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ECONOMIC REFORM PROGRAMME

OF

SERBIA
(2021-2023)

COMMISSION ASSESSMENT

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1. EXECUTIVE SUMMARY

After a relatively mild economic contraction in 2020, the economic reform programme projects a strong rebound in 2021 and growth at pre-crisis rates thereafter. The COVID-19 crisis led to only a mild contraction of the Serbian economy in 2020, mostly driven by lower private consumption, net exports and investment that were partially offset by higher government consumption and inventories. Serbia's economic performance turned out to be among the most favourable in Europe, supported, inter alia, by strong pre-crisis momentum; sizeable and timely fiscal and monetary mitigation measures; the sectoral structure of the economy with limited reliance on tourism; and the relatively low average stringency of containment measures. In a rather optimistic scenario, the economic reform programme (ERP) projects a remarkably strong rebound of the economy by 6% in 2021 before returning to the pre-crisis rate of expansion of around 4% in 2022-2023. Growth is expected to be broad-based, driven by private consumption, investment and exports. As elsewhere, the projected strength of the rebound in 2021 is subject to high uncertainty regarding the protracted impact of the pandemic, especially in Serbia's main trading partners. The favourable growth projections for 2021 and the two following years also crucially hinge on the projected evolution of net exports that assume further build-up of export capacity. The financial sector has remained stable and credit growth held up, but the lagged impact of the crisis may still worsen bank balance sheets at a later stage.

The fiscal strategy assumes a strong improvement in the budget balance and falling debt-to-GDP ratios starting already in 2021, which however does not yet take account of the recently announced further support measures. As a result of the economic crisis and very sizeable fiscal mitigation measures, the general government deficit increased very substantially to 8% of GDP in 2020. The original 2021 budget aims to substantially reduce the deficit to 3% of GDP, mostly based on non-renewal of the crisis-mitigation measures. However, a recently announced new support package will add another 2% of GDP in temporary, and mostly non-targeted, crisis-mitigation expenditure in 2021, likely triggering a budget revision. The fiscal scenario projects further gradual fiscal consolidation towards a budget close to balance in 2022 and 2023, mainly driven by expenditure growing more slowly than nominal GDP. The debt-to-GDP ratio, which has risen by some five percentage points to around 58% of GDP in 2020, is projected to gradually decline as of 2021 in the ERP baseline. However, the additional support package in 2021 is expected to delay the declining trend by one year. Significant unaddressed gaps in fiscal governance remain, in particular as regards fiscal rules, public wages and State-owned enterprises (SOEs).

The main challenges in these respects include the following.

- **Fiscal sustainability needs to be anchored by a credible framework and supporting reforms.** Serbia has been able to very substantially mitigate the crisis due to available fiscal buffers and is projected to continue to achieve good macro-fiscal results. In view of the protracted uncertainty about the pandemic impact, providing crisis mitigation until the recovery is entrenched seems appropriate, while the plan to gradually return to a budget close to balance is key to rebuilding fiscal space in the medium term. To underpin medium-term expenditure restraint, containing spending on wages continues to be a key challenge. Since overall fiscal performance has been sensitive to the economic and political cycle over the last two decades, a strengthening of fiscal rules could provide more effective guidance for public finances and help institutionalise sound fiscal policies.

- **There is further scope to control fiscal risks and improve revenue administration.** Increased transparency on fiscal risks could also contribute to better addressing them. This concerns in particular state-owned enterprises, whose governance deficiencies and incomplete restructuring and privatisation still represent a substantial risk to public finances. On the revenue side, there appears to be scope for further improvements in the tax administration, in particular as regards electronic fiscalisation and invoicing.

- **Serbia has made notable progress in reducing the regulatory and administrative burden for businesses, but the business environment should be further strengthened by cutting red tape and improving the predictability of the implementation of legislation.** The widespread shadow economy remains a major impediment to the development of a strong corporate sector and the creation of a functioning market economy. Businesses identify corruption and problems in the exercise of the rule of law as key obstacles to investment climate and economic development. Business predictability is negatively affected by the lack of full transparency in the adoption of legislation on business-related matters. Foreign direct investment (FDI) continue to receive generous public support, while other firms, in particular domestic small and medium-sized enterprises (SMEs), are left in a less favourable position. Further efforts are needed to improve the transparency, assessment and prioritisation of public investments.

