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COMMISSION STAFF WORKING DOCUMENT

ECONOMIC REFORM PROGRAMME

OF

**SERBIA
(2019-2021)**

COMMISSION ASSESSMENT

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1. EXECUTIVE SUMMARY

The economic reform programme's baseline projection of continued robust economic growth seems plausible, but faces increased downside risks. The 2018 outcome was better than expected: strong domestic demand and base effects lifted growth above 4% for the first time in a decade. The economic reform programme (ERP) expects the economy to expand steadily at 3.5-4.0% in 2019-2021 due to solid growth in export, private consumption and investment. However, short-term economic prospects have worsened due to the slowdown of external demand from main trading partners, Kosovo's imposition of prohibitively high import tariffs and EU's introduction of steel import quotas. The ERP's projection of gradually narrowing current account deficits rests crucially on the assumption of large foreign direct investment inflows in tradable sectors underpinning further improvements in competitiveness. The financial sector has been sound and actively supported economic growth, but reforms and privatisations of state-owned financial institutions are incomplete.

The fiscal strategy envisages a reduction of government debt below 50% of GDP through broadly balanced budgets, but it lacks a strong pro-growth orientation. Due mainly to a continually strong revenue performance, the general government budget was in surplus for a second year in a row. However, the growth-enhancing policy measures in the 2019 budget are too modest. The budget used most of the available fiscal space to increase collective consumption and pensions. Productive capital expenditure remained at a rather low level, compared to high investment needs in some sectors like education, health and environment. Government debt and debt servicing costs, which have declined significantly over recent years, are expected to fall further but economic risks remain elevated and government debt is not yet in safe waters. There are still gaps in fiscal governance.

The main challenges in these respects include the following.

- **Despite the good macro-fiscal results of the previous year, the reform process has lost momentum.** Although the baseline scenario is realistic, it faces major uncertainties and risks. Finalising some long-standing public sector reform initiatives such as the wage system reform and progressing faster on public administration reform in general could provide an important signal to investors and further lower the country risk premium.
- **Good fiscal results are not yet sufficiently anchored and there is further scope to increase capital spending.** Previous experience has shown the vulnerability and sensitivity of fiscal performance to the economic and political cycle. The strengthening of existing fiscal rules would guide public finance and help institutionalise sound fiscal policies. Keeping a lid on wage and pension expenditure and further strengthening the process of capital expenditure execution is required in order to free and better use existing resources in areas such as education, health and the environment. The system for prioritising and monitoring government investments does not cover all projects, regardless of their source of financing.
- **The business environment is affected by unfair competition coming from public companies, non-transparent state aid schemes, the informal economy and an unpredictable regulatory environment.** 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. Although access to finance improved, own resources remain the principle source funding for SMEs. A new industrial strategy is needed to bring about more clarity as to

how the government intends to support industrial development. New regulation on economic issues is often adopted without business being properly consulted.

- **The restructuring of state-owned enterprises in the energy sector continued to face delays.** The unstructured sector and prices of energy below cost recovery level prevent further investment, in particular into energy efficiency. In addition, incomplete restructuring and privatisation of state owned enterprises still poses a risk to public finance.
- **Weak labour market integration of women and young people and a large number of unemployed people continue to be a key labour market challenge.** At the same time, the emigration of workers, primarily to the EU, poses longer-term risks to labour market expansion. Apart from the lack of job opportunities, higher wages abroad are a key factor for brain drain. Structural reforms need to give more consideration to containing these developments. The level of informality remains high and needs to be addressed in a more comprehensive manner. Social challenges are multi-fold, with continuous high levels of poverty despite positive economic trends over the past years. Reform plans in this area are further delayed and lack a strategic vision.

The policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2018 has been partially implemented. Most of the revenue over performance was saved and the 2018 budget was in surplus. The medium-term fiscal strategy targets a broadly balanced budget. There were no measures taken to advance work on strengthening fiscal rules. There has been some improvement in the composition of government spending in 2018. Only very limited steps to develop a single mechanism for prioritising and monitoring all government investment have been taken. 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. Governance and restructuring in the energy sector remained largely unaddressed. The process of drafting an industrial strategy has not yet started and there is no proper control mechanism to ensure that all support given to companies is in line with state aid rules. Efforts have been made to regulate para-fiscal charges, but effects of the new regulation remain to be seen. No progress has been made in reducing the high non-wage labour cost of jobs at the lower sections of the wage distribution. Increases in the provision of active labour market measures have been modest. Further steps have been taken to establish the National Qualifications Framework, including the involvement of stakeholders.

The ERP partially aligns with the reform priorities identified by the Commission. The macroeconomic and fiscal frameworks are sufficiently comprehensive and integrated with the overall policy objectives, providing a good basis for policy discussions. The structural reform part of the ERP remains largely unchanged from last year, reflecting delays in implementation of main reforms. It appropriately continues with measures to improve the performance and 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 and introduction of some new services, including e-government. The diagnostic presented in the ERP for education, employment and social policies is relevant and lists some key challenges, while the proposed measures are rather limited and lack a strategic vision for these three sectors. Objectives and targets are not clearly defined, hindering both ex-ante and later implementation assessments.

2. ECONOMIC OUTLOOK AND RISKS

The ERP's baseline projection of robust economic growth remains unchanged from the previous programme and is broadly in line with the Commission's autumn forecast. The 2018 outcome was better than expected: strong domestic demand and base effects lifted real GDP growth above 4% for the first time since 2008. The baseline scenario sees the economy expanding steadily at 3.5-4.0% in 2019-2021, due to continuing solid growth in exports, private consumption and investment. Export growth is seen outpacing imports, resulting in a positive net export contribution to growth in each of the years. On the supply side, services, industry and construction would be the engines of growth. After the closure of the negative output gap in 2018, it is projected to stay positive over the ERP period. The envisaged economic expansion should also further increase employment and reduce the unemployment rate to a single digit level by 2021.

However, some elements of the macro scenario are less incontrovertible and it faces increased downside risks. This pertains mainly to the slightly over-optimistic export projections and the forecasted reduction of external imbalances. The positive output gap, rising investment, and expansionary fiscal policy should all work against the envisaged narrowing of external imbalances. Since the autumn, when the forecast was prepared, short-term economic prospects have also worsened due to Kosovo's imposition of prohibitively high tariffs on imports from Serbia and EU's introduction of steel import quotas. A further decline in car production by the country's biggest exporter could also hurt short-term growth prospects.

Table 1:
Serbia - Comparison of macroeconomic developments and forecasts

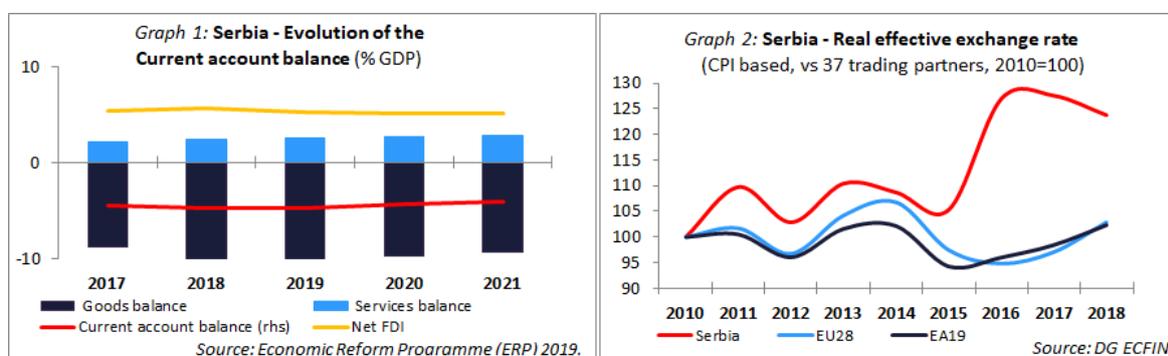
	2017		2018		2019		2020		2021	
	COM	ERP								
Real GDP (% change)	2.0	2.0	4.1	4.2	3.8	3.5	3.8	4.0	n.a.	4.0
<i>Contributions:</i>										
- Final domestic demand	2.7	3.1	5.1	4.4	4.6	3.5	4.6	3.7	n.a.	3.9
- Change in inventories	0.5	0.9	0.8	0.7	0.2	0.0	0.2	0.0	n.a.	0.0
- External balance of goods and services	-1.2	-2.0	-1.8	-1.0	-1.0	0.1	-1.0	0.3	n.a.	0.2
Employment (% change)	2.8	2.7	1.5	1.8	1.3	1.4	1.2	1.6	n.a.	1.6
Unemployment rate (%)	13.6	14.1	13.1	12.7	12.0	11.8	10.9	10.6	n.a.	9.0
GDP deflator (% change)	2.8	3.0	2.3	2.4	2.9	3.3	3.0	3.4	n.a.	3.4
CPI inflation (%)	3.2	3.1	2.1	2.1	2.9	2.3	3.0	3.0	n.a.	3.0
Current account balance (% of GDP)	-6.2	-5.2	-5.9	-5.2	-7.4	-5.0	-7.9	-4.5	n.a.	-4.2
General government balance (% of GDP)	1.2	1.1	0.4	0.6	-0.3	-0.5	-0.5	-0.5	n.a.	-0.5
Government gross debt (% of GDP)	61.6	58.7	56.4	54.4	54.1	51.7	52.1	49.3	n.a.	46.9

Sources: Economic Reform Programme (ERP) 2019, Commission Autumn 2018 forecast (COM); COM forecast does not take into account the latest national account revision.

The ERP presents a clear view of economic risks and uncertainties but is rather sanguine about their possible implications. The programme acknowledges major international risks related to fluctuations of commodity prices, divergent monetary policies of main central banks, and trade tensions; domestically, it outlines risks stemming mainly from a slower-paced implementation of economic reform, in particular of state-owned enterprises, public administration and investment management. Continuing and accelerating economic reforms would provide important signals to potential investors about the authorities' commitment to modernising the economy, a process that depends heavily on attracting productive capital in tradable sectors. Although its underlying assumptions are not evident, the programme presents an alternative macroeconomic and fiscal scenario, envisaging lower economic growth and worse fiscal performance.

However, in view of the magnitude of the risks and historical experience, the alternative scenario seems too benign, is not sufficiently elaborated and lacks details about its demand and supply composition.

