustainability.** Government debt is still high and fiscal risks are elevated as key public sector reforms remain unfinished. Fiscal rules are weak, not binding and remain largely irrelevant for policy making. As gains in revenue collection have been instrumental in stabilising public finance, safeguarding them would necessitate further improvements to the tax administration on the basis of its recently updated transformation programme.

- **There is significant scope to improve the composition of government expenditure.** The economic programme expects lower payments on activated guarantees, on some transfers, and on interest expenditure over the medium term, channelling part of the savings towards increasing capital expenditure. Making budgetary spending more growth friendly would also require keeping a lid on wage and pension expenditures and strengthening the capital expenditure execution process.

- **Incomplete restructuring and privatisation of state-owned enterprises still poses a risk.** Non-performing loans and other performance indicators remain worse in state-owned banks. The privatisation and restructuring of state-owned enterprises continued to face delays, which are most critical in the energy sector.

- **Stepping up capital expenditure with a better system of planning and execution.** Serbia should develop a single mechanism for prioritising and monitoring all investments regardless of the source of financing, as provided for in the public finance management (PFM) reform programme. Public support to companies should seek a better balance between the current limited support to domestic small and medium-sized enterprises (SMEs) and generous state aid to incoming foreign direct investment.
- **The business environment has improved but remains costly with unfair competition coming from the public and the informal sector.** There was no progress on regulating parafiscal charges. Own resources remain the principle funding for SMEs. Trade integration with the EU is growing, but remains hindered by many non-tariff barriers, especially in the phytosanitary area.
- **Youth and women did not sufficiently benefit from the positive labour market trends in 2017.** More substantive labour market reforms and increased investments in active labour market policies are needed to support access to employment for the large pool of unemployed, also with regard to the longer-term shrinking of the workforce. Education reforms need to be pursued vigorously and in concertation with all stakeholders.

The policy guidance jointly adopted at the Economic and Financial Dialogue of 23 May 2017 has been partially implemented. The 2017 budget was in surplus, significantly above the initially planned deficit. While most of the available additional fiscal space was used to further reduce the deficit in 2017, the execution of capital expenditure underperformed. There were no administrative or legal measures taken to address the recommendation to strengthen fiscal rules and the economic reform programme (ERP or 'the programme') does not include any plans or a timeline for it. The reform of state-owned enterprises advanced, albeit unevenly, while transformation of the tax administration proceeded with the introduction of risk management, but there were delays in other areas. While the monetary policy stance was in line with achieving the inflation target, limited steps were taken to restructure and privatise state-owned banks. The management of public projects has improved, but public investment remains relatively low and below the needs of both public and private operators. The single project pipeline for infrastructure investment is not yet in place. Regulatory dialogue with businesses should be further improved, especially on taxation. Parafiscal charges remain unregulated despite years of dialogue on the issue. Introduction of new financial instruments does not follow the needs of SMEs. The reduction of non-wage labour cost has been marginal and was not specifically targeted at the lower sections of the wage distribution.

The ERP partially matches the reform priorities identified by the Commission. The macroeconomic and fiscal frameworks are sufficiently comprehensive and coherent, providing a good basis for policy discussions. The structural reform part of the ERP remains largely unchanged from last year. The ERP proposes a set of measures to boost fiscal performance. It continues with the restructuring of publicly-owned operators in the energy and transport markets. The programme is strongly focused on the business environment, especially on the reduction of red tape. Reforms in education, employment and social policies are mostly prolonged up to 2020, thus beyond the three-year timeframe aimed for.

2. ECONOMIC OUTLOOK AND RISKS

Economic growth is forecast to pick up markedly. In 2017, weather-related supply shocks trimmed growth to just below 2 %, well under initial expectations. However, economic expansion gathered pace in the second half of the year, supported by stronger investment. Economic expansion is expected to continue in the following years, mainly on the back of recovering private and public consumption, reaching 4 % in 2020. Domestic demand is set to increase steadily, while growth contributions from net exports remain marginal and negative throughout most of the period covered by the programme. Decelerating from double-digit levels, export growth is nonetheless forecast to continue to be a major driver of economic activity. On the supply side, the industry (including construction) and service sectors are expected to be the main drivers of growth.

The macroeconomic scenario is premised on the continuation of economic reforms. It also assumes a benign external environment and the attraction of further significant foreign direct investments in tradable sectors. The baseline scenario is plausible, although it is slightly more optimistic than the latest European Commission forecast from autumn 2017. Contrary to previous years, economic growth is likely to be supported by an expansionary fiscal policy. The ERP expects the negative output gap to close and even turn slightly positive by 2020 as the economy grows above its potential.

Table 1:

Macroeconomic developments and forecasts

	2016		2017		2018		2019		2020	
	COM	**ERP**	COM	**ERP**	COM	**ERP**	COM	**ERP**	COM	**ERP**
Real GDP (% change)	2.8	**2.8**	2.0	**2.0**	3.3	**3.5**	3.5	**3.5**	n.a.	**4.0**
Contributions:										
- Final domestic demand	2.0	**2.1**	2.6	**2.4**	3.3	**3.4**	3.6	**3.7**	n.a.	**4.4**
- Change in inventories	0.3	**0.5**	0.0	**0.0**	0.0	**0.0**	0.0	**0.0**	n.a.	**0.0**
- External balance of goods and services	0.5	**0.2**	-0.6	**-0.4**	0.0	**0.1**	-0.1	**-0.2**	n.a.	**-0.4**
Employment (% change)	5.6	**4.4**	3.2	**2.9**	2.0	**1.4**	2.1	**1.4**	n.a.	**1.6**
Unemployment rate (%)	15.3	**15.9**	13.5	**13.6**	11.6	**11.6**	9.5	**10.0**	n.a.	**8.1**
GDP deflator (% change)	2.5	**2.5**	2.8	**2.8**	3.0	**2.8**	3.0	**2.8**	n.a.	**3.0**
CPI inflation, annual average (%)	1.1	**1.1**	3.2	**3.1**	3.3	**2.7**	3.0	**2.8**	n.a.	**3.0**
Current account balance (% of GDP)	-4.0	**-3.1**	-5.4	**-4.6**	-5.7	**-4.2**	-5.8	**-4.1**	n.a.	**-3.9**
Budget deficit (% of GDP)	-1.3	**-1.3**	0.8	**0.7**	0.0	**-0.7**	0.0	**-0.5**	n.a.	**-0.5**
Government debt (% of GDP)	72.5	**73.0**	64.9	**63.7**	63.9	**62.8**	61.5	**59.8**	n.a.	**56.3**