- **Serbia remains highly dependent on coal and lacks a coherent long-term strategy that combines energy and climate targets.** Serbia's competitiveness continues to be hampered by a polluting and inefficient energy sector that is not properly regulated. Inefficient energy use represents a major concern in the country. Major investments are needed to modernise the country's energy infrastructure and lower carbon emissions. Increased efforts are necessary to diversify supply and Serbia's overall energy mix. The restructuring of state-owned enterprises in the energy sector is facing delays, posing a risk to public finances.

- **School-to work transitions are considerably more difficult compared to the EU average and structural barriers remain to be addressed.** At the same time, the emigration of workers across the occupational spectrum is continuing. The government has adopted fiscal measures to stimulate circular migration but the impact is still limited. The low labour market participation of women remains an issue. Finally, measures to reduce the tax wedge for workers with a low end income have not been bold enough to support wage-led consumption.

The sizeable fiscal and monetary support measures substantially cushioned the economic effects of the COVID-19 crisis in 2020 while the concrete policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2020 has been partially implemented. The authorities have allowed for crisis mitigation via fiscal stabilisers and by comprehensive fiscal support packages. Following a strong increase in 2020, the share of public wages in GDP is projected to decline in 2021 while steps towards a public sector wage system reform have been delayed. The adoption of new fiscal rules has also been postponed by another year due to the crisis. Capital spending has further increased to a record level of 5.4% of GDP in 2020. While the fiscal risk analysis and the monitoring of SOEs appear to have been reinforced within the Ministry of Finance, the precise implications and timeframe of projected savings from implementation of recommendations remain unclear. A strategic document on SOE ownership including restructuring has been adopted. The government provided effective, transparent and non-discriminatory support to businesses affected by the COVID-19 pandemic and ensured cross-sectoral coordination within the government and across public administration to

effectively respond to COVID-19. The public consultation process on new legislation remains to be strengthened. Little progress has been made in reducing the high non-wage labour cost of jobs at the lower part of the wage distribution. There were no measures regarding the formalisation of labour in non-agricultural sectors and the funding for Active Labour Market Policies remains insufficient. Job retention schemes were rolled out effectively but there was no activity on expanding access to unemployed compensation schemes.

The ERP is aligned in part with the reform priorities identified by the Commission. The macroeconomic and fiscal frameworks are sufficiently comprehensive and integrated with the overall policy objectives, providing an adequate basis for policy discussions. However, the alternative scenario may seem somewhat too optimistic. The part covering structural reforms remains largely unchanged from the previous year, reflecting delays in implementation. It repeats important reform measures aiming to reduce the administrative and regulatory burden for businesses, but fails to effectively address underlying structural weaknesses in the investment environment. The ERP also lacks ambitious reforms regarding clean energy transition and energy efficiency. The diagnostic presented in the ERP for education, employment and social policies is correct, while the proposed measures in the areas of employment and social protection based on the diagnostics either lack clearly defined objectives or do not remedy the fundamental challenges.

2. ECONOMIC OUTLOOK AND RISKS

After a relatively mild annual contraction induced by the COVID-19 pandemic in 2020, the ERP projects a retrieval of the pre-crisis output level already in 2021. The 2020 contraction was the result of decreases in private consumption, net exports and investment that were only partially offset by higher government consumption and higher inventories. The relatively mild contraction reflects a series of mitigating factors: the strong growth by 5.2% y-o-y in the first quarter of 2020; the relatively short duration of the first and most stringent lockdown; the structure of the economy, in particular the low share of tourism; an exceptionally good agricultural season; a sizeable package of fiscal and monetary support measures and the relatively low stringency of new lockdown measures in the second half of the year. The baseline scenario projects that after a strong rebound by 6% in 2021, the economy will retrieve its pre-crisis pace of expansion by 4% annually in 2022 and 2023. Both the rebound and the further steady expansion are expected to be mostly driven by private consumption and gross fixed capital formation and a relatively favourable evolution of net exports. While net exports are expected to significantly subtract from growth in 2021 as domestic demand rebounds (even with a relatively moderate import growth), their contribution to GDP growth is expected to be close to balance as of 2022 as export growth is expected to substantially exceed import growth. After turning negative in 2020 due to the crisis, the output gap is projected to close in 2021 and to remain close to balance thereafter as potential growth and real growth are projected at similar levels. The scenario thus assumes production capacity to have been safeguarded throughout the crisis. The annual unemployment rate decreased slightly in 2020 due to a strong reduction in the months before the crisis and discouraged workers leaving the labour market during the peak of the crisis. It is projected to broadly stabilise in 2021 (when labour market participation is expected to regain lost ground) and resume its pre-crisis downward trend as of 2022.