Inflationary pressures are low and price stability seems well anchored despite the cyclical upswing. Consumer inflation has been low and stable for several years. It averaged 2.0% in 2018, staying below the mid-point of the central bank target tolerance band of $3\% \pm 1.5$ pps throughout the year. The central bank maintained its cautious stance, lowering its key policy rate in two steps in 2018 by 25 points each to 3%. In view of exchange rate's importance for the price-setting behaviour of economic agents and financial stability, the central bank continued its frequent and sizeable interventions on both sides of the foreign exchange market, buying a net EUR 1.6 billion in 2018. The ERP envisages, realistically, a slight increase in inflation towards the mid-point of the target band by 2020. Food and oil price fluctuations would continue influencing short-term price dynamics, while growing aggregate demand will be the main factor pushing inflation up during the programme period. The projected stability of the dinar exchange rate, which is also one of the key factors determining inflation, would help contain inflation within the target range.



External imbalances have widened but there are still divergent opinions on their direction. Contrary to expectations in last year's ERP, strong import growth and worse terms of trade drove the trade deficit to expand to 12.3% in 2018, while the current account deficit remained unchanged at 5.2% of GDP. The authorities' view is that external imbalances have peaked and will already start shrinking in 2019, with the current account deficit gradually narrowing to 4.5% of GDP by 2021. This expectation is based on the projection of a continued robust export performance, supported by foreign direct investments (FDI) in tradable sectors. However, recent experience shows that the net contribution of new export capacities to lower external imbalances is likely to be constrained due to a major import component. Even though the recent sizeable foreign direct investments enlarged the production and export base, the slowdown of external demand from main trading partners, international trade tensions, and the already high export base are strong arguments for more prudent export projections. In addition, the baseline scenario of growing domestic demand should also trigger further strong import growth, while primary income outflows will likely increase along with the rising stock of foreign investment. The envisaged deterioration of the public savings-investment gap is another factor that may keep external imbalances elevated in the near term.

Large foreign direct investment inflows fully cover the current account deficit and remain crucial for external sustainability and improving competitiveness. Net FDI inflows have ensured solid financing of the external deficit: over the last 4 years, they amounted to more than 5% of GDP per year, covering on average one and a half times the current account deficit. FDI inflows have also been key for the ongoing structural

transformation of the economy towards tradable sectors. The FDI stock increased by nearly 50% since 2013 and, attesting to the attractiveness of the country as an investment destination, reinvested earnings have more than tripled their share in total FDI. Foreign investors benefit also from generous incentives (direct cash subsidies, tax breaks and various forms of in-kind governmental support, primarily land and infrastructure). Thus, the programme's assumption of continuing strong FDI inflows over the next few years is plausible, if supported by continued macroeconomic stability, persistent implementation of economic reforms and further improvements in the business environment. Over the last 5 years, the stock of net FDI also increased its share in Serbia's net international investment position from two-thirds to more than 80%. Since FDI can be considered a more stable source of funding, this trend has reduced vulnerabilities to external shocks, despite a persistently high and negative net international investment position of close to 90% of GDP. Another factor that could possibly cushion external shocks is the relatively high level of foreign exchange reserves, which have consistently been covering around six months' worth of imports and are expected to remain at an adequate level during the programme period.

The financial sector has been supportive of growth and its performance is sound, but reforms and privatisation of state-owned financial institutions are incomplete. The capital adequacy, liquidity and profitability indicators of commercial banks remained high. Favourable financing conditions and labour market developments have boosted credit growth in 2018. Lending to households and corporates increased at double-digit rates, excluding effects from exchange rate fluctuations and non-performing loan (NPL) sales and write-offs. Although the central bank does not consider the overall credit level excessive, in order to curb the build-up of risk, it took steps to limit credit growth in some market segments like household cash loans with long maturities. The 2015 NPL resolution strategy provided good results and NPLs declined from a high of close to 22% to 5.7% in 2018. The authorities have also recently updated their memorandum on the dinarisation strategy and taken steps to address the legacy NPLs in the portfolio of the Deposit Insurance Agency. The government adopted a new programme for NPL resolution 2018-2020, focusing on limiting the rise of new NPLs. While these and other steps to strengthen the financial sector are welcome, reforms to wind down the still sizable state presence in the sector and improve the governance of state-owned banks have advanced slowly.

Table 2:**Serbia - Financial sector indicators**

	2014	2015	2016	2017	2018
Total assets of the banking system (EUR million)	34 618	35 655	36 992	37 676	41 514
Foreign ownership of banking system (%)	74.5	76.1	76.7	76.9	76.3**
Credit growth	3.1	2.9	2.5	1.9	9.4
Deposit growth	7.6	6.5	11.4	3.3	15.2
Loan-to-deposit ratio	1.1	1.1	1.0	1.0	1.0
Financial soundness indicators					
- non-performing loans	21.5	21.6	17.0	9.8	5.7
- net capital to risk-weighted assets	20.0	20.9	21.8	22.6	22.8**
- liquid assets to total assets	35.6	34.3	36.9	36.7	37.3
- return on equity	0.6	1.6	3.4	10.6	11.3***
- forex loans to total loans* (%)	70.0	71.9	69.3	67.5	68.8

* Includes both denominated and indexed positions.

Note: Data for December 2018 are preliminary.

** September 2018

*** As of 30th November 2018

Sources: ERP 2019, National Central Bank.

3. PUBLIC FINANCE

The good fiscal performance continued in 2018. The general government budget was in surplus for a second year in a row. Thanks mainly to a continued strong revenue performance, the budget surplus of 0.6% of GDP for 2018 significantly outperformed the initial target of a deficit of 0.7% of GDP. Better labour market developments and increased corporate profits have led to higher income tax revenue, while one-offs, mostly from collected claims by the Deposit Insurance Agency, boosted non-tax receipts. On the expenditure side, savings on interest payments have largely offset higher than planned spending on goods and services and government investment. The better fiscal results also provided sufficient space for abolishing the crisis-related pension cuts and increasing pensions for those at the lower end of the pension scale.

Table 3:**Serbia - Composition of the budgetary adjustment (% of GDP)**

	2017	2018	2019	2020	2021	Change: 2018-21
Revenues	41.5	41.1	39.9	39.2	38.7	-2.4
- Taxes and social security contributions	36.1	35.8	35.3	35.1	34.9	-0.9
- Other (residual)	5.4	5.3	4.5	4.1	3.8	-1.5
Expenditure	40.4	40.6	40.4	39.7	39.2	-1.3
- Primary expenditure	37.9	38.5	38.4	37.9	37.6	-0.9
<i>of which:</i>						
Gross fixed capital formation	2.8	3.6	4.0	4.0	4.1	0.5
Consumption	15.3	15.9	16.0	15.9	15.8	-0.2
Transfers & subsidies	17.5	16.9	16.7	16.6	16.3	-0.6
Other (residual)	2.2	2.0	1.7	1.5	1.4	-0.6
- Interest payments	2.5	2.1	2.0	1.8	1.6	-0.5
Budget balance	1.1	0.6	-0.5	-0.5	-0.5	-1.1
- Cyclically adjusted	1.3	0.6	-0.6	-0.7	-0.7	-1.3
Primary balance	3.6	2.7	1.4	1.3	1.1	-1.5
- Cyclically adjusted	3.8	2.7	1.3	1.1	0.9	-1.7
Gross debt level	58.7	54.4	51.7	49.3	46.9	-7.5

Sources: *Economic Reform Programme (ERP) 2019.*

The 2019 budget is set to provide a stimulus but measures promoting long-term growth are too modest. The parliament adopted the budget on 7 December 2018. The planned fiscal policy stance is pro-cyclical, targeting a consolidated deficit of 0.5% of GDP, which would result in a deterioration of the cyclically-adjusted primary balance by 1.3% of GDP. Revenue projections can be considered as conservative and do not take into account any possible gains from improved tax collection. Planned expenditure reflects policy changes. The authorities expect a marginal decline in total expenditure as a ratio to GDP and a fall in total revenue by 1.2 percentage points to 39.9% of GDP. The success of fiscal consolidation over the last several years and lower indebtedness should bring additional reduction in interest payments in 2019. Expenditure on social benefits are planned to decline thanks to the growing economy and employment. These savings, along with the envisaged change from a surplus in 2018 to a deficit in 2019 opened up significant fiscal space. The budget used most of it to increase collective consumption (selective public sector wage hikes and higher expenditure on goods and services) and pensions. A small portion of the fiscal space has also been channelled to eliminate the unemployment insurance contribution (0.75%) paid by employers and to abolish certain parafiscal charges in order to reduce the burden on businesses. Although there has been some increase in capital spending, to 4% of GDP, it is mostly because of higher spending on military and police equipment, while productive capital expenditure remains at rather low levels. The budget also phases out, in two steps over 2019 and 2020, the crisis-era obligation on state-owned enterprises (except the electricity company EPS) to make payments to the budget resulting from wage cuts.

Box: The 2019 budget

Parliament adopted the 2019 republican budget on 7 December 2018.

The general government deficit target is RSD 25.1 billion (0.5% of GDP), which implies a moderate fiscal policy easing. Most of the new measures are on the expenditure side: selective wage increases, pension increases, higher capital spending. On the revenue side, the main policies are the abolishment of certain fees (with negligible budgetary effect), the increase of the hourly minimum wage, the elimination of the unemployment insurance contribution paid by employers, and the first phase of lifting of the obligation on state-owned enterprises to pay their savings from wage cuts to the budget.

Main measures in the 2019 budget*

Revenue measures	Expenditure measures
<ul style="list-style-type: none">• Elimination of the 0.75% unemployment insurance contribution paid by employers (-0.2 % of GDP)• Lifting of half of the wage cuts in state-owned enterprises (-0.2% of GDP)• Increase in minimum wage from RSD 143 to RSD 155 per hour (0.1% of GDP)	<ul style="list-style-type: none">• Selective wage increase (0.7% of GDP)• Revocation of pension cuts and 5% pension hike of low pensions (0.8% of GDP)• Increase in capital expenditure (0.4% of GDP)
Total revenue effect	Total expenditure effect
(-0.3% of GDP)	(1.9% of GDP)

* Estimated impact on general government revenue and expenditure.