Sources: Economic Reform Programme (ERP) 2018; Commission autumn 2017 forecast

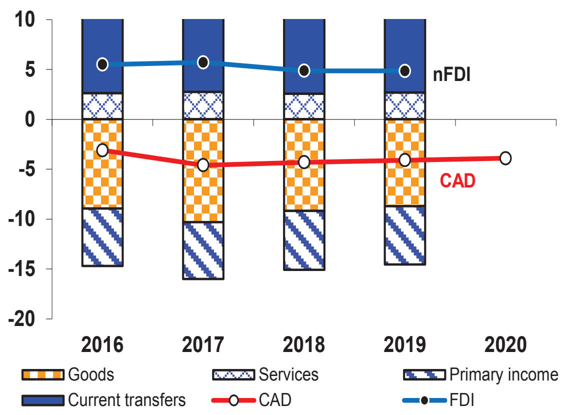
Risks remain elevated. The main challenges to the growth scenario are clearly outlined in the programme. Domestically, they are linked to the pace of implementation of structural reforms, in particular further improving the performance of state-owned enterprises and reforming the public administration. These reforms have also an important signalling effect about the authorities' commitment to the process of modernising the economy. As a result, they affect the country risk premium. In addition, maintaining a proper macroeconomic policy mix and continuing difficult structural reforms will represent a challenge, as the three-year Stand-By Arrangement with the IMF was successfully concluded in February and fiscal rules remain weak and largely irrelevant. Externally, developments in the EU, which is the main export market and source of most of Serbia's foreign investment, exert a major influence on the country's economy. As economic growth largely depends on capital flows, risks also stem from the impact on them of monetary policy adjustments by the European Central Bank and the Federal Reserve.

In view of these risks and uncertainties, the ERP presents an alternative, pessimistic scenario. It envisages lower economic growth by 1.5 pps on average in comparison to the baseline scenario. There are very few details, however, on the precise assumptions underlying the alternative scenario and their impact on the various demand components.

Inflation is forecast to stay close to the central bank target of 3 %. As expected, in 2017 inflation slightly increased and entered the new tolerance band[1], averaging 3.2 % for the year as whole. The relatively stable price dynamics for a fourth year in a row and persistently strong fiscal performance created room for additional monetary policy relaxation. Cuts in the key policy rate resumed in the autumn when it was lowered in two steps of 25 basis points each, to 3.5 %, followed by another 25 points cut in March. Short-term price pressures remain contained, also in view of the fall in imported inflation due to a strong appreciation of the dinar. The high pass-through effect from the exchange rate remains a key price-setting factor and in order to prevent excessive daily exchange rate oscillations the central bank intervened regularly on the foreign exchange market. Over the medium term, rising aggregate demand is expected to push inflation up, while forecast uncertainty is mainly related to movements in primary commodity prices and policy decisions by major central banks.

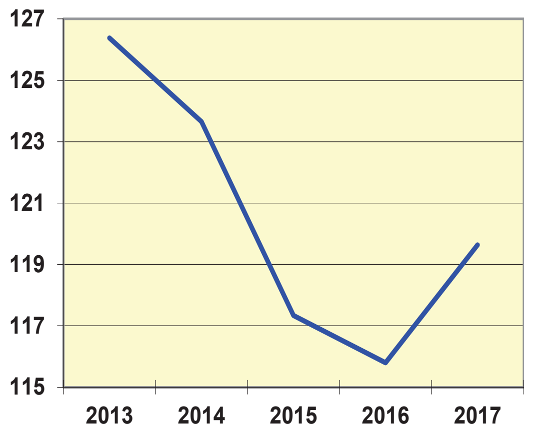
Graph 1: **External competitiveness and the current account**

Evolution of the current account balance (% of GDP)



Source: ERP 2018, Commission calculations

Real effective exchange rate (CPI-based, total economy, 2005=100)



Views diverge on the direction of the current account deficit. The ERP envisages that the current account deficit will start shrinking again after going up in 2017, falling to 3.9 % of GDP by 2020. The main driver behind its reduction is expected to be a robust export performance on the back of continued foreign direct investment inflows in manufacturing and other tradable sectors. In parallel, a pick-up in investment activity and consumption should sustain import growth, and primary income outflows would increase further, along with rises in non-resident investment. While both these trends are recognised in the programme, it has a rather benign evaluation of their magnitude, which together with expectations of more favourable terms of trade, leads to a lower current account

[1] In view of low inflation and inflation expectations, the central bank reduced its inflation target by 1 pp. to 3% ± 1.5 pps as of 2017.

deficit than forecast by the Commission. Due to the envisaged deterioration of the public savings-investment gap, the forecast reduction of the current account deficit would require a narrowing private-sector gap, which does not seem plausible in an economic scenario based on higher investment and consumption growth.

Attracting foreign direct investment in tradable sectors is crucial for external sustainability and improving competitiveness. Although price and cost competitiveness indicators worsened in 2017, export performance remained solid. Past reforms and foreign direct investment in export-oriented sectors have sustained further improvements in structural competitiveness. This was attested by Serbia's progress in various international rankings, albeit at a slower pace than in previous years. In the last 3 years, foreign direct investment not only contributed to expanding the production base but also fully covered the current account deficit. This is expected to persist over the programme period. The net international investment position is forecast to remain negative at above 100 % of GDP. However, external buffers are set to remain sound as foreign exchange reserves cover around 6 months' worth of imports and close to three times the short-term external debt at residual maturity.

Financial-sector indicators improved but there are still pockets of vulnerability. Commercial banks remained highly liquid and well-capitalised, and their profitability increased. Lending activity accelerated last year, supported by lower borrowing costs and easing credit standards. Credit to households, in particular cash loans, grew faster than other segments. Progress with the strategy for non-performing loans and the mandatory write-off of fully provisioned impaired loans helped lower the gross non-performing loan ratio to 9.8 % by the end of 2017. The results, however, were uneven and less pronounced in state-owned banks where there is still a large overhang of bad loans. Privatisation plans for state-owned financial institutions have been delayed amid persistent governance issues in the sector, which the ERP fails to address. In the last 2 years, overall deposit and loan dinarisation increased, albeit from very low levels. Financial stability was supported by the introduction of Basel III standards in 2017.

Table 2:

Financial sector indicators

	2013	**2014**	**2015**	**2016**	**2017**
Total assets of the banking system, EUR million	34 378	34 618	35 655	36 992	37 714
Credit growth	-4.4	3.1	2.9	2.5	1.9
Deposit growth	3.3	7.6	6.5	11.4	3.3
Loan to deposit ratio	1.2	1.1	1.1	1.0	1.0
Financial soundness indicators					
- non-performing loans	21.4	21.5	21.6	17.0	9.8
- total provisions to gross NPLs	113.8	114.5	114.2	118.9	133.3
- regulatory capital to risk weighted assets	20.9	20.0	20.9	21.8	22.6
- liquid to total assets	38.5	35.6	34.3	36.9	36.7
- return on equity	-0.4	0.6	1.6	3.4	10.6
- forex loans to total loans*	70.9	70.0	71.9	69.3	67.5

Sources: ERP 2018, National Central Bank, DataInsight
** Includes both denominated and indexed positions.*

3. PUBLIC FINANCE

For the first time in more than a decade the budget was in surplus. In the 4 years from 2014 to 2017, the general government budget turned from a deficit of 6.6 % of GDP to a surplus of 1.2 % of GDP[2]. Last year's outcome outperformed by far the initial budget deficit target. As in the previous 2 years the better than expected result was mainly driven by strong revenue performance. Although a drought in the summer of 2017 undermined economic activity, it mainly affected agriculture, which is comparatively less taxed. On the other hand, positive developments in the labour market boosted consumption and labour tax bases and, aided by some one-offs, revenue collection improved across the board. This created space for the payment of bonuses for some public-sector employees and one-off payments to pensioners at the end of the year.