In a context of high uncertainty, achieving some aspects of the macro scenario appears particularly challenging. The macroeconomic and fiscal outlook continues to be affected by high uncertainty due to the COVID-19 pandemic. In particular, the projected

strong rebound by 6% in 2021 in the baseline scenario appears subject to substantial risks. The projected strong increases in investment and private consumption should typically imply a strong growth in imports, which does not seem to be adequately reflected in the relatively low import elasticity underlying the 2021 projection. At the same time, a potentially protracted impact of the epidemic in main trading partners, in particular in the EU, may weigh on the projected strong export rebound. On the other hand, the baseline scenario did not yet incorporate the impact in 2021 of the additional substantial fiscal support package announced in February 2021, which constitutes an upside risk. While for 2022 and 2023 the import elasticity appears closer to the long-term trend, the expected balanced contribution of net exports to growth hinges on a further substantial expansion of new export capacities. As regards potential growth, while FDI inflows, domestic innovative activity and digitalisation may indeed increase the contribution of total factor productivity to potential growth rates, the strong projected increase as of 2020 nonetheless appears challenging in view of the substantially lower pre-crisis track record under similar conditions. This suggests that there is some risk of an increasingly positive output gap over 2022-2023. Real growth might, accordingly, be constrained at some point by limitations in potential growth.

Table 1:

Serbia - Comparison of macroeconomic developments and forecasts

	2019		2020		2021		2022		2023	
	COM	ERP	COM	ERP	COM	ERP	COM	ERP	COM	ERP
Real GDP (% change)	4.2	4.2	-1.8	-1.0	4.8	6.0	3.8	4.0	n.a.	4.0
<i>Contributions:</i>										
- Final domestic demand	6.2	6.3	-2.2	-1.5	6.1	6.7	3.6	4.0	n.a.	4.1
- Change in inventories	0.4	0.5	-0.1	0.0	-0.1	0.0	0.0	0.0	n.a.	0.0
- External balance of goods and services	-2.4	-2.6	0.5	0.5	-1.2	-0.8	0.2	-0.1	n.a.	0.0
Employment (% change)	2.4	1.8	-0.6	0.5	1.4	1.2	0.8	1.0	n.a.	1.0
Unemployment rate (%)	10.3	10.9	9.3	10.2	9.6	10.1	9.0	9.2	n.a.	8.5
GDP deflator (% change)	2.4	2.4	2.9	2.9	2.7	2.6	2.4	2.7	n.a.	3.1
CPI inflation (%)	1.7	1.9	1.5	1.6	1.8	1.9	1.8	2.3	n.a.	2.5
Current account balance (% of GDP)	-6.9	-6.9	-5.8	-5.0	-6.0	-5.5	-5.2	-5.1	n.a.	-4.6
General government balance (% of GDP)	-0.2	-0.2	-8.9	-8.9	-2.9	-3.0	-2.5	-1.6	n.a.	-1.0
Government gross debt (% of GDP)	52.8	52.9	61.5	59.0	60.7	58.7	59.6	57.9	n.a.	56.0