Source: ERP 2019

The generally prudent medium-term fiscal strategy lacks a strong pro-growth orientation and leaves some key measures not sufficiently elaborated upon. The programme sets out the medium-term budgetary objective at the same level as last year, a deficit of 0.5% of GDP. This deficit is sufficient to guarantee fiscal sustainability and ensure government debt is reduced further to below 50% of GDP within the programme period, not counting possible restitution-related obligations. The fiscal objectives are also broadly in line with last year's policy guidance to target a balanced budget over the medium term. Both revenue and expenditure ratios are set to decline further at the same pace in 2020-2021. The programme does not present any estimates of the cost of the planned reform of the public wage system nor the reintroduction of pension indexation as of 2020. After some improvement in 2018, the composition of government spending is expected to remain more or less at its 2019 level. This implies keeping overall spending on wages and pensions as a ratio to GDP unchanged. The planned reduction of current non-interest spending is slower than envisaged last year. Capital expenditure is set to level off at around 4.0% of GDP, which is at too low a level in view of the large investment needs and underinvestment, in particular in some sectors like education, health and environment.

Government debt and debt servicing costs, which have declined significantly over recent years, are expected to fall further. The ERP forecasts government debt to continue falling, albeit at a slower pace than in recent years, reaching 46.9% of GDP in 2021. Yields on government bonds and the country risk premium have declined markedly over recent years and are likely to fall further under the baseline macroeconomic scenario. The prudent fiscal policy should also ensure debt-servicing costs are further reduced. The programme envisages interest expenditure falling to 1.6% of GDP in 2021, nearly half from its peak in 2015. In 2018, the primary surplus was the main factor behind the drop in government debt. However, due to the pro-cyclical fiscal expansion, as of 2019 the snowball effect, capturing the difference between interest payments and nominal GDP

growth, will become a key debt-reducing factor. Under the assumption of a broadly stable dinar exchange rate and no major privatisation receipts, the stock-flow adjustment is expected to contribute only marginally to debt dynamics.

Government debt is not yet in safe waters. Under the baseline scenario, debt indicators would still be significantly above their levels before the 2008 global financial and economic crisis. In the years following the crisis, budget performance was easily derailed and fiscal sustainability deteriorated quickly. Gross financing needs remain large at close to 10% of GDP and the high share of foreign currency denominated debt still exposes government debt to non-negligible fluctuations from exchange rate movements. A rules-based framework does not yet sufficiently anchor policymaking. In view of that, guaranteeing debt sustainability will remain a major policy challenge in the short term. Strengthening existing fiscal rules as envisaged by the authorities, to make them more binding and relevant for policymaking, could play a major role in achieving this goal.

Fiscal risks and uncertainties are not insignificant. Despite good fiscal results, reform implementation has been uneven and slow in general and the reform agenda remains largely unfinished. This has resulted in known systemic weaknesses being prolonged, like the public employment freeze and an opaque public wage system, as well as inadequate and inefficient capital spending. There remain major challenges with fiscal implications related to the performance of state-owned enterprises and financial institutions, public sector employment and wage policy, and the overall fiscal governance framework. Some of the newly adopted fiscal measures, such as (i) the selective wage hikes, (ii) the targeted increase of some pensions, (iii) the abolishment of the pension indexation formula, and (iv) the recent acquisition spree by the majority state-owned telecom, are also difficult to justify and eat up space for more productive expenditure. As in previous years, the programme fails to mention possible restitution-related obligations of up to EUR 2 billion or some 4% of GDP. The authorities have once again postponed the deadline for issuing government debt to cover these obligations from 2018 to December 2021.

The authorities could further strengthen the institutional underpinnings of the budgetary process and fiscal sustainability. The capacity of the Ministry of Finance to analyse fiscal risks and assess public-private partnerships has increased recently. The authorities also took major steps to improve the capital budgeting process and work progressed on strengthening the tax administration. The coverage of the Budget Execution Information System continued expanding, along with ongoing efforts on developing general government sector statistical information in line with ESA 2010. However, the overall institutional environment related to the budget process is still challenging. The budget calendar is not fully complied with and the Fiscal Strategy has repeatedly been adopted in autumn instead of spring. There was no meaningful parliamentary debate on the 2019 budget and the authorities did not submit final annual budget execution reports to the parliament. Work on revising fiscal rules has largely stalled. The existing fiscal rules remain weak, detached from the policy process and do not offer adequate sanctions in cases of non-compliance nor effective enforcement mechanisms. The improvement in the quality and timeliness of budgetary statistical information was slow. The budget execution reports did not provide information about large one-offs.

Box: Debt dynamics

Table 4:
Serbia - Composition of changes in the debt ratio (% of GDP)

	2017	2018	2019	2020	2021
Gross debt ratio [1]	58.7	54.4	51.7	49.3	46.9
Change in the ratio	-10.1	-4.3	-2.7	-2.4	-2.3
<i>Contributions [2]:</i>					
1. Primary balance	-3.6	-2.7	-1.4	-1.3	-1.1
2. "Snowball" effect	-0.9	-1.7	-1.6	-1.9	-1.9
<i>Of which:</i>					
Interest expenditure	2.5	2.1	2.0	1.8	1.6
Growth effect	-1.4	-2.4	-1.9	-2.0	-1.9
Inflation effect	-2.0	-1.4	-1.7	-1.7	-1.6
3. Stock-flow adjustment	-5.6	0.0	0.3	0.7	0.6

[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 in cash and accrual accounting, accumulation of financial assets and valuation and other effects.

Source: *Economic Reform Programme (ERP) 2019, ECFIN calculations.*

The government debt to GDP ratio fell by 4.3% of GDP in 2018. Most of the decline was due to the still sizeable primary surplus. Economic growth, which picked-up notably, also contributed to the fall in the debt ratio. Contrary to previous years, the stock-flow adjustment had a negligible effect, reflecting a stable dinar exchange rate and the booking of the large concession fee for the Belgrade airport in 2019. Looking ahead, the programme forecasts that the stock-flow adjustment and interest payments will remain the only debt-increasing factors. However, government debt is expected to decline further thanks to sound fiscal policy and stable economic growth. Restitution-related debt

and fluctuations in government financial assets, not included in the baseline scenario, could also significantly affect debt dynamics.

4. STRUCTURAL CHALLENGES AND REFORM PRIORITIES

Serbia has been progressively restructuring its economy, principally by investing into the tradable sector. Exports have been a major driver of growth. Manufacturing has modernised and diversified over recent years, but traditional industry, in particular the energy sector has not been restructured. Its underperformance negatively affects economic growth by up to 1% per year. Moreover, to reach higher growth rates, opportunities of the internal market and services will need to be better exploited, through ensuring a level playing field for all companies. Economic growth and improvement of living standards towards EU levels will thus depend on continuous implementation of structural reforms across many sectors. The Commission has conducted an independent analysis of Serbia's economy and identified the main structural challenges to competitiveness and inclusive growth, drawing on Serbia's own ERP and other sources. The analysis highlights a number of structural challenges across many sectors. The three most important ones are: (i) increasing the contribution of labour to growth, (ii) improving transparency and predictability in the regulatory environment and facilitating competition and (iii) tapping energy saving potentials and fully opening the energy market.

4.1. Key challenges

Key challenge #1: Increasing the contribution of labour to growth

Considerable gaps in labour market participation, education and school-to-work transition have not yet been addressed in a strategic manner. The labour market potential of the population at working age is not fully used. Women, young people and recent graduates are not well integrated into the labour market and their employment levels are still below the country's potential. The large number of unemployed people does not benefit from appropriate support for reintegration into employment. The continuing brain

drain, including of people with particular skills, risks aggravating labour shortages in the future, given demographic developments. Limited consideration is given to improving the attractiveness of the labour market, in particular in the medium and lower range of wages. Fiscal space has been used predominantly to increase public wages and pensions. However, a broader and more equitable approach to improving socioeconomic conditions is required in the longer term. The continuing high level of undeclared work calls for a more comprehensive approach to encourage formal work, thus strengthening the position of labour in the country's overall economic framework.

Key challenge #2: Improving transparency and predictability in the regulatory environment and facilitating competition

In the private sector there is a strong sense of unfair competition. The sentiment on unfair competition is primarily fuelled by the omnipresence of public companies, which contribute 20% of GDP but possess 70% of assets, but also by the large informal sector (27% of GDP) and state aid schemes favouring foreign investors over domestic SMEs. Businesses are also concerned by the unpredictable and non-transparent fiscal and para-fiscal revenue collection system.

State-owned enterprises crowd out private sector development. Many public companies consume excessive national resources, provide poor services to the rest of the economy and negatively affect fiscal results. Furthermore, both public and private large firms have established a special relationship with the state, which results in tailor-made policies and financial advantages.

Unfair competition is also fuelled by the large informal sector. Many SMEs and sole traders operate partially in the grey economy, so as to avoid the relatively high tax wedge on wages or to avoid red tape. While in view of the fiscal policy needs the government has been careful in reducing the tax burden, it has stepped up the fight against the informal sector by increasing tax and labour inspections. For example, the labour inspectorate filed 15% more irregularities concerning employment in 2017 than in 2016. The aim is to bring down the level of the informal sector from the current 27% to 25% of GDP. A new action plan on informality, which is planned for adoption in 2019, focuses on similar measures as in the past - monitoring of financial flows, improvement of tax administration, stimulation measures for fair competition, legalisation of small entrepreneurship and raising awareness. Once adopted, the action plan should be implemented as a matter of priority. In order to achieve more significant results, improvements are also needed in the overall business environment, especially on tackling corruption, rule of law, contract enforcement and better regulation.

Serbia's FDI attraction policies are among the most effective in the region, according to the OECD (2018); however, these policies are not in line with state aid rules and leave domestic companies underserved. The state provides services, which enable swift installation and operation, and in addition offers tax breaks and subsidies for new employment to foreign investors. On the other hand, the budget for SME policies is growing but remains modest compared to the amounts of state aid and tailor-made services offered to big investors. Good policies to support (foreign) investors need to become more inclusive and better financed. Those most in need of such support are domestic business, particularly those that are smaller and innovative, which have the possibility of reaching international markets or establishing links with incoming FDI.

The revenue collection system needs more predictability and fairness. Local companies most often complain about the unpredictable taxation system and the large discretionary levies of local authorities or independent agencies employ into collecting

revenue (para-fiscal charges) for their services, regardless of the actual cost of this service. In Parliament, many of the business-related laws are still passed by urgent procedure. When it comes to curbing the powers of independent authorities to levy fees and taxes, a new law on fees on the use of public goods was passed, by urgent procedure, in December 2018. It remains to be assessed to what extent the law will contribute to predictability of para-fiscal charges and ensure that these fees represent a fair value of a particular service.