Table 3:

Composition of the budgetary adjustment (% of GDP)

	2016	2017	2018	2019	2020	Change: 2017-20
Revenues	43.2	43.9	42.4	41.8	41.2	-2.7
- Taxes and social security contributions	37.1	38.3	37.2	36.9	36.5	-1.8
- Other (residual)	6.1	5.6	5.2	4.9	4.7	-0.9
Expenditure	44.5	43.2	43.1	42.3	41.7	-1.5
- Primary expenditure	41.4	40.5	40.6	40.0	39.6	-0.9
of which:						
Gross fixed capital formation	3.3	3.0	3.6	3.7	3.7	0.7
Consumption	16.5	16.6	16.8	16.8	16.7	0.1
Transfers & subsidies	19.4	18.5	18.1	17.8	17.5	-1.0
Other (residual)	2.2	2.4	2.1	1.7	1.7	-0.7
- Interest payments	3.1	2.7	2.5	2.3	2.1	-0.6
Budget balance	-1.3	0.7	-0.7	-0.5	-0.5	-1.2
- Cyclically adjusted	-1.2	1.0	-0.5	-0.4	-0.6	-1.6
Primary balance	1.8	3.4	1.8	1.8	1.6	-1.8
Gross debt level	73.0	63.7	62.8	59.8	56.3	-7.4

Sources: ERP 2018, Commission calculations.

The budget consolidation success masks an unfinished reform agenda. While the good fiscal results are undoubtedly a significant achievement, sustaining them would require completing key public-sector reforms. Among them, restructuring and privatising state-owned enterprises, in particular in the petrochemical, transport, mining and energy sectors, remain of utmost importance in order to decrease contingent liabilities and remove a major source of fiscal risk. Delays in public administration reform need to be addressed in order to improve the quality and sustainability of public services. As gains in revenue collection have been instrumental in stabilising public finance, safeguarding them would necessitate further improvements in the tax administration on the basis of its recently updated transformation programme. Furthermore, the existing significant public infrastructure gaps and deficiencies in the preparation and execution of public capital

[2] The text comments on the actual execution data for 2016, which differ from those in the ERP.

projects would have to be tackled, so as to ensure that the available fiscal space is used in a productive and efficient manner.

Fiscal policy is projected to turn expansionary. The medium-term budget deficit target of 0.5 % of GDP is sufficient to ensure fiscal sustainability and further reduction of government debt. However, this target, in combination with the expected closure of the output gap, would mean shifting the fiscal stance from pro-cyclical and restrictive to pro-cyclical and expansive. The fiscal expansion is expected to be predominantly driven by a steady decline in the revenue share in GDP, in particular non-tax, excise duties, and corporate tax revenue. Most of this decline is due to expiration of the one-offs that have boosted results in 2017, as well as to noticeably conservative revenue estimates, which points to the existence of potentially sizeable implicit buffers within the indicated deficit targets. Following a marginal reduction in the personal income tax burden in 2018, there are no other tax policy changes envisaged over the period covered by the programme.

Total expenditure is set to decline further but to become more supportive of growth. The level of government spending is high and the share of productive expenditure remains low. The ERP foresees remedying this by decreasing payments on activated guarantees, on some transfers, and on interest expenditure over the medium term, channelling part of the savings towards increasing capital expenditure. In addition, although this was not explicitly identified as in the previous programme, the authorities have signalled their intention to use any potentially available fiscal space to further boost investment spending. Expenditure on employees and on pensions is expected to stabilise at 9.5 % of GDP and 11.0 % of GDP, close to their respective levels in 2017.

Box: The 2018 budget

Parliament adopted the 2018 republican budget on 15 December 2017.

The general government deficit target is RSD 32.0 billion (0.7 % of GDP). Besides an increase in the non-taxable threshold for the personal income tax, there are no other major tax policy changes. On the expenditure side, despite falling interest payments, wage and pension hikes and a sizeable increase of capital expenditure are planned to keep the overall spending share in GDP broadly unchanged.

Table: Main measures in the 2018 budget*

Revenue measures		Expenditure measures	
• Increase in personal income tax non-taxable threshold from RSD 11 790 to RSD 15 000 **(-0.2 % of GDP)**		• Targeted wage increase **(0.7 % of GDP)** • 5 % pension hike **(0.5 % of GDP)** • Increase in capital expenditure **(0.8 % of GDP)**	
Total revenue effect	**(-0.2 % of GDP)**	**Total expenditure effect**	**(2.0 % of GDP)**

* Estimated impact on general government revenue and expenditure.
Source: ERP 2018

The 2018 budget is conservative. It is built on the basis of prudent revenue estimates, reflecting forecast dynamics of respective tax bases but without fully taking into account better outcomes in 2017. As in previous years, any possible gains due to improved tax collection and reduction of the informal economy are also not included. The budget contains some buffers on the expenditure side, although not explicitly. For example, investment expenditure has been increased by close to 30 % over the previous year, which given its poor implementation record and deficiencies in the capital budgeting process is likely to result in budget savings due to under-execution. Therefore, under the baseline macroeconomic scenario, the planned deficit of 0.7 % of GDP could be again easily outperformed.

The budget could have been more ambitious in addressing legacy issues. Most of the available fiscal space was used for targeted increases of public-sector wages and a 5 % rise in pensions. However, delaying the public administration reform has triggered another extension of the cumbersome partial employment freeze in the public sector. In addition, the budget did not remove the progressive cuts to pensions and public sector employees' salaries that were introduced in 2014 on a temporary basis in response to the fiscal crisis. Maintaining the reductions might create potentially significant implicit liabilities.