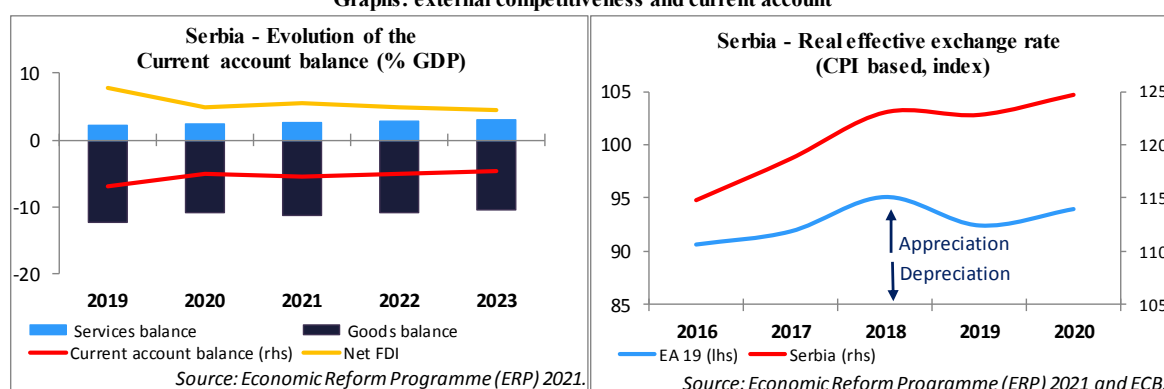
Sources: Economic Reform Programme (ERP) 2021, Commission Autumn 2020 forecast (COM).

The ERP presents a clear and broad view of economic risks and includes a detailed alternative macroeconomic scenario. The programme acknowledges that the risks to the baseline macroeconomic scenario are unusually high, in particular as regards the further evolution of the pandemic and the measures taken to contain it. Risks to the external environment are considered as tilted to the downside in the short term, in particular as to uncertainty impacts on capital flows, lower external demand and higher oil prices, which may however be mitigated by upside risks regarding higher metal export prices, further expansion of export capacities and the effects of the abolition of 100% tariffs on products delivered to Kosovo. Domestic risks are considered to be tilted to the upside on top of the positive baseline of a complete recovery of consumption in 2021, supported by fiscal and monetary support measures that have preserved disposable income and employment. While the further opening up of contact-intensive service sectors will be dependent on the evolution of the pandemic and risks to the agricultural season and investment

implementation are seen as balanced, the programme sees some upside risks stemming from reforming public enterprises, in particular in the energy sector. The relatively fast progress of vaccination in Serbia could constitute an upside risk for domestic demand in 2020 that was not yet included in the ERP risk assessment. The programme presents an alternative macroeconomic and fiscal scenario, projecting substantially lower economic growth (only 3.2% in 2021 and 3.0% annually thereafter) and less favourable fiscal performance in the event of prolonged uncertainty regarding the course of the pandemic. This would mainly translate into a slower recovery of exports and investments that would also affect the labour market and private consumption. However, while the alternative scenario very usefully points to the potential magnitude of uncertainty-related risks, the underlying assumptions related to a prolonged pandemic have not been sufficiently specified to allow for a further assessment.

Consumer price inflation has remained low throughout the crisis and is projected to rise only moderately towards 3% in the medium-term. Following a track-record of low and rather stable inflation for seven consecutive years, consumer price inflation averaged 1.6% in 2020, hovering mostly close to the lower end of the central bank's target tolerance band of $3\% \pm 1.5$ pps. As part of a series of monetary measures to mitigate the crisis, the central bank lowered the key policy rate in four steps from March to December by overall 125 bps. to 1.0%. This was accompanied by a series of liquidity-supporting measures to provide dinar and foreign exchange liquidity to the market. These measures also included the purchase on the secondary market of government securities and corporate bonds issued by SOEs. To stabilise the exchange rate, particularly in view of some mostly crisis-induced depreciation pressures from February to October, the central bank continued to apply its policy of frequent interventions on both sides of the foreign exchange market, selling a net EUR 1450 million in 2020. The ERP projects inflation to remain in the lower half of the target range, closer to the lower limit, in 2021, assuming relatively low international aggregate demand and inflation combined with the dissipating effect of lower oil prices. Thereafter, inflation is expected to accelerate moderately in 2022 and 2023 in line with the projected domestic and international recovery, while staying below 3%. Overall, the moderate inflation projections appear plausible, in particular as regards domestic drivers, but subject to increased uncertainty as regards imported inflation.