The lack of effective rule of law is one of the main factors that hampers the private sector and enables informality. Effective and independent judicial systems are needed for developing of the business environment and attracting more FDIs. A strengthened rule of law would positively contribute to a more predictable regulatory framework, contract enforcement and increase of transparency, leading to a more competitive economy. Moreover, it will also help reduce corruption.

Key challenge #3: Tapping energy saving potentials and fully opening the energy market

Serbia's competitiveness continues to be hampered by a polluting, inefficient and not properly regulated energy sector. The energy sector represents 4% of GDP. Its regular underperformance leaves an important mark on growth. The energy supply is generally uninterrupted but continues to rely mostly on lignite, polluting heavily. Electricity tariffs are too low to enable necessary investment in infrastructure; the country performs badly in energy efficiency terms.

Adjustments in the electricity tariffs and further restructuring of the sector are needed to improve its performance. Most energy companies are state-owned and have through the years relied to a different degree on support from the budget. The government has made efforts to professionalise the governance of the electricity generator EPS. Furthermore, it had restructured the debts that the gas provider Srbijagas accumulated, due to supply of gas to non-paying publicly owned companies. While these companies no longer represent a threat to public finances, their restructuring is still not finalised. Moreover, electricity tariffs are not cost-reflective and should increase gradually by 50% to reach full cost recovery level. This should be accompanied by appropriate social programmes to mitigate possible adverse effects.

Proper regulation is a key priority for the sector. While Serbia's primary legislation is compliant with the third energy package and its rules on the internal energy market, implementation is lagging behind, particularly in gas. In the past years, Serbia has stalled its gas market reforms. In breach of its obligations under the Energy Community Treaty, Serbia continues to delay unbundling in the gas sector and fully finalising unbundling in electricity. Proper regulation of electricity and gas markets is key to increase the sector's efficiency and effectiveness.

The energy sector has attracted non-EU investors. In some occasions, their investments do not seem to undergo proper screenings for EU public procurement, state aid and technical rules. This can potentially lead to breaches of obligations vis-a-vis the agreements signed with the EU and create hiccups in interoperability. Therefore, the state needs to exercise particular caution when it engages with investors from third countries.

Serbia's energy sector is at the core of the Western Balkans connectivity agenda. Infrastructure and cross border connectivity have been improving, but significant further large investments are needed. These include the upgrade of the Trans-Balkan electricity corridor and the construction of the Serbia-Bulgaria gas interconnector. To further regional connectivity on energy, Serbia should swiftly implement the connection agreement reached in the dialogue between Belgrade and Pristina.

Large investments are needed in environmental upgrading in order to reduce pollution. Due to its large reliance on coal burning, EPS needs to invest significantly in combatting air pollution. According to a study by the Energy Community Secretariat (2013), Serbia needs to invest EUR 640 million in the energy sector to comply with the Large Combustion Plant Directive and EUR 710 million to comply with the Industrial Emission Directive. Environmental protection fees should be fully allocated to finance environmental investments (polluter pays principle). Serbia needs to increase its environmental investments substantially, also in view of obligations arising from the EU *acquis*.

The poor energy efficiency is a key challenge for the near future. Energy intensity in Serbia is four times higher than that of OECD countries. The introduction of energy efficiency measures largely depends on local governments, which have neither the necessary resources nor the capacities. The role of the central government is therefore crucial: It needs to address energy efficiency by pursuing a more strategic approach, investing more into stepping up financial and human resource capacities and ensuring better coordination with stakeholders at local government level and outside the government. The introduction of an energy efficiency fee in early 2019 was a first, although limited step in the right direction. Improving Serbia's institutional set-up and financing mechanisms are needed to enable scaling up urgently needed investments into energy efficiency.

4.2. Labour market, education and social policies

Labour market developments

The labour market continued to improve slightly in 2018, although at a rate below economic growth and less pronounced than in 2017. The activity rate (15-64 years) continued to increase with 1.1 pps year-on-year (2018: 67.8%, 2017: 66.7%), while the employment rate improved with 1.5 pps year-on-year (2018: 58.8%, 2017: 57.4%). Employment reached its highest level since 2014 with more than 2,8 million people in work in 2018. The recent decrease in unemployment from 2017-2018 (-0.8 pps) was less noticeable compared to 2016-2017 (- 1.8 pps). Positive labour market trends were moderated however by continued emigration at estimated 50,000 to 70,000 potential workers in 2018, caused by lack of jobs, low wages and living standards. Pronounced regional and urban/rural disparities in employment persist.

Women, young people and low skilled people are still underrepresented in employment. Although positive economic trends have substantially reduced youth unemployment, which has fallen faster than overall unemployment in recent years, it still remains over two times higher than for the overall workforce (2018: 29.7%). A further reduction of the proportion of young people not in employment, education or training (NEET) by 0.7 pps (15–24 years) was seen in 2018 (16.5%), but the problem remains significant for the age group 25-29 years with a NEET rate of 29.5% (2017). The new national youth strategy 2018-2020 was adopted recently. The employment gender gap persists at 13.6 pps (15-64 years), and female unemployment, in particular when young, remains constantly higher than for men (3.7 pps in 2018). There is no comprehensive approach for activation and retention of women in employment. The employment rate of recent graduates (20-34 age group) of 56.9% in 2017 is well below the EU average of around 80%, representing untapped potential for developing value-added economic activities.

Active labour market policies (ALMPs) in Serbia remain insufficient in scope and content. Funding for carrying out ALMPs is very low (2017: 0.08% of GDP). The

measures provided under the yearly National Action Plan on Employment (NEAP) are mostly one-day services such as job fairs and job-search training, covering around 120,000 participants per year. Measures may be useful but have limited impact on improving job prospects for unemployed people. Only around 3% of registered unemployed people have been included in measures such as training, employment and self-employment subsidies or public works. Training measures are mostly for medium and highly educated jobseekers. No comprehensive data are available about the scope of ALMPs provided at local level, based on agreements between the National Employment Service and local self-government units.

High informal employment and low-work intensity are problematic trends in the employment increase in recent years. Informal employment remains constantly high at around 20% and is present in agriculture and other sectors as well. A new law on seasonal work in agriculture enters into force in 2019 aiming to reduce informal work in the sector. No targets have been set for its implementation. Low work-intensity in marginal jobs is twice as high as the EU average, one worker in five is employed in seasonal, part-time or casual jobs. The recent economic improvements have not yet led to substantial income increases; the average monthly wage reached around EUR 420 in 2018. However, three out of four workers' earnings are lower. The minimum wage was increased to RSD 155 per hour (EUR 1.30) in 2019. Public sector wages nominally increased by close to 10% in both 2018 and 2019.

Social dialogue is weak, in particular for the private sector. Since the cancellation of all collective agreements in 2015 after the Labour Code revision in 2014, new collective agreements have been mostly concluded in the public sector including in public companies. Very few agreements at branch level exist in the private sector, due to non-conducive rules for extending agreements. Tripartite social dialogue, in particular within the Economic and Social Council of Serbia, has become more regular in 2018, but Social Partners consider their impact on political decisions as rather limited. The revision of the law on strike has been further postponed.

Box: Monitoring performance in light of the European Pillar of Social Rights

The European Pillar of Social Rights, proclaimed on 17 November 2017 by the European Parliament, the Council and the European Commission, sets out 20 key principles and rights on equal opportunities and access to the labour market, fair working conditions, and social protection and inclusion to benefit citizens in the EU. Since the 20 principles are essential for countries if they are to achieve fair and well-functioning labour markets and welfare systems, they are equally relevant for candidate countries and potential candidates. The new reinforced social dimension for the Western Balkans includes an increased focus on employment and social reforms through greater monitoring of relevant policies (EC, 2018). The Western Balkans Ministers' Declaration on improving social policy in the Western Balkans (6 November 2018) confirms that they will use the Pillar to guide the aligning of their labour markets and welfare systems with the EU's.

In most of the principles of the European Pillar of Social Rights, Serbia performs weaker relative to the EU average, according to the indicators of the Social Scoreboard¹. Improving trends in employment have been observed over recent years. While in some areas lower performance is in a certain way unavoidable, since Serbia is poorer than any one of the EU Member States, more attention needs to be paid to fields that are less dependent on the level of national income, such as gender equality and inequality.

SERBIA		
Equal opportunities and access to the labour market	Early leavers from education and training (% of population aged 18-24)	N/A
	Gender employment gap	Worse than EU average, improving
	Income quintile ratio (S80/S20)	Worse than EU average, no change
	At risk of poverty or social exclusion (in %)	Worse than EU average, improving
Dynamic labour markets and fair working conditions	Youth NEET (% of total population aged 15-24)	Worse than EU average, improving
	Employment rate (% of population aged 20-64)	Worse than EU average, improving
	Unemployment rate (% of population aged 15-74)	Worse than EU average, improving
Social protection and inclusion	GDHI per capita growth	N/A
	Impact of social transfers (other than pensions) on poverty reduction	Worse than EU average, deteriorating
	Children aged less than 3 years in formal childcare	Worse than EU average, improving
	Self-reported unmet need for medical care	Worse than EU average, improving
	Individuals' level of digital skills	Worse than EU average, improving

Women in Serbia have a significantly lower employment rate than men. The gender employment gap is wider than the EU-28 average (14.1 pps vs 11.5 pps in 2017) with no significant change in the last 5 years. The wide employment gap is mainly due to the low activity of women in the labour market. The lower statutory retirement age for women and low level of part-time work (12% for women) combined with care responsibilities are some of the root factors.

Serbia's performance on social inclusion, social protection, income equality and poverty alleviation could be significantly improved. The at-risk-of-poverty rate stands around 25%, among the highest in Europe. Children and young people below 25 years of age face an at-risk of poverty rate of 30%. Disposable income of individuals in the top income quintile is on average almost ten times higher than of those in the lowest quintile. Serbia's tax-benefit system is not as efficient as elsewhere in Europe in reducing market inequality. Furthermore, high government expenditure does not reduce income inequality much. Pensions, for example, although they comprise some 12% of GDP, among the highest shares in Europe, are less effective in reducing inequality in the EU.