There is a clear understanding of major fiscal risks and their potential budgetary and economic implications. The section on fiscal risks is one of the most extensive and detailed in the programme. A cluster of risks is associated with the functioning of public enterprises. Some of them, like those related to already issued guarantees or to foregone budget revenue and potential assumption of liabilities, have declined as a result of previous policy measures and the improved financial performance of state-owned enterprises. Nevertheless, these risks remain significant and, coupled with other sources of risk stemming from court decisions and deposit insurance, require close attention and prudent management. The programme is also upfront in acknowledging risks from natural hazards and disasters. However, given the gravity of this risk, the devastating impact of the 2014 floods and the unstable performance of a key sector like agriculture due to its sensitivity to weather conditions, the analysis and mitigating policies could be strengthened further. As in previous years, the programme fails to mention possible restitution-related obligations of up to EUR 2 billion or some 5 % of GDP that the government is legally required to issue already in 2018.

The alternative fiscal scenario does not sufficiently reflect all risks. The ERP presents a sensitivity analysis, estimating that 1 pp. lower economic growth would lead to 0.36 % of GDP higher budget deficit. In view of the high foreign currency-denominated government debt and debt service costs, the programme also traces the channels through which inflation impacts the budget and flags the relevance of exogenous factors like the exchange rate and interest rates. On the basis of the alternative macroeconomic scenario, the programme also outlines a fiscal path with a bigger deficit and slower pace of government debt reduction. However, the alternative fiscal scenario is still too benign and does not sufficiently take into account the numerous risks facing the budget and the high revenue volatility.

Low budget deficits should keep government debt and interest payments on a downward path over the medium term. After it reversed its growing trend in 2016, government debt fell markedly last year, helped by a high primary surplus and a strong appreciation of the dinar, especially against the US dollar. Although primary surpluses are planned to decline significantly over the programme horizon, they would remain a key debt-reducing factor, overtaken in importance only in 2020 by the so called 'snow-ball' effect capturing the impact of the differential between interest rates and nominal growth. As a consequence of lower primary surpluses, the pace of government debt reduction is forecast to slow down, especially in 2018 when the stock-flow adjustment is expected to contribute positively to debt. The envisaged fiscal stance would, nevertheless, support further reduction of government debt and interest payments.

There are downside risks to the debt trajectory. Despite declining under the baseline scenario, government debt and interest costs are forecast to remain high, reaching 56.3 % of GDP and 2.1 % of GDP in 2020 respectively. Gross financing needs (defined as the sum of new deficits and maturing debt) as a share in GDP, although falling as well, would stay in the double digits. Due to the high share of foreign currency-denominated debt, nearly four fifths of the total, government debt dynamics is highly sensitive to fluctuations of the dinar exchange rate. The government debt-to-GDP ratio could even potentially increase temporarily in 2018 if restitution-related bonds are issued or some of the other underlying budget assumptions turn out marginally worse. This possible setback, along with other risks related to the unfinished reform agenda, call for using excess revenue and possible under-execution of some budget expenditure to support a more prudent fiscal stance of close to a balance or in surplus, especially in 2018. This is also warranted given the better budgetary outcome in 2017 and the planned strong pro-cyclical fiscal expansion. Looking forward, existing fiscal rules should be strengthened by making them more binding and relevant for policy making, given also the loss of an important external fiscal anchor following the expiry of the IMF programme.

Box: Debt dynamics

Table 4:

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

	2016	2017	2018	2019	2020
Gross debt ratio [1]	**73.0**	**63.7**	**62.8**	**59.8**	**56.3**
Change in the ratio	-3.0	-9.3	-0.9	-3.0	-3.5
Contributions [2]:					
1. Primary balance	**-1.8**	**-3.4**	**-1.9**	**-1.8**	**-1.6**
2. 'Snow-ball' effect	**-0.7**	**-0.6**	**-1.2**	**-1.4**	**-1.8**
Of which:					
Interest expenditure	3.1	2.7	2.5	2.3	2.1
Growth effect	-2.0	-1.4	-2.1	-2.1	-2.2
Inflation effect	-1.8	-1.9	-1.7	-1.7	-1.7
3. Stock-flow adjustment	**-0.4**	**-5.3**	**2.2**	**0.3**	**-0.1**

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

[2] The snowball 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: ERP 2018, Ministry of Finance; Commission calculations.

The government debt-to-GDP ratio fell by close to 10 % of GDP in 2017. More than half of this decline was due to the appreciation of the dinar against the euro and the US dollar. The continuing strong fiscal performance, which brought the primary surplus to nearly 4 % of GDP, was the second important factor behind the steep debt reduction last year. Debt-reducing effects from real GDP growth and inflation also helped, more than offsetting the impact of the still high interest payments. Together with maintaining primary surpluses, they are forecast to contribute to a further decline of government debt over the period covered by the programme. Restitution-related debt and potential privatisation (concession) receipts, not included in this scenario, could significantly impact debt dynamics as well.

4. Structural reforms

The low level of public and private investment is a main bottleneck to competitiveness in the Serbian economy. While the fiscal consolidation was successful, there were delays in the implementation of much-needed structural reforms due to a lack of sufficient determination in this area. There is mismanagement of public enterprises, in particular in the energy sector. Government support to foreign direct investment has gone up, while support to domestic companies remains low. The business environment remains unpredictable with only a limited amount of services and financial instruments available to companies. State aid continues to escape proper control, which impacts negatively the budget and erodes fair competition. In addition, the education system does not fully address the large skills mismatch. Overall, Serbia needs to show more determination to implement reforms to better support the private sector and ensure public finance sustainability. The ERP contains a realistic analysis of the key obstacles to competitiveness, growth, employment and social development.

The structural part of the ERP remained stable with 14 out of 18 measures rolled over from the previous programme. The measures proposed respond to the obstacles, but they are often modest given the real structural challenges. Contributions from the budget are provided for in all measures. However, the methodology for establishing these contributions varies from measure to measure and is not a reliable indicator of commitment. The Commission assessment of the ERP has been progressively taken into account over the years. In particular, in transport and energy there is a slow shift from a focus in investment to structural reforms. The programme would have benefited from more market economy oriented reforms, which may not have significant funding needs but would improve the overall economic framework and socioeconomic outcomes. Looking forward, the next generations of the ERP should take into account that the situation in Serbia has changed since the first programme was adopted. Future measures should be more ambitious in order to better support private investment and job creation.

Public finance management

Increasing public investment and supporting growth strongly depends on continued reform of the budget process and increased efficiency of the tax administration. The tax collection improved as the tax administration, which has been mismanaged over the years, reorganised and became less tolerant towards the grey economy. The level of revenues has been going up faster than economic growth. Despite these changes, the tax administration remains a vulnerable part of the civil service with severe human resource problems. The unpredictable taxation system and the level of taxation of lower end salaries are repeatedly cited by the business community as one of the weakest aspects of the business environment. In addition, economic growth has been undermined by persistent under-execution of government investment spending, as some projects are not well prepared and cannot be implemented in time. Both at state and municipal level, the investment rates are the lowest in the region.