Graphs: external competitiveness and current account



Following a substantial decrease in 2020, the current account deficit is expected to widen temporarily in 2021 and gradually narrow thereafter. The current account balance recorded a strong crisis-triggered improvement in 2020, narrowing the deficit to 4.3% of GDP from 6.9% of GDP in 2019. This was mainly the result of a lower primary income deficit (essentially due to lower reinvested earnings) and a lower goods trade deficit (as exports of goods contracted less than imports). These balance-improving factors

were partially offset by lower secondary income, mainly corresponding to lower worker remittances. In line with the expected recovery, the ERP projects the current account balance deficit to rise to 5.5% of GDP in 2021 before gradually narrowing to 4.6% of GDP in 2023. This favourable development is expected to be underpinned by an FDI-driven reduction of the merchandise trade deficit, an increasing services surplus, a recovery of workers remittances to pre-crisis levels and a decrease of interest payments due to the lower interest rates. However, growing domestic demand may lead to import growth outpacing at least temporarily export growth, and primary income outflows are set to increase with the rising stock of foreign investment.

Net FDI inflows continue to play a central role for external sustainability and competitiveness. After a record level of EUR 3.6 billion in 2019, net FDI decreased substantially in the crisis context to EUR 2.9 billion or 6.2% of GDP in 2020 (without the EUR 0.4 billion inflow for the privatisation of *Komercijalna Banka* they would have turned out at EUR 2.5 billion or 5.4% of GDP). They thus continued to fully cover the current account deficit. After a rebound in 2021, the ERP projects net FDI to broadly stabilise at EUR 2.7 billion over 2022-2023, thereby assuming a gradual decrease in % of GDP while maintaining full coverage of the current account deficit. FDI inflows are also considered crucial for the continued structural transformation of the economy towards tradable sectors. In view of continued government support to foreign investors, the sustained inflow of FDI appears plausible if macroeconomic stability is preserved and the business environment is further improved. The stock of net FDI has maintained a broadly stable share in Serbia's net international investment position of around 90% despite increased public debt issuance in the crisis. This reduces Serbia's vulnerability to external shocks, notwithstanding the relatively high net foreign liability position which stood at 91% of GDP at the end of 2020 (up by 3 pps. from the end of 2019). The relatively high level of foreign exchange reserve that has allowed for successful cushioning of the crisis impact in 2020 is projected to continue to cover around six months worth of imports throughout the programme lifetime.

The financial sector contributed to cushioning the crisis impact in 2020 while maintaining sound macroprudential indicators. Supported by a series of liquidity-enhancing measures by the central bank and the guarantee schemes set up by the government, the capital adequacy, liquidity and profitability indicators of commercial banks have remained high despite the crisis impact in 2020. Favourable financing conditions and the effect of the three credit moratoria supported credit growth. Lending to households and corporates increased by 11% and 9% respectively which was however largely related to moratorium-related maturity extensions as the volume of newly approved loans decreased at double-digit rates (by around 13% and 20% respectively). A large share of the growth in corporate lending was also not for investment but for liquidity and working capital, which suggests some vulnerabilities. Mainly due to the effect of the first two loan moratoria, the NPL ratio has continued to decline to 3.4% at the end of the third quarter of 2020, before a slight increase to 3.7% at the end of the year following the end of the first two general credit moratoria. There appears to be a risk of some further deterioration of asset quality and other macroprudential indicators due to some lagged effects of the crisis. The state presence in the sector has been considerably further reduced by the completion on 30 December 2020 of the sale of *Komercijalna Banka*, Serbia's third-largest bank by assets.

Table 2:

Serbia - Financial sector indicators

	2016	2017	2018	2019	2020
Total assets of the banking system (EUR million)	36 992	37 676	41 514	46 060	50 820
Foreign ownership of banking system (%)	76.7	76.9	75.4	75.7	86.0
Credit growth	2.5	1.9	9.4	9.1	11.9
Deposit growth	11.4	3.3	15.3	8.5	17.5
Loan-to-deposit ratio	1.00	1.00	1.00	0.96	0.91
Financial soundness indicators (end of period)					
- non-performing loans	17.0	9.8	5.7	4.1	3.7
- net capital to risk-weighted assets	21.8	22.6	22.3	23.4	22.4
- liquid assets to total assets	38.9	35.1	35.7	36.0	37.3
- return on equity	3.3	10.5	11.3	9.8	6.5
- forex loans to total loans* (%)	69.4	67.5	68.5	67.1	64.7

* Includes both denominated and indexed positions.