Serbia has a well-developed statistical system. The Statistical Office of the Republic of Serbia is the main producer of primary data from the Labour Force Survey and the Survey on Income and Living Conditions (SILC). The Institute of Public Health produces detailed statistics related to public health and demographic trends. The semi-governmental Social Inclusion and Poverty Reduction Unit is especially active in processing and interpreting data on poverty and inequality as well as developing indicators for monitoring of the social situation. In academic and civil society circles the monitoring of the social situation in Serbia is critically discussed, regarding methodology and results.

¹ The Social Scoreboard includes 14 headline indicators, of which 12 are currently used to compare Member States performance (<https://ec.europa.eu/eurostat/web/european-pillar-of-social-rights/indicators/social-scoreboard-indicators>). The 12 indicators are also compared for the Western Balkans and Turkey. The assessment includes the country's performance in relation to the EU-28 average (performing worse/better/around EU-28 average) and a review of the trend for the indicator based on the latest available 3-year period for the country (improving/deteriorating/no change). Data from 2014-2017 are used.

Social Protection System

Despite continuing positive economic trends, poverty and income inequality remain high. Over 2014-2017 the at-risk-of-poverty-and-exclusion rate fell by 5.9 pps to 36.7%, due to lower material deprivation levels. The at-risk-of-poverty rate did not change, with one quarter of the population at risk (2017: 25.7%, -0.2 pps from 2014). The share of the population at risk in at least 3 consecutive years increased in 2017 to 18.4% (up 1.7 pps from 2014). Households of two adults with three or more children (55.8%), single individuals over 65 years old (39.6%) and children (nearly one in three) are most at risk. There is no strategic policy approach to lift people in substantive numbers above the threshold in the short-to-medium term. Income inequality measured by SILC is markedly above EU level.

The minimum income scheme (FSA) does not provide sufficient coverage nor is it sufficiently effective. Around 3-4% of the population receive FSA (EUR 69 per month for adults, less for children), less than half of the number of people living in absolute poverty according to national criteria. The FSA is well-targeted and cost-effective, as around 75% of benefits reach the poorest population quintile, but the funds provided do not cover basic living needs. The gap between the FSA level and the poverty threshold widened in recent years and stands around 45 pps. Amending the Social Protection Law was postponed after public consultations in mid-2018. Envisaged changes focused on improving the capacities of the public welfare service, strengthening FSA conditionality and activating FSA recipients able to work. No measures for increasing the adequacy of cash benefits were proposed. Spending on FSA is around 0.35% of GDP, below not only European but also regional standards. There are no plans for a targeted increase in social spending in this area.

Incentives for increasing birth rates were enacted in 2018, but are not accompanied by improved provisions for early childhood education. The new financial support for the first four children is means-tested (but quasi universal) and it comprises specifically monthly instalments for the third and fourth child over the first 10 years. The proportions of children up to 6 years old attending kindergarten increased markedly from 27.3% in 2014 to 39.6% in 2016. The attendance level is very high for children from well-off families (78%), but only 9% for children from the poorest families and 6% for Roma children (data: UNICEF MICS5). This is despite the priorities set by law for children from vulnerable groups. Kindergartens are funded by local governments but not all of them have sufficient financial means for providing the necessary services.

A new law on pensions adopted in September 2018 gives the government the discretionary right to regulate future increases of pensions. The law abolishes the temporary progressive cut on higher pensions affecting 40% of pensioners, which was enacted since 2014 for fiscal consolidation reasons. The replacement of the previous indexation method based on inflation and GDP growth by a discretionary right to regulate future increases of pensions endangers the stability and predictability of the public pension system, which is already under strong pressure due to the ageing population.

Education and skills

Serbia's education system outcomes are not contributing sufficiently to longer-term socioeconomic development. The education level of the population is growing relatively rapidly, due primarily to the far lower educational achievements of the older population exposed to demographic attrition. In 2015, about 71% of people over 25 years of age had completed at least upper secondary education (men 77%, women 65%). At this level, Serbia still ranks below those EU Member States that joined in 2004 and later (81.7%), but

it is catching up. Tertiary level attainment is increasing (31.4% in age group 30-34), but this potential is not translated into high quality occupations. The analysis of skills mismatch in Serbia shows that one in four workers with tertiary education is employed in occupations below their attainment level (which means they are over-qualified) while among the medium-educated the incidence is about 7%. PISA results (2016) indicated high shares of underperforming pupils (40% in mathematics and 30% in reading). Further insights on longer-term trends will be obtained from PISA 2018, TIMSS 2019 and PIRLS 2021.

The education strategy and its action plan are being implemented, albeit with important delays. Some progress was made in improving school curricula, including pre-school education. The regular training of school staff is not yet consistent with new outcome-based curricula; innovation in teacher education relies primarily on individual initiatives and international development projects. A larger donor-driven initiative was launched in 2018 with the teacher training program for implementing outcome-oriented learning. The Roma and other ethnic minority groups continue to significantly underperform in a school system that replicates social inequalities. A national action plan on inclusive education was adopted in 2018. The legislative and institutional framework of the national qualifications framework is in place now and 12 sector skills councils have been set up.

Vocational education and training (VET) is still the dominant option to take in secondary education. At present nearly 75% of students follow VET (involving classroom-training), which shows better employment outcomes (52.1% employment rate in 2017) than the general education path (41.2%). A new type of VET involving work-based-learning has been tested since 2016 and the corresponding legislative provisions were complemented in 2018. The system is still in its pilot stage with around 4500 students enrolled so far (equal to around 2% of all students in secondary education). Quality assurance mechanisms have not yet been introduced, and first evaluation results will become available in 2021 when the first four-year cycle is concluded. Entrepreneurship has been introduced as a separate subject in general education for the first time in 2017. University curricula have been modernised and new start-up development and intellectual property management courses have also been developed. Rapid strides have been taken to improve the innovation infrastructure to link business with academia through science and technology parks in Serbia's three main economic hubs.

Adult education and lifelong learning opportunities are insufficient to improve the labour market integration of vulnerable groups. Lifelong learning participation is low (4.4%), as well as second chance education for adults. There is little coordination between public and private institutions involved in implementing education and training policies for labour market integration and social inclusion. The high proportion of adults with lower education attainment presents a serious obstacle to their better inclusion in the labour market as well to mitigating poverty. Measures for improving educational attainment cannot be successfully implemented because the adoption of a number of relevant by-laws did not follow the Law on adult education.

4.3. Competitiveness and sectoral issues

Business environment

There is a political commitment to further improve the business environment. Serbia is ranked favourably in the World Bank's Doing Business (2019) report, but the latest reports show that the pace of progress has slowed down as reforms are becoming more

difficult to design and implement. The most significant measure to improve the business environment was the introduction of a simplified construction permit procedure in 2015. It has contributed to the boom in the construction sector and availability of real estate. Serbia also ranks high when it comes to opening a new company or trading across borders. The macroeconomic stabilisation significantly improved the access to finance for companies, but financing remains primarily in the form of loans, while more complex financial instruments are underdeveloped. Serbia is now perceived as one of the most attractive investment destinations in southeast Europe, supported principally by the low cost of labour, geographic proximity to the EU's most developed markets and generous tax incentives for FDI.

At the same time, more difficult reforms to improve the business environment face delays both in design and implementation. This concerns more complex business support services, such as protection of investors, enforcement of contracts or fair competition and taxation. Progress has been made with adoption of an e-government law in April 2018. The implementing legislation and a new e-government strategy for 2019-2021 are being developed and should contribute to improve the services for both citizens and businesses. Some further e-services have been developed, such as on e-payments. Digital signatures are being used but uptake of this service is only around 5% of the population. A more modern e-government portal is currently being designed. Introduction of these e-government services is a much welcome initiative as it can help improve the environment for business by speeding up procedures and reducing the scope of favouritism or corruption by the administration.

The role of SMEs in the economy is not as pronounced as in the EU although they are receiving increasing attention from policymakers. The Ministry of Economy of Serbia launched a policy initiative in 2016, the Year of Entrepreneurship, which subsequently became the Decade of Entrepreneurship initiative, increasing overall financial and non-financial support to SMEs. The Ministry of Economy also adopted in 2015 an SME Development Strategy & Action plan 2015-2020, envisaging the establishment of a legal framework for non-bank, non-deposit credit institutions by end-2016, in order to ease access to funds for micro-enterprises and entrepreneurs. The uptake of SMEs for these services is remarkably high, demonstrating their needs and willingness to engage with public agencies. Loans in local currency increased, improving SMEs' access to bank finance, but more complex instruments are still not developed and regulated. The uptake of SMEs in public procurement tenders remains relatively low.

Research, development and innovation

Investment in research, development and innovation is weak and industrial innovation in particular needs more support to increase the value-added of exports. Although the country has a relatively good scientific base, the level of investment in research and development is only 0.9% of GDP. The share of private investment in research is only 0.3% of GDP. Cooperation between the public and private sectors remains weak and is not systematically supported. Most public funds for research end up in public research institutes while companies receive a very small share. Infrastructure for science and technology parks is being expanded, but support services for these institutions remain limited and need to be expanded. Similarly, the Innovation Fund, which provides grants for industrial research, needs a more prominent role in the national funding system.

Digital economy

Digital transformation is a key priority for Serbia. The government established an Office for information technology and electronic government, which deals with a

comprehensive introduction of e-services. A key challenge for public policy is also to improve broadband roll-out, which is still below the EU average and keeps the country trailing behind when benchmarked against its peers in the World Economic Forum's Network Readiness Index and the EU Digital Economy and Society Index. The lack of broadband prevents uptake of e-government and business services and is slowing down the transformation of the economy, decreasing its efficiency. In particular, provisions of business-to-business and public services over the network are assessed as being very weak.

The ICT sector needs more support as it has the potential to help modernise the economy. A number of ICT clusters across the country have been established and technology parks have most incubated companies in this area. Investment of the ICT sector in research is above the national average, but still low compared to EU averages. Some Serbian ICT firms and researchers are highly successful in the EU Horizon 2020 programme, pointing at pockets of global excellence. The sector now employs just 2% of total labour, but it is estimated to contribute significantly to the export of services (17%), has higher employment growth (10% per year) and pays higher salaries. The challenge remains to ensure there are links between the ICT sector and traditional industries so as to speed up the latter's modernisation.