There has been limited progress on the implementation of the measure to transform the tax administration. An assessment on the strengths and weaknesses of the tax administration was carried out by the IMF in 2016 under its Tax Administration Diagnosis Assessment Tool (TADAT) and provides valuable guidance on the way forward. A system of risk analysis directed towards sectors and tax payers with higher probability of tax evasion has been prepared and needs to be effectively put in place. The key goal of the first ERP measure is to continue increasing tax revenues; therefore it proposes only revenues as a monitoring indicator. However, the indicators should address also other issues, which the diagnostics recognises as long term challenges, such as the need to train and retain the most valuable human resources, to channel resources to core tasks and to stop deploying them to non-core administrative activities. The latter is a pending recommendation of the EU Serbia economic policy dialogue from previous years.

The measure to improve public capital expenditure management and execution remains hampered by weaknesses in budgeting, planning and contract oversight. In 2017, public investment underperformed again, staying below the budgeted level of 3.3%

of GDP. At 3% of GDP, government investment spending was significantly below the economy's needs and the lowest in the region. To improve this situation, a new decree regulating how ministries propose and execute projects was adopted. As the next step, the ERP proposes a very unambitious measure to establish an inter-ministerial database, which would include all projects. Serbia should step up the ambition, also by developing a single mechanism for prioritising all investments regardless of the source of financing, as provided for in the public finance management reform programme adopted by the government. The ERP diagnostic correctly detects that a significant share of public investment is financed from municipal budgets. However, the current measure does not address issues at local level, which are often even more problematic than those at state level.

Energy and transport market reform

The state of energy and transport infrastructure continues to be an obstacle to economic development and regional trade integration. Underdeveloped transport infrastructure coupled with a non-harmonised regulatory framework result in high transport costs and low levels of trade integration within the Western Balkans and with the EU. An underdeveloped electricity and gas transmission network and not sufficient level of interconnectivity render the energy market inefficient and its contribution to economic development limited.

The ERP identifies many of the weaknesses and challenges in both sectors. It rightly points to the need to increase investments in infrastructure and strengthen capacities in order to implement energy and transport market reforms effectively. Regarding transport, more emphasis is put on regulatory reforms which continue to be implemented steadily. On energy, the ERP analysis is weak. Serbia needs to transform its energy sector and make it more environmentally sustainable on its path towards full EU membership. The magnitude of the necessary changes is not sufficiently reflected in the ERP's diagnostic. Moreover, the presentation of the regulatory framework is not entirely correct. The unbundling of state-owned enterprises has not been finalised. The current monopolistic situation blocks market development, in particular in the gas sector.

On energy, the measure rightly highlights the Trans-Balkan Corridor and the Niš-Dimitrovgrad gas pipeline as Serbia's priority energy infrastructure projects. Increased regional integration and connectivity with the EU will positively impact on Serbia's economic development. However, more importantly, the programme should introduce concrete measures to advance restructuring of public energy enterprises and reform tariffs to make Serbia's energy sector more efficient. EU accession requires large investments to upgrade Serbia's energy sector and meet environmental standards. Tariffs which reflect these costs will stimulate much-needed investment in energy efficiency. Both will help modernise Serbia's economy, create new jobs and business opportunities and support the achievement of its climate objectives.

The two measures on improving the transport market are welcome. The planned improvement in the capacity and quality of transport infrastructure and services rightly focuses on activities to enhance road infrastructure safety as required in TEN-T network standards. On rail, Serbia's plans to continue prioritising railway sector reforms are adequate, allocated with sufficient resources and, in line with the objective of progressive integration in the European rail transport market. However, adoption of the 2016-2025 transport strategy including a framework for introducing intelligent transport systems (ITS) for road and railway transport is overdue. Concrete measures supporting ITS and the multimodal dimension of transport are also needed.

Sectoral development

Agricultural sector development

The challenges facing the agriculture sector are land fragmentation, low productivity due to outdated technologies, small economic size and low utilisation of agricultural land per farm. While diagnosis in the ERP recognises the main agricultural challenges, it does not address further alignment of food safety, veterinary and phytosanitary regulations with EU standards, necessary strengthening of competent authorities in those areas, and a need for improved risk analysis and risk-based performance of border inspections. In addition, the performance indicators proposed in the ERP refer only to one of the IPARD measures namely 'processing and marketing', while support for the agricultural production measures is not reflected. It is recommended that indicators for the measure "Investments in physical assets of agricultural holdings" be added. Moreover, the real estate market for agricultural land is hindered by the weak state of cadastre/property registration, implementation of the restitution legislation, as well as the lengthy procedures for case settlements in courts. This kind of challenges could be in future addressed by the ERP reform measure on improving the geospatial sector.

The measure aiming to improve the competitiveness of agricultural holdings should focus on putting in place the conditions necessary to make use of the entire IPARD programme and efficient mechanisms to address problems arising from adverse weather conditions. From the point of view of increasing sector competitiveness, Serbia needs to proceed with the accreditation of more IPARD measures than the current two. Investors should also be encouraged by increasing the attractiveness of the sector through a predictable legal framework, full liberalisation of the market for agricultural land and development of modern infrastructure (irrigation systems, agricultural real estate management, rural planning, access roads, storage facilities, etc.).

Industry sector development

Foreign direct investment (FDI) continued flowing into Serbia and has now reached pre-crisis levels; FDI is much more diversified than in the past. The ERP diagnostic, however, does not consider the price to attract FDI through various tax breaks and other incentives offered to foreign investors. Any analysis of price and impact of measures to attract FDI is hampered by the fact that there is no comprehensive and efficient state aid control. Moreover, it is estimated that foreign companies receive several times more subsidies than those available for domestic SMEs, which is only partially justified by higher productivity of FDI.

Plans to increase the competitiveness of the processing industry consist of administrative steps to prepare a new industrial strategy. It is a positive development that Serbia started working on a new industrial strategy which appears to be focused on industries with growth potential and not defending companies with a high number of employees, as has been the case with the previous strategy and policy. The Ministry of Economy should not be the only responsible ministry, as many measures would concern such areas as agriculture, telecommunications, environment, energy etc. In parallel, new instruments of industrial support need to be introduced to benefit smaller and domestic investors. The current ERP omits development of new instruments and only deals with the process of the new strategy, which reveals low ambitions of the policy in this area. The ongoing smart specialisation exercise offers an opportunity to engage with stakeholders from industry and academia and should provide guidance for development of new instruments.

Service sector development

Services constitute the greatest part of Serbia's economy and are most exposed to the lack of work skills. The ERP includes a diagnosis of the challenges faced by the service sector; however, there is no service-focused response, although it could be argued that most of the cross-cutting measures in the ERP will improve the environment for services. In particular, SMEs would benefit from a better registry and a modern regulation of e-commerce. Creative industries and the tourism sector have been growing strongly, in particular in Belgrade. The ERP could focus on the provision of additional tourist services or increased attractiveness of less-visited rural Serbia.