Note: Data for December 2020 are preliminary.

Sources: ERP 2021, National Central Bank.

3. PUBLIC FINANCE

The crisis led to a marked deterioration in the budget balance in 2020 mainly reflecting sizeable fiscal support measures. As a result of the COVID-19 pandemic and the sizeable fiscal support packages to mitigate its epidemiological and economic impact, the general government deficit increased very strongly to 8.1% of GDP in 2020, up from a mere 0.2% of GDP in 2019, and compared to a deficit of 0.5% of GDP in the original 2020 budget. The fiscal support packages with a planned overall fiscal impact of 8.1% of GDP in 2020 (according to the ERP) comprised, inter alia, the deferral of income tax and social security contributions, direct wage subsidy support to SMEs and large companies, limited direct support to the hospitality sector, direct lump sum payments to certain groups and to all adult citizens (see overview table in box below). The approach of offering support to all SMEs seems to have been appropriate and effective for timely implementation of the first package of support, presented in April. A somewhat more targeted approach focussing support on the most affected sectors and companies could have been envisaged for the second package, presented in July. As regards support to citizens, while the undifferentiated equal support to all citizens may have helped timely implementation, also to informally employed people, a stronger focus, e.g. excluding people with the highest formal income, could have more significantly cushioned the crisis impact for the most affected citizens. Compared to the original 2020 budget, total revenues fell short of 1.6% of estimated 2020 GDP, while total spending exceeded the budgeted amounts by 5.9% of GDP. Overall revenue decreased by 1% y-o-y as compared to a planned increase by 2.7% in the original 2020 budget (in relation to 2019 outturn). The most significant revenue shortfalls concerned social security contributions (0.9% of GDP, reflecting deferrals to 2022 and 2023) and VAT (0.6% of GDP, reflecting the contraction of private consumption). As regards the expenditure side, overall spending increased by 17.8% y-o-y, compared to the anticipated 3.5% in the original 2020 budget. The most significant expenditure overruns beyond the original budget concerned subsidies (2.5% of GDP), reflecting crisis-mitigation support to enterprises, other current expenditure (1.4% of GDP), driven by crisis support to citizens, purchases of goods and services (0.8% of GDP), due to higher health spending, capital expenditure (0.6% of GDP), reflecting higher

infrastructure investment, and expenditure for employees (0.4% of GDP), including higher wages for healthcare workers. While the increases for the first three expenditure categories are mainly due to the temporary one-off crisis-mitigation measures, the latter category is set to have a more durable character. As a result of the limited estimated increase of nominal GDP by 1.8% of GDP¹, the ex-post share of public wages in GDP has risen from 9.5% in 2019 to 10.6% in 2020. The share of capital expenditure in GDP also recorded a further increase from 4.9% in 2019 to 5.4% in 2020. In addition to the measures with direct budgetary impact, the fiscal support packages also included the setting up of a guarantee scheme for loans worth 4.4% of GDP in 2020, bringing the total planned size of the package of fiscal and liquidity-support measures to 12.5% of GDP (see overview table in box below). At a maximum call rate at portfolio level of 30%, the guarantee scheme would entail a contingent liability of around 1.4% of GDP but the ERP estimates related guarantee calls not to exceed a cumulative total of around 0.3% of GDP over 2021-2023.