Investment activity

FDI inflows are increasing, but positive spillovers could be better captured by domestic firms, particularly SMEs. Due to the conflicts in the 1990s, Serbia was late in attracting foreign investors. First waves of investment in the early 2000s occurred in services, such as telecommunications or banking. The global financial crisis significantly reduced the willingness of investors to expand. Incoming FDI recovered only with the recent macroeconomic stabilisation and the start of EU accession negotiations. Serbia continued working closely with investors and FDI inflows grew to EUR 3.2 billion in 2018, the highest recorded in recent years. The stock of FDI is now at around 80% of GDP. Investment is spread across many sectors, with more than a quarter going into manufacturing. The top 15 exporters are mainly foreign-owned, securing jointly just under 30% of total exports. The backward linkages between FDI and domestic firms remain weak. Tailor-made measures are needed to link incoming investors with domestic suppliers, integrating them further in their value chains. To this end, economic clusters remain limited and their activities are not systematically supported by the government. Similarly, the ongoing programmes for internationalisation of SMEs need to be stepped up to reach a higher number of beneficiaries.

Trade performance

Trade performance improved further in 2018, but external imbalances increased. Trade openness rose to above 110% of GDP from 88% five years earlier as both imports and exports maintained strong growth. Access to the EU market without customs duties applies for 93.3% of Serbian products. Exports rose by more than 9% in 2018 despite some loss in price competitiveness due to a strong dinar. However, external imbalances increased as higher investment and consumption pushed up imports by 11% in 2018. Nevertheless, the current account deficit remained fully covered by net FDI inflows. Metals, cars, car parts and electric appliances were the most significant sectors of exports. The same sectors are the most significant on the import side as well, along with energy imports, which is the top import category, amounting to EUR 2.5 billion or 11.6% of total imports of goods.

Foreign investment and trade are well-placed to continue driving growth, but the potential of trade integration with the EU and countries in the Central Europe Free

Trade Agreement (CEFTA) is still not fully realised. Serbia's FDI and trade integration levels with the EU are still below some of its peer countries. The frameworks of the Stabilisation and Association Agreement and the Central European Free Trade Agreement (CEFTA) can be better used. A number of non-tariff barriers hinder trade with the EU, particularly in the area of food and agriculture. The regional economic area (REA) commitments need to be pursued with determination, including finding pragmatic solutions to political obstacles under CEFTA.

Transport

Transport infrastructure suffers from years of bad maintenance and underinvestment and hampers faster trade expansion. Its quality is ranked by the World Economic Forum as lower than in most other Western Balkan countries, with poor scores in all four categories (rail, road, water and air). An intelligent transport strategy, as required by the EU *acquis*, has not yet been put in place in Serbia. On the other hand, Serbia ranks better in terms of logistics, as it provides enough services on its transport routes to secure shipments of large volumes of goods. Critical improvements are needed in the areas of traffic management, maintenance, and road safety. Adequate funds for these goals have now been secured, but timely implementation remains a challenge. The reform of the railway system has started but needs to be completed. River ports have started to become an important trade channel, but they need to be further upgraded and their full inter-operability with roads and railways needs to be secured.

Agriculture

The importance of agriculture for the economy is slowly diminishing, but remains significant when coupled with the more dynamic food processing sector. Agriculture accounts for slightly more than 7% of gross added, although it employs around one-fifth of the labour force. Agriculture and food products exports contribute significantly to employment and the balance of payments (15% of all exports). Exports to the EU even dropped. Weather conditions continue to have a strong influence on the sector performance. The other challenges facing the agricultural sector are (i) high exposure to weather, (ii) land fragmentation, (iii) low productivity due to outdated technologies, (iv) small economic size and (v) low utilisation of agricultural land per farm. In addition, the sector faces EU obligations in the areas of food safety, veterinary and phytosanitary regulation, strengthening of responsible authorities in those areas, and a need to improve border inspections as regards risk analysis and risk-based performance. Moreover, the real estate market for agricultural land is hindered by the weak cadastre/property registration, as well as the lengthy procedures for case settlements in courts.

Industry

The competitiveness of industry is key to growing the economy. Support for incoming FDI is principally oriented towards attracting manufacturers. After years of declining industry, the share of industry in GDP has now stabilised. Industry constitutes a quarter of the value added with stable manufacturing, but includes a very variable performance from traditional industries such as mining and electric production. The government is planning to adopt a new industrial strategy, which should be based on smart specialisation. Its measures should be better targeted towards the sectors and firms with most potential. While support for investment is well rolled-out, other services are less developed. Clusters, technology parks, internationalisation, and industrial research do exist, and new standards or digitalisation in traditional industries have been introduced; however, these have not yet had a systemic impact. These kinds of measures should be stepped up, also in view of their

full compliance with state aid rules. The smart specialisation strategy should address the issue of skills, which need to accompany modernisation.

Services

Services represent more than half of the economy and close to 30% of total exports. Around half of the value-added by services comes from retail, real estate and healthcare. Services have been increasing their share in total exports and have a potential to expand further. The export structure by service type is dominated by tourism, transport and ICT services. To further expand these fast growing and competitive services, investments in infrastructure and skills need to be adjusted to their needs. A dedicated effort is needed to slow down the brain drain of most skilled labour. Under the Stabilisation and Association Agreement with the EU, there is no framework for the liberalisation of services, but this does not significantly affect the above sectors. The CEFTA agreement highlights further sectors in which services could expand regionally, provided that a significant work on mutual recognitions of qualifications and certificates is accomplished. Belgrade is well-positioned to function as a hub for the regional provision of many skill-intensive services.

ANNEX A: IMPLEMENTATION OF THE POLICY GUIDANCE ADOPTED AT THE ECONOMIC AND FINANCIAL DIALOGUE IN 2018

Overall: Partial implementation (40.9%)²	
2018 policy guidance	Summary assessment
<p>PG 1:</p> <p>Use any revenue over-performance in 2018 for debt reduction.</p> <p>Target a balanced budget over the medium term, in order to lock in recent fiscal consolidation gains and create sufficient buffers against fiscal risks.</p> <p>Adopt a credible and binding system of fiscal rules, capable of anchoring fiscal policy.</p>	<p>There was partial implementation of PG1.</p> <p>1) Substantial implementation: The 2018 revenue outcome was better than expected by RSD 70 billion. Most of the over-execution was saved and the budget ended in a surplus of 0.6% of GDP.</p> <p>2) Substantial implementation: The medium-term fiscal programme targets a budget deficit of 0.5% of GDP, i.e. close to a balanced budget.</p> <p>3) No implementation: There were no administrative or legal measures taken to address this policy guidance. Although it reconfirms the authorities' commitment, the ERP 2019 does not include any specific plans or a timeline for strengthening fiscal rules.</p>
<p>PG 2:</p> <p>Further improve the composition of government spending by reducing non-interest current expenditure and increasing capital spending as a share of GDP over the medium term.</p> <p>In order to better plan and execute public investments, develop a single mechanism for prioritising and monitoring all investment regardless of the source of financing.</p>	<p>There was limited implementation of PG 2:</p> <p>1) Partial implementation: The composition of government spending improved somewhat in 2018. Current non-interest expenditure fell from 35.0% in 2017 to an estimated 34.8% of GDP in 2018, while capital expenditure went up from 2.8% to 3.6% of GDP. The current non-interest expenditure is expected to decline further over the medium-term by 0.4-0.5 percentage points per year but the decline comes mainly from the group of other current spending and social benefits. Collective consumption (wages and good and services) is actually envisaged to increase slightly to 16.0% of GDP in 2019. Capital expenditure are also levelling off at 4.0% of GDP.</p> <p>2) No implementation: The adopted decree maintains a double system for the screening of investment.</p>
<p>PG 3:</p> <p>Conduct monetary policy in line with achieving the inflation target.</p> <p>Consider to gradually allow for more exchange rate flexibility as macroeconomic stability is cemented.</p>	<p>There was substantial implementation of PG3:</p> <p>1) Full implementation: Monetary policy was kept accommodative in 2018 and inflation fluctuated within the tolerance band, in the lower part, on account of low imported inflation and existing spare capacity.</p> <p>2) Limited implementation: The NBS intervened to curb appreciation pressures through the year such that the dinar exchange rate toward the euro was broadly unchanged. As a result, the IMF reclassified</p>

² For a detailed description of the methodology used to assess policy guidance implementation, see Section 1.3 of the Commission's Overview and Country Assessments of the 2017 Economic Reform Programmes available at https://ec.europa.eu/info/publications/economy-finance/2017-economic-reform-programmes-commissions-overview-and-country-assessments_en.

<p>Implement the remaining action points from the NPL resolution strategy</p> <p>and finalise the privatisation process of the remaining state-owned banks.</p> <p>Continue to promote the use of the local currency inter alia by maintaining a favourable treatment of dinar reserve requirements compared to those in foreign currency and by fostering the development of interbank markets and secondary markets for government securities.</p>	<p>the exchange rate as crawling peg.</p> <p>3) Substantial implementation: The authorities have implemented most measures of the NPL resolution strategy. The government adopted a new programme for NPL resolution 2018-2020, focusing on limiting the rise of new NPLs.</p> <p>4) Partial implementation: There are delays in the restructuring of Banka Poštanska štedionica. More progress has been made regarding the privatisation of Komercijalna Banka. The restructuring of small state-owned banks is ongoing.</p> <p>5) Substantial implementation: The authorities have kept the spread between reserve requirements in foreign and local currency unchanged. An update of the dinarisation strategy was published in December, which provides for, among other things, measures to foster developments of secondary markets for government securities.</p>
<p>PG 4:</p> <p>Gradually adapt electricity tariffs so they reflect real costs including necessary investments to upgrade the energy network and to meet environmental standards.</p> <p>In parallel, increase investments in energy efficiency.</p> <p>Finalise the unbundling of state-owned enterprises alongside accelerating their restructuring, in particular Srbijagas and EPS.</p>	<p>There was limited implementation of PG 4:</p> <p>1) Limited implementation: Electricity prices have slightly increased but the reform of the system of tariffs remains a significant challenge.</p> <p>2) Partial implementation: The law on fees has been adopted and includes an energy efficiency fee, which should have a positive impact on the financing of energy efficiency projects.</p> <p>3) Limited implementation: The restructuring of Srbijagas continued but progress on unbundling was negligible. The restructuring of EPS continued but not all outstanding issues regarding unbundling were addressed.</p>
<p>PG 5:</p> <p>Use findings of the smart specialisation exercise to finalise a new industrial strategy</p> <p>and ensure that all instruments of support to companies are in line with state aid rules.</p> <p>Implement the law on fees so that parafiscal charges will be predictable and based on a fee-for-service principle.</p> <p>Ensure predictability and risk based control of phytosanitary checks at the border.</p>	<p>There was limited implementation of PG 5:</p> <p>1) No implementation: While the analytical work on smart specialisation proceeded, the process of the drafting of the industrial strategy has not yet started.</p> <p>2) No implementation: Investment incentives provided to companies based on the Law on Investments and the relevant by-laws are mainly in line with state aid rules. However, companies also benefit from numerous other types of aid, which are not notified to the Commission for Control of State Aid. There is no mechanism to ensure accumulation of aid that companies receive. Overall, companies receive different types of aid from both national and local authorities.</p> <p>3) Partial implementation: The Law on fees was adopted in December 2018. However, the rulebook on its implementation is not finalised yet. There is no assessment on the extent to which the fees will be reduced.</p> <p>4) Partial implementation: Border inspections involved in control of food import consignments appear to apply risk-based approach based on the implementing legislation in force. This legislation and procedures require further improvements, in particular the risk-based approach and the use of IT tools. The newly established committee on trade</p>