Business environment and reduction of the informal economy

The business environment has benefitted from a number of reforms, but it still presents a lot of uncertainty and costs. Serbia has climbed up the World Bank's Doing Business ranking, but the reforms have slowed down since the substantial simplification of the process of issuing construction permits. Private investment remains hampered by factors including a costly, unpredictable and non-transparent system of para-fiscal charges, difficult access to capital for smaller firms and red tape. Competition remains distorted by state-owned enterprises and the informal economy. The ERP diagnostic discusses challenges in land registry, financial markets and governance of public utilities. However, the below proposed measures lack ambition and could, solve only partial problems in these listed areas.

The measure to improve access to finance for SMEs should focus on the delayed regulatory plans for introduction of new financial instruments. As part of the macroeconomic stabilisation efforts, the government and the central bank addressed some of the main weaknesses in the banking sector and helped reduce the number of non-performing loans. The cost of access to finance has been reduced, but most SMEs remain locked out of loans and continue to use own resources as the primary source to finance expansion. Some of these SMEs would benefit from improved regulation of financial markets to provide additional financing instruments, beyond loans. Several challenges remain in place, such as: (i) high cost and collateral requirements for innovative, young and potential growth companies, (ii) underinvestment in areas such as innovation financing, infrastructure financing, and environmental projects, and (iii) inadequate support for long-term finance, guarantee instruments and equity financing. The introduction of new financial regulations is announced for a third year and has accumulated delays, which are not explained in the ERP. The financial market would also benefit from full liberalisation of capital flows, as agreed between the EU and Serbia in the Stabilisation and Association Agreement.

The measure aimed at improved corporate governance of public utilities and state-owned companies is of key importance for competitiveness. The public corporate sector remains the biggest employer and investor in the country. In particular, the energy sector has a key impact on growth. The reform in governance of public companies has been identified as a core part of the ERP since the first programme. It has achieved some good results and these companies now pose less tax risk. However, public companies remain largely inefficient and are influenced by political deals, which go beyond managerial appointments. The proposed reform recognises these challenges, but proposes to deal just with procedural rules for appointments. More ambitious steps should be taken to lock politics out of daily management of these companies.

The measure aiming to unify the system of public registries of administrative procedures lacks a clear commitment and scope. Administrative burdens for businesses, in particular parafiscal charges, constitute a significant cost for businesses and tend to be unpredictable. The ERP indicates that the government has continued working on a law on fees which could reign in parafiscal charges. However, the ERP does not provide a concrete commitment as to the empowerment of the registry or the law to reduce the charges and ensure their proper control by the central government. The private sector has been appropriately involved in the process and its input should lead the government towards more specific announcements which go beyond the current procedural steps forward. Moreover, a significant part of the charges is set and collected by municipalities, but their contribution to the reform remains unclear.

The measure establishing a common information platform for all inspections (e-inspection) is only one of many possible initiatives to combat the informal economy. The informal economy remains large, although the government significantly increased revenues received from inspections and tax collection. The years 2017 and 2018 were formally proclaimed as years for combating the informal economy. The tax authority started an information campaign on the negative effects of informality. Beyond the measure, there are weaknesses in the fiscal and social regimes which do not incentivise the formalisation of employment or company operations. The planned but delayed platform should be completed by a proper risk assessment system ensuring that inspections are better targeted. Its main indicator should not be the number of inspections coordinated via the e-platform, but perception of businesses that inspections are carried out with fairness and expedience.

The new measure on a geospatial database can improve the clarity of ownership, which slows down investment decisions. If properly implemented, the reform measure has potential to contribute to the efficiency of the taxation system, leading to fairer distribution. The measure should be upgraded into a country-wide fully digitised and up-to-date cadastre. For this, ministries and the judiciary need to be involved in the measure, which is at the moment under the sole responsibility of the Geodetic Authority. Moreover, the acquis-prescribed establishment of the land parcel identification system (LPIS) in Serbia as part of the integrated administration and control system (IACS) may be sped up due to better access to the geospatial data infrastructure.

Research, development and innovation and the digital economy

Pockets of the Serbian economy are innovative and excel globally. Although the country has a relatively good scientific base, the level of investment in research is just 0.9% of GDP. At the same time, cooperation between the public and private sectors is weak and not systematically supported. Most public funds for research end up in public research institutes while companies receive a very small share. With regard to this, the efforts linking academia with industry carried out by the ANTARES (Centre of Excellence for Advanced Technologies in Sustainable Agriculture and Food Security) project constitute an important example for other domains. The Prime Minister announced that digital services will be one of the priorities of her government, but this ambition is not reflected in the ERP. The mapping of broadband is still on-going. In the coming years, a subsidy for developing digital infrastructure in low population density areas needs to be budgeted for.

The measure supporting innovations and technological development includes support to private companies through the Innovation Fund and is an example of a targeted and well implemented support activity for SMEs. However, the fund continues to function in isolation from other possible measures that could make up a more comprehensive reform. More could be done to systematically push for public and private research cooperation, such as technology transfer offices and new science parks, both with the aim to support high tech start-ups. Therefore, the long overdue multiannual action plan to the implement the national strategy for research should include explicit support to various initiatives that bring public and private actors together. The finalisation of the EU-guided smart specialisation exercise will provide further guidance on possible measures for innovation that merit increased public support.

The measure aimed at the development and improvement of the national broadband communications infrastructure will address a limited number of bottlenecks. The measure stops short of describing specific services that the benefiting public institutions will provide on the improved network. The ERP does not envisage rules providing for e-government and e-services over the internet and it still remains to be developed. The sector needs investments but the weak market regulation hinders expansion, while there are still some protectionist measures in place. For instance, the import of telecom equipment is cumbersome due to non-recognition of EU conformity certificates and unnecessary inspections. The access of telecom operators to ducts and antennas - although regulated based on prior assessment by the regulator'- remains very difficult in practice. In view of this, the financial and political independence of the electronic communications regulator needs to be ensured.

Trade-related reforms

Trade integration with the EU further increased and occurs across a high number of industrial sectors. FDI has climbed back to pre-crisis levels. However, FDI and exports are too often in low value products. Determined political and administrative action is needed to work better with incoming investors so that they can fully use Serbia's potential and establish links with domestic suppliers, integrating them in their value chains. To this aim, some companies created clusters but their activities are not supported by a systemic public action. Similarly, the ongoing programmes for the internationalisation of SMEs need to be stepped up to reach a higher number of beneficiaries. These actions need to include services, such as IT, which have a strong potential for export. The Central European Free Trade Agreement (CEFTA) and regional economic area (REA) commitments need to be pursued with more determination, including finding workable solutions to political obstacles.

The measure to improve conditions for product safety and remove barriers to trade targets specific products; its scope should be extended to other products and areas. Serbia still needs to complete a thorough review of all legislation, technical regulations and standards, and remove distortive non-tariff barriers to trade that do not derive from the use of certificates of conformity, standards or other technical requirements. Non-tariff barriers are often disguised under the pretext of preserving public health. Sanitary inspections at the border continue to be performed largely without any risk analysis and in a way which adds unnecessary costs for the importers.