Box: Review of the package of fiscal and liquidity-support measures to support the economy and the population in 2020 (planned amounts as of 30 September 2020)

	In % GDP
Tax policy measures	
Deferred payment of payroll taxes and contributions for the private sector during the state of emergency and for one additional month; private companies will repay these obligations in instalments, but not before January 2021	3
Deferred advance payment for the second quarter of 2020 corporate income tax	0.4
Exemption from VAT for all donors	-
Total	3.4
Direct support to the private sector	
Direct support to entrepreneurs who pay a flat tax and entrepreneurs who pay real income tax, micro, small and medium enterprises in the private sector - three months of payment of the net minimum wage and two additional months of payment of 60% of the net minimum wage	2.3
Direct support to large private companies - support in the amount of 50% of the net minimum wage (during a state of emergency) to employees who have received a decision on termination of employment (based on Articles 116 and 117 of the Labour Law)	0.1
Direct support to the hotel sector – EUR 350 per bed, EUR 150 per room, in dinar equivalent calculated according to the official middle exchange rate of the NBS	0.0
Total	2.4
Measures to preserve private sector liquidity	
COVID-19 financial support programme during the crisis through the Development Fund of the Republic of Serbia	0.4
Guarantee schemes to support the economy during the COVID-19 crisis	4.4
Total	4.8

¹ Based on the most recent quarterly GDP estimates, the outturn of nominal GDP growth in 2020 may still be somewhat lower at around 0.8%.

Other measures	
Moratorium on dividends until the end of the year, excluding public companies and loss of income arising from dividends	0.3
Wage increase measures and other direct financial assistance (10% increase in salaries of health workers, direct financial assistance of RSD 4 000 to all pensioners, support to agricultural producers)	0.3
Fiscal incentive - payment of EUR 100 to all adult citizens	1.3
Total	1.9
Assessment of the total fiscal impact of the measures	8.1
Total package of measures	12.5
Other costs related to COVID-19 (medical equipment and medicines)	-
Total planned costs related to COVID-19 as of 30 September 2020	12.5

Source: Economic Reform Programme Serbia 2021-2023

Table 3:

Serbia - Composition of the budgetary adjustment (% of GDP)

	2019	2020	2021	2022	2023	Change: 2020-23
Revenues	42.1	40.3	40.4	40.5	39.7	-0.6
- Taxes and social security contributions	36.8	35.8	36.2	36.3	35.6	-0.3
- Other (residual)	5.3	4.5	4.2	4.2	4.2	-0.3
Expenditure	42.3	49.2	43.4	42.1	40.7	-8.5
- Primary expenditure	40.3	47.2	41.5	40.4	39.1	-8.1
<i>of which:</i>						
Gross fixed capital formation	4.9	5.2	5.5	5.6	5.7	0.5
Consumption	16.5	18.7	17.7	17.2	16.7	-2.0
Transfers & subsidies	16.7	19.4	16.3	15.8	15.3	-4.1
Other (residual)	2.1	3.9	2.0	1.7	1.5	-2.5
- Interest payments	2.0	2.0	1.9	1.7	1.6	-0.4
Budget balance	-0.2	-8.9	-3.0	-1.6	-1.0	7.9
- Cyclically adjusted	-1.0	-8.1	-3.1	-1.7	-1.2	6.9
Primary balance	1.8	-6.9	-1.1	0.1	0.6	7.5
- Cyclically adjusted	1.0	-6.1	-1.2	0.0	0.4	6.5
Gross debt level	52.9	59.0	58.7	57.9	56.0	-3.0

Sources: Economic Reform Programme (ERP) 2021.

A gradual return to a budget close to balance is a key objective of the ERP's fiscal strategy over the medium-term. The projected reduction of the deficit to 3% of GDP in 2021, 1.6% in 2022 and 1.0% in 2023 is expected to ensure a declining path of the debt-to-GDP ratio as of 2021. The overall planned fiscal stance aiming at gradual return towards

budget deficits close to balance and gradually declining debt ratios, after completion of one-off crisis mitigation expenditure measures, appears appropriate to ensure medium-term fiscal sustainability. On the revenue side, most categories are expected to evolve in line with nominal GDP, thus keeping their share of GDP broadly stable over the programme period. The most notable exception to this profile is the 0.9 pps. increase of the GDP share of social security contributions in 2021 (as compared to the 2020 outturn) to be followed by broad stabilisation in 2022 and a 0.4 pps. decline in 2023. This projection corresponds to the deferred 2020 payments postponed to the two following years. Higher revenue from contributions is however projected to be almost offset by a lower estimate for non-tax revenue based on the conservative