	facilitation has indicated this area as a priority.
<p>PG 6:</p> <p>Reduce the high non-wage labour cost of jobs at the lower sections of the wage distribution.</p> <p>Increase substantially the inclusion of unemployed in active labour market measures, in particular women and Roma.</p> <p>Involve closely all relevant actors for the country-wide roll-out of dual learning.</p> <p>Accelerate the envisaged reforms for better targeting of social assistance.</p> <p>Further attention should be devoted to tackling undeclared work.</p>	<p>There was limited implementation of PG 6.</p> <p>1) Limited implementation: The elimination of the employers' contributions of 0.75% of gross salary for unemployment benefit is not targeted to jobs at the lower sections of the wage distribution.</p> <p>2) Limited implementation: The number of unemployed included in ALMPs of the national employment action plan remained broadly unchanged in 2018. No aggregate figures are available on ALMPs provided at local level.</p> <p>3) Substantial implementation: The Government established a Commission for the Development and Implementation of Dual Education. Three by-laws to the Law on Dual Education were adopted, whose development involved expert community and relevant stakeholders. The Government Decision on the establishment of 12 sector skills councils was adopted and their members are nominated, but employers are not yet sufficiently included.</p> <p>4) No implementation: Plans to adopt new legislation in the sector have been postponed to 2019.</p> <p>5) Partial implementation: Additional efforts have been made to address the issue of undeclared work through Labour Inspectorate activities. However, the problem remains.</p>

ANNEX B1: ASSESSMENT OF THE STRUCTURAL REFORM MEASURES INCLUDED IN THE ERP

Measure 1: Energy market development coupled with energy infrastructure construction

This measure is rolled over from the two previous ERPs. The planned works, if implemented, will help the energy network to function better. However, the reform would be more credible if other measures to improve the functioning of the network and the market were added, such as the further restructuring of the inefficient producer EPS or a revision of energy prices, which are low and do not secure sufficient funds for further investment nor provide incentives for energy efficiency.

Measure 2: Improvement of conditions for increasing energy efficiency and improvement of the existing infrastructure in the energy consumption sector

Energy efficiency is appropriately included in the ERP for the first time. The new law on fees will provide more funds for energy efficiency, while amendments to the law on energy efficiency are planned so as to ensure that eco-design could be financially supported at a later stage. This should enable much needed investment in this field. However, to achieve more ambitious results, many more measures are needed. The government should also commit to engaging with international financial institutions that are willing to provide more substantial amounts of funds for this purpose.

Measure 3: Improvement of the capacity and quality of transport infrastructure and services

The measure proposes to plan and budget road safety audits and road maintenance more efficiently. It clearly and realistically envisages how safety audits will be performed and maintenance agreements costed and contracted. However, the ERP does not address issues related to the preparation of documentation for constructing, modernising and restoring the transport infrastructure regulated by the Law on planning and construction and the set of relevant by-laws. The recent experience gained throughout the implementation of transport projects shows that often the quality and accuracy of preparatory activities e.g. geotechnical investigation, is not done to a sufficient level. In addition, in the majority of cases, projects are not selected and technically prepared, based on the results of the previously conducted cost-benefit analyses. This leads to projects running above their capacity, which implies high maintenance costs and a mismatch between the quality of infrastructure and required services.

Measure 4: Reform of the railway sector

The liberalisation of the railway sector, announced in previous ERPs, is progressing and this measure presents two more steps to achieve this. In addition to the activities contained in the measure, the process needs to ensure the granting of train driving licences and safety certificates to foreign operators and mutual recognition of the rolling stock. Railway needs to be included in the intelligent transport system (ITS) rulebook in order to ensure interoperability with the EU. Using rail as a means to export and import goods should be more systematically encouraged in order to reduce the pressure on the environment and roads.

Measure 5: Improvement of competitiveness of agricultural producers and processors

This measure is rolled over from the two previous ERPs and identifies the implementation of IPARD as the main factor to increase competitiveness. However, IPARD resources are comparatively scarce to cater for the sector's needs. The full rolling out of IPARD has also faced some delays. Therefore, more nationally funded measures are needed to address more specific challenges, especially in processing food. The authorities propose land consolidation as a new part of the measure, in order to address a key challenge in the sector. This part of the measure consists of a new law, but there are only vague proposals on how the law will be implemented.

Measure 6: Raising the competitiveness of industry

This is one of the key issues for the Serbian economy as the manufacturing industry continues to be dominated by labour-intensive activities, which cannot secure sustainable growth. Serbia is focusing its industry-related activities towards attracting foreign investors. However, there has not been much development in preparing a comprehensive strategy, although the smart specialisation exercise already provides the authorities with insight on key sectors. The credibility of the process will depend also on the strategy having a proper budget, which is not included in the ERP.

Measure 7: Tax administration transformation

Tax Administration transformation has been a key structural reform for years. The announced activities are ongoing but the progress is rather limited and major tasks remain. The action plan for the transformation programme for 2018-2023 remains valid. Activities planned in 2018 are being carried out, albeit with delays. For 2019, further consolidation of core activities is planned in a smaller number of branches in parallel with the restructuring of the Head Office, which is identified as the main challenge. Long-term challenges, such as the need to train and retain the most valuable human resources and to channel resources to core tasks and prevent them being deployed for non-core administrative activities, remain and should be given more attention. The measure remains appropriate, but the commitment to implement it needs to be stepped up.

Measure 8: Improved management of capital investments

The planning of public investment remains troublesome and affects the growth potential. The initiative to improve management of capital investments and to establish a single capital investment platform (including the single capital project database) remains relevant, appropriate and necessary. Once again, the measure is rolled over from previous ERPs as previous efforts to implement it focused only on improvements in the nationally funded projects. The updated initiative recognises the complexities of the planning system and the need for more coordination. However, it remains unclear whether all stakeholders are willing to work on the system and whether there are adequate capacities across many layers of the administration.

Measure 9: Improved access to finance for SMEs and sole traders

The measure to improve access to finance for SMEs and sole traders intends to focus on the adoption of a development financing strategy aimed at improving different financial market segments and introducing new financial instruments that are lacking. SMEs would benefit from improved regulation of financial markets to provide additional financing instruments, beyond traditional loans. Several challenges need to be addressed in the new instruments, which are only partially spelled out in the ERP's plans: (i) high cost and

collateral requirements for innovative and young 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 ERP announces the introduction of new financial regulations and instruments for the fourth year in a row. There are obviously delays with this measure, but they are not explained. The goals look ambitious, but lack real commitment.

Measure 10: Establishment of a sustainable system for environmental protection financing by improving the functioning of the green fund

This new measure is welcome, as environmental protection is one of the most budget intensive and complex chapters in the process of Serbia's EU accession negotiations. Serbia is obliged to significantly increase investment in this area, with estimated investment needs of about EUR 8.5 billion in the next 10 years. The allocations need to triple from the current 0.3 to 0.4% of GDP in order to meet the prescribed standards. Most environmental protection investment will come from the national budget funds. However, the existing funding system does not ensure the necessary level of investment. In order to ensure a steady inflow of finance into a green fund and greater use of IPA funds, an efficient financial, legal and institutional framework, which will ensure predictability, stability and continuity of investment in environmental protection, needs to be established. The proposed measure is a first cautious step in this direction, which proposes to identify the conditions needed to establish a fund that functions better. At this stage, the measure is not budgeted, which needs to be changed in the future.

Measure 11: Improvement of corporate governance in public enterprises

This measure aims to improve corporate governance of public utilities and state-owned companies — this is of key importance for competitiveness given the large share of these companies in the Serbian economy. The reform in governance of public companies has been identified as a core part of the ERP since the very first programme. Although some good results have been achieved in terms of restructuring and privatising some companies (these companies now pose less of a tax risk), public companies in general remain largely inefficient and influenced by politics, which go beyond managerial appointments. The proposed measure focuses on improvements in managerial appointment and training as well as improving the supervision boards in the public authorities. More ambitious steps are needed in order to properly restructure the big public sector.

Measure 12: Simplification of procedures and other conditions for doing business

The measure aiming to unify the system of public registries of administrative procedures is a continuation of activities from previous ERPs. The ERP indicates that the government adopted a new law on fees at the end of 2018, which should rein in para-fiscal charges (though a significant portion of the charges is set and collected by municipalities, and their contribution to the reform remains unclear). The ERP does envisage further steps in simplifying and digitalising procedures, but lacks ambition as it leaves major activities (adoption of a law and establishment of the register) for the later stage of the process.

Measure 13: Improving the effectiveness of inspection oversight

The measure aims to improve the effectiveness of inspection oversight by combining measures from previous ERPs (a common information platform for all inspections through e-inspection), but also through strengthening human resources, i.e. recruitment of new inspectors. Despite good results in combating the grey economy lately (according to IMF estimates its share has fallen but was still above 25% in 2017) and increased revenues stemming from improved inspections, the informal economy remains large. Improvements

in coordination and in inspection oversight planning, now based on risk analysis, have contributed to better performance and need to be continued. The specific issue of border phytosanitary controls, which is often raised by the business community as highly problematic, is identified as posing a particular challenge and should be seriously tackled.