Education and skills

Quality and output of the education system are important factors for Serbia's growth and prosperity given the population decrease. Enrolment rates in compulsory schooling are high (pre-school programme and primary education 95.1 % in school year 2015-16), but overall preschool education coverage increased only slightly to 58.8 %, far below EU benchmarks. Children from Roma communities continue to be underrepresented at all education levels from early on. Studies on the competencies acquired in formal education and the school-to-work transition point to skills mismatches. High youth unemployment and the share of those who are not in education, employment, or training (NEET) which stood at 17.6 % in 2017, illustrate these findings. Low skills level of adult unemployed is a key obstacle for their access to employment.

The ERP continues to prioritise the introduction of workplace-based learning in vocational education and the establishment of a National Qualifications Framework (NQF). The corresponding ERP measure is rolled over from the ERP 2017-2019, and partly from the ERP 2016-2018. Following the adoption of the law on dual education (work-based learning), the main challenge is now to translate the legal framework into practice on the basis of a clear roadmap that is yet to be set up. The steps presented in the ERP are limitedly linked to the core objectives of the reform. Establishing closer and smooth cooperation among state bodies, social partners – as highlighted in the 2017 policy guidance - and economic actors both a central level and on the ground remains essential for an effective introduction of dual learning across the country.

The establishment of Serbia's National Qualification Framework is behind the schedule presented in the two previous ERPs. Following the recent adoption of the Law on NQF, efforts should now focus on establishing the relevant institutional setup and the implementation of the NQF system, in cooperation with relevant stakeholders.

Employment and labour markets

Some positive labour market trends continued in 2017. Labour force participation (15-64 years) reached 66.7 % in 2017, up 1.1 pps compared to 2016, and the employment rate increased by 2.2 pps to 57.4 %. Over the same period, the unemployment rate went down by 1.8 pps to 14.1 %. Long-term unemployment also dropped significantly. A strong gender gap above 10pps persists in women's labour force participation and employment. Youth has benefited as well from labour market improvements but their unemployment is still nearly 2.5 times higher than overall unemployment. Employment increase in 2017 was largely due to growth in manufacturing and services and strengthened formal employment. Despite improvements, job quality is a concern. Informal employment continues to hover near 20 %, partly due to its pervasiveness in agriculture. One fifth of all workers have very low work intensity, increasing the in-work poverty risk, compared to the EU average of one in ten (SILC 2017).

The ERP highlights the need for reforms conducive to employment, but does not include substantive labour market reforms. The ERP measure aimed at increasing active labour market policies has been further prolonged until 2020 with a moderate budget increase and accompanied by initiatives for improving quality and efficiency of services and active labour market measures. However, active labour market policies continue to have a very low coverage; less than 20 000 beneficiaries (around 3 % of registered unemployed) were included in measures such as training, employment or self-employment subsidies and public works in 2017. Most services delivered by Serbia's public employment service to around 110 000 beneficiaries (15 % of registered unemployed) consist of one-day support such as job search training and employment fairs. The ERP measure thus needs to be complemented by a significant budget increase for active labour market policies in order to support access to employment for the large pool of unemployed, also with regard to future demographic constraints on the size of the workforce.

A small step has been taken towards lowering the high non-wage labour costs in relation to last year's policy guidance. The 27 % increase of the tax-exempt part of the gross wage, taking into account the increase of the minimum wage from EUR 1.1 (RSD 130) net per hour to EUR 1.2 (RSD 143) as of January 2018, represents a total monthly saving from this change per employee of slightly less than EUR 3. Although the direction of this step is good, its impact is marginal and not particularly targeted at low-income earners. Advancing reforms of labour market institutions in Serbia could contribute to broadening employment opportunities and strengthening formal employment. The envisaged establishment of legal frameworks for the operation of private employment agencies and for seasonal work should be pursued without further delay.

Social inclusion, poverty reduction and equal opportunities

Despite positive labour market developments, inequality and poverty remain at elevated levels. The Gini coefficient in 2016 based on the most recent SILC survey was 38.6 %, up from 38.2 % in 2015, and is higher than in any EU Member State. The quintile ratio (ratio of income of 20 % richest to 20 % poorest) in Serbia increased from 9.0 in 2015 to 9.7 in 2016, which is 17% higher than in the EU Member State with the highest ratio (Romania 8.3). The share of persons at-risk of poverty or social exclusion is the highest among all countries conducting SILC, standing at 38.7 %; similarly, the at-risk of poverty rate stood at 25.5 % in 2016, impacting around 1.8 million people in Serbia. Most at risk are young people aged 18-24 (32.7 %) and children and youth below 18 (30.2 %), while the population over 65 years has the lowest at-risk of poverty rate of 19.1 %. Half of all households composed of two adults and three or more dependent children and 40 % of working-age single member households are at risk of poverty.

Few elements of the measure for improving the adequacy, quality and targeting of social protection introduced in the ERP since 2016 have been completed so far. The new Law on financial support to families with children adopted in December 2017 increases the lump sum grant for the first child from EUR 325 to EUR 850, gives access to paid maternity leave for mothers working on service and temporary contracts as well as insured farmers, and extends eligibility to child allowance in justified cases from 19 to 21 years. Preparations for the introduction of an electronic information system for managing all social benefits through 'social cards' are under way, including a better targeting assistance to those in need and improved coordination between employment and social services. The reform is still at an early stage not yet allowing an assessment of its impact with regard to tackling poverty.

ANNEX 1: IMPLEMENTATION OF THE POLICY GUIDANCE ADOPTED AT THE ECONOMIC AND FINANCIAL DIALOGUE IN 2017

2017 policy guidance	Summary assessment
PG 1: Ensure a continuous reduction of the budget deficit in 2017 and over the medium term. Use any additional fiscal space to lower the deficit beyond the targets that are currently envisaged, while continuing to increase capital expenditure. Adopt a credible and binding system of fiscal rules, capable of anchoring consolidation efforts.	PG 1 has been **partially implemented**. • **Full implementation**: The 2017 budget was in a surplus of 1.2 % of GDP, significantly above the initially targeted deficit of 1.7 % of GDP. The current ERP also targets lower budget deficits in the 2018-2020 period. The updated medium-term budgetary objective is a deficit of 0.5 % of GDP, instead of the previously targeted deficit of 1.0 % of GDP. • **Partial implementation**: While most of the available additional fiscal space was used to further reduce the deficit in 2017, the execution of capital expenditure underperformed and was even below the 2016 level. • **No implementation**: Despite last year's commitment, there were only discussions on a possible design for a new set of fiscal rules and no administrative or legal measures were taken to address this policy guidance. Moreover, the updated ERP 2018 does not include any plans or a timeline for strengthening fiscal rules.
PG 2: Support the fiscal scenario by reinvigorating reforms of the state-owned enterprises and of the tax administration. Improve the composition of budget expenditure by further reducing public spending on wages and pensions as a share of GDP.	PG 2 has been **substantially implemented**. • **Partial implementation**: Reform of state-owned enterprises advanced unevenly. Further measures were taken by the railways company and the power utility EPS, more than 275 companies went into bankruptcy proceedings, more than 45 have been privatised since the end of 2014, and 10 strategic companies were resolved. However, a solution is still due for around 150 companies, employing some 50 000 people, including a number of big strategic companies in the mining and energy sectors. • **Partial implementation**: The action plan on implementing the tax administration transformation programme was adopted with some delays in December. Core activities are to be consolidated in 36 offices by June 2019. • **Full implementation**: Government expenditure on wages declined from 9.8 % of GDP in 2016 to 9.5 % of GDP in 2017, while public spending on pensions fell from 11.6 % of GDP to 11.1 % of GDP in the same period (excluding the 2017 payment of bonuses amounting to 0.2 % of GDP).
PG 3: Implement the remaining measures of the NPL	PG 3 has been **substantially implemented**. • **Substantial implementation**: The authorities

resolution strategy.	have substantially implemented the measures of the NPL resolution strategy. All measures included in the NBS action plan were completed, and while some measures pertaining to the government action plan are still pending, preparation has started with a view to complete them by 2018.
Continue efforts to promote the use of the dinar, inter alia by maintaining a spread between reserve requirements in foreign currency and local currency also going forward.	• **Full implementation**: The authorities maintained a spread between reserve requirements in foreign and local currency. More generally, the efforts to promote the use of the local currency have yielded some positive results.
Finalise the reform and privatisation of the two large state-owned banks and find a solution for the remaining small state-owned banks.	• **Limited implementation**: The restructuring of Banka Poštanska štedionica is proceeding with some delays relative to original plans, while the privatisation of Komercijalna Banka has been delayed, and a solution is yet to be found for the remaining three small state-owned banks.
The monetary policy stance should be in line with achieving the new inflation target.	• **Full implementation**: The monetary policy stance has been conducted in a way to achieve the new inflation target, supported by the evidence that through the year headline inflation remained anchored within the new target tolerance band.
PG 4: Gradually adjust electricity tariffs to reflect actual costs.	There was **partial implementation** of PG 4. • **Limited implementation:** Regulated electricity tariffs increased by 2 % in October 2017, i.e. less than average inflation in 2017, and do not fully reflect actual costs.
Further improve payment collection	• **Partial implementation:** Collection rate for electricity bills has gone up to the very high level. Collection of gas bills has also improved.
and avoid future accumulation of arrears in the energy sector.	• **Substantial implementation:** The financing of weak public entities through arrears to Srbijagas and electricity company EPS has been significantly reduced.
Advance the announced restructuring of Srbijagas debt and the implementation of EPS's optimisation plan.	• **Limited implementation:** Srbijagas and EPS continued with restructuring, but with limited results.
Expand the scope of the Single Project Pipeline to cover all large investment projects regardless of their source of funding and establish clear links to the budgetary process.	• **Limited implementation:** a decree was adopted but it is unclear if it introduces parallel structures and processes instead of the objective of establishing a single platform and single methodology for capital investment analysis and planning. Finally, there is no evidence that the provisions of the decree intended, to put the single project pipeline into operation are being conducted on time or at all.
PG 5: Regulate the amount and number of para-fiscal charges at state level.	PG 5 has been **partially implemented.** • **Limited implementation:** Law on republican taxes adopted, progress made on a registry of procedures. A draft law on fees under

Develop the regulatory framework for new financial instruments, and improve the access to finance. Put in place risk management systems in order to improve the functioning of the Tax Administration and to ensure better targeting and efficiency of inspections.	preparation. • **Partial implementation:** Regulatory framework still pending. Access to finance improved via other channels (increased range of loans). • **Substantial implementation:** New risk management system put in place, but full implementation is still pending.
PG 6: Increase labour market participation and reduce the high non-wage labour cost of jobs at the lower sections of the wage distribution in a fiscally neutral way. Target active labour market measures to vulnerable groups, including social assistance beneficiaries. Develop dual learning in vocational education and training in close cooperation with social partners.	PG 6 has been **partially implemented**. • **Substantial implementation:** Labour market participation rate increase by 1.1 pps in 2017; however not of critical groups (women, youth). • **Limited implementation:** 27 % increase of the untaxed part of the gross wage; this represents a monthly saving of around EUR 3 for any worker but is not specific for lower wages. • **Limited implementation**: the share of vulnerable groups (women and young) among the beneficiaries of active labour market measures increased, however their scope is so small in terms of numbers of beneficiaries that this does not qualify as a targeted approach. No progress was made regarding activation of social assistance beneficiaries. • **Partial implementation**: In 2017 the Law on Dual Education was prepared and adopted. Involvement of the social partners in the design of the law was insufficient. Only in December 2017 a first workshop for involving them into next steps of the measure took place.

ANNEX 2: COMPLIANCE WITH PROGRAMME REQUIREMENTS

The government adopted and formally submitted the Economic Reform Programme on 31 January 2018. The programme is in line with the medium-term fiscal strategy and the 2018 budget and covers the period 2018-2020. In conformity with the new approach to economic governance, the programme includes an enhanced description of structural reform priorities.

Inter-ministerial coordination

The preparation of the programme was centrally coordinated by the Ministry of Finance, which established an ERP working group. Relevant ministries and other institutions (the National Bank of Serbia, the National Employment Service, and the Statistical Office of the Republic of Serbia) are associated with the work and have contributed in their areas of responsibility.

Stakeholder consultation

Two public consultations were conducted to give social partners, civil society and all relevant stakeholders an opportunity to contribute, especially to the drafting of chapter 4 on structural reforms. However, the draft ERP was not discussed in the Economic and Social Council of Serbia.

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 baseline 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. Revenue and expenditure measures are well explained. The programme does not present long-term projections of population trends or of the implications of an ageing population on the labour market and public finances, in particular on health and pension systems. Significant further efforts would be needed to ensure ESA 2010 compatibility of fiscal data.

Structural reforms

The programme's structure does not always fully follow the guidance provided by the Commission. The reporting of the implementation of the policy guidance and the structural reform measures from 2017 is sufficient and up-to-date. The number of reforms and page length are within the limit. The measures are focused and planned with good detail; however, their scope of ambition often refers to a single procedural reform rather than a systemic long-term reform with real impact on competitiveness and inclusive growth. Contributions from the budget are provided for in all measures. However, the methodology for establishing this contribution varies from measure to measure and is not a reliable indicator of commitment. The annexed tables are filled in appropriately.