Measure 14: Improvement of the geospatial sector to support the investment decision-making process

This measure is rolled over from previous ERPs and should help further improve the clarity of ownership and thus contribute to an easier investment decision-making process. Initial steps have been taken to establish the National Spatial Data Infrastructure (NSDI) and improve the address register together with some other major activities. The implementing legislation and an NSDI strategy are expected to be adopted in the coming years. The process should significantly contribute to the real estate taxation system and increase property tax revenues for local authorities, which collect and use them. The process requires strong cooperation from a large number of institutions and organisations and this is rightly identified as the major potential challenge. More involvement from ministries and the judiciary is also needed; at the moment activities are under the sole responsibility of the Geodetic Authority. Moreover, the establishment of the land parcel identification system in Serbia, prescribed by EU law, as part of the integrated administration and control system may be sped up due to better access to the geospatial data infrastructure. The measure is ambitious, but will face serious challenges.

Measure 15: Set of measures providing support to research and innovation

This measure supports the functioning of the Innovation Fund, which provides finance for industrial research. Both EU and national funds are used for this purpose. However, the budget of the Innovation Fund is marginal compared to all other public funds for research and the measure is not a real reform as it has been in place for years. More ambitious goals and a more reformist approach should be established. In particular, significant changes are planned regarding the funding of research in the public sector and a new science fund has been established. In addition, findings of the smart specialisation exercise will need to be applied in the governance of the national innovation system.

Measure 16: Improvement of e-government services through the development of national ICT infrastructure

The broadband network needs to be improved and more public e-services developed to support businesses and citizens. This measure addresses these two main challenges, by committing to further regulate on broadband and by establishing a new data centre. The first process is already now affected by delays and it is not clear whether the regulation will be adopted in time and how private broadband will be able to contribute to the process. Regarding the new data centre, the goals are ambitious because the feasibility part is not accomplished yet. Moreover, in addition to the establishment of technical infrastructure, more consideration should be given to the service that the government plans to roll out due to the existence of this new data centre.

Measure 17: Improving conditions for product safety and removing barriers to trade

Support for further trade integration with the EU and CEFTA demands more facilitation at the border and beyond. The measure focuses on the implementation of the Regional Economic Area Multinational Action Plan. Significant practical steps need to be made in order to speed up and reduce the cost of shipping goods across the region. Similar steps would be much welcome at the EU border. In addition, Serbia is committing to put in place changes to its law on genetically modified organisms, which are a main stumbling

block in the WTO accession process. The announcements need to be followed up with speed and determination, unlike in the past.

Measure 18: Qualifications oriented to labour market requirements

The establishment of the national qualifications framework (NQF) is included in the ERP since 2016 and again being rolled over, outlining the further steps to be taken until 2021. The measure presents only partial segments of ongoing and planned reforms in the field of qualifications, which concern NQF, validation of non-formal and informal learning, comprehensive VET reform, short study cycles in higher education, introduction of final examinations in secondary education, curricular reform and its successive introduction in pre-university system, and new quality assurance mechanism in higher education. The overview of the activities planned for 2019/20/21 is narrow and does not outline any activities relating to the building of capacities of new institutions and creating ownership over the new qualifications system. Activities do not include any plans on a wider VET reform. In addition, activities are described in rather general terms. Potential risks rightly identify the low level of participation of economic operators and social partners in the NQF system and dual education, but do not foresee mitigation measures.

Measure 19: Increased labour activation of social welfare beneficiaries who are fit for work, hard-to-employ unemployed persons in line with employment legislation and other hard-to-employ persons from particularly vulnerable groups, and strengthened formal employment

Design and focus of this measure are poorly developed. The measure consists of three components, adoption and implementation of a Law on Social Entrepreneurship, implementation of the law on seasonal work in agriculture adopted in 2018, and adoption of a legislative framework for the operation of private employment agencies. While all three components are relevant activities as such and close gaps in the labour market framework, it remains unclear how the primary objective of this measure, the increased activation of vulnerable categories of jobseekers, shall be achieved. No employment targets are defined. The budget for this measure is not sufficiently elaborated. The possible expected impact on the competitiveness of the economy appears limited.

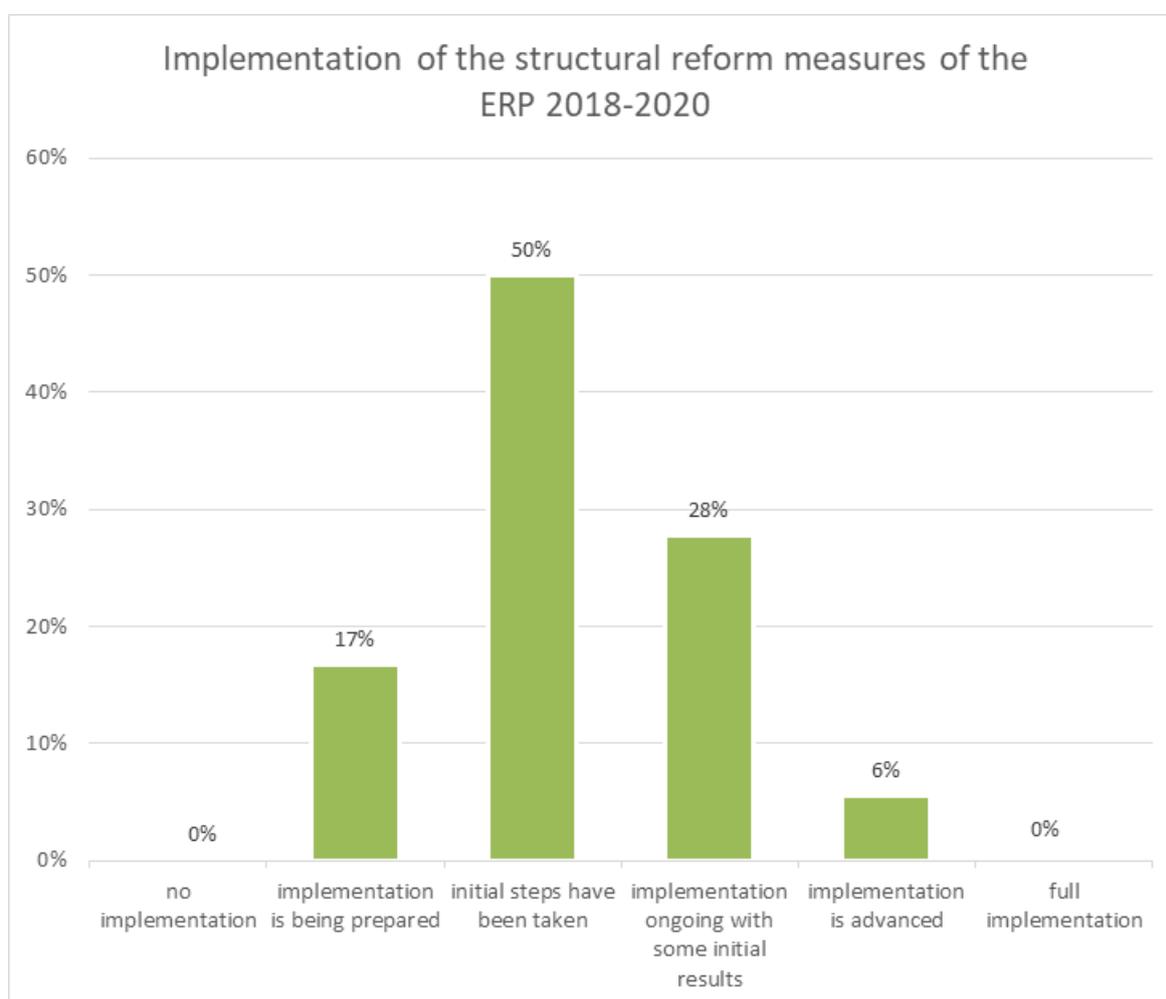
Measure 20: Improvement of the adequacy, quality and targeting of social protection measures

A measure to improve adequacy, quality and targeting of social protection is being included in the ERP since 2016 and has brought some partial results so far. The presentation in this year's ERP continues to suffer from a lack of strategic vision for this sector. It includes two activities, amending the Law on Social Protection and the introduction of Social Cards (supposedly for beneficiaries of cash benefits). Amendments of the law have been further postponed after the public consultation in 2018. The proposed amendments did not include sufficient steps for improving the adequacy of financial social assistance. The outline of the measure lacks a discussion of budgetary aspects. No information is given on whether there are any plans for increasing the level of public spending on financial social assistance, which is currently very low.

ANNEX B2: PROGRESS WITH STRUCTURAL REFORM MEASURES FROM ERP 2018-2020

There was some progress in implementing the measures in 2018, with an average score of 2.6 out of 5. The reporting on the planned activities is precise and fair. Some relatively easy reform steps contribute to higher grades, but overall there is a good description of the level of implementation and indication on what remains to be done.

The highest level of implementation involves the measures on active labour market policies and agriculture, reflecting well-prepared steps in the preceding years. However, for more complex measures, the implementation rate drops significantly, often to below 50%. The reform of management of public investment was not implemented at all and as a result this measure has completely changed in this year's ERP. There is also a slow pace of implementation in the area of governance of public enterprise. However, in this area this year's measure remains largely unchanged and has even become less ambitious.



ANNEX C: COMPLIANCE WITH PROGRAMME REQUIREMENTS

The government adopted and formally submitted the Economic Reform Programme on 31 January 2019. The programme is in line with the medium-term fiscal strategy and the 2019 budget and covers 2019-2021.

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. The macroeconomic framework is sufficiently comprehensive and coherent. The baseline macroeconomic scenario is broadly plausible and major uncertainties and risks are clearly outlined and recognised. The programme presents an alternative macro-fiscal scenario. Although not sufficiently elaborated upon, it is based on an assumption of lower economic growth, and higher budget deficit and debt levels.

Fiscal framework

The fiscal framework is based on the baseline medium-term macroeconomic scenario and is sufficiently comprehensive and integrated with the overall policy objectives. In general, revenue and expenditure measures are explained well, although the medium-term impact of some of them is not sufficiently elaborated upon. 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 the fiscal data is compatible with the ESA 2010.

Structural reforms

The reporting on the implementation of the policy guidance and the structural reform measures from 2018 is sufficient and up-to-date. However, the reporting on the implementation of the policy guidance in the area of education, employment and social protection is limited. The quality of the measures vary. In some cases they are focused and planned in good detail, while in others — especially in the fields of employment and education — they have declined compared to previous years. Overall, the measures' scope of ambition is often too limited and refers to a single procedural reform rather than a systemic long-term reform with real impact on competitiveness, despite the recognition of serious systemic challenges in the analyses of these areas. The annexed tables are filled in appropriately.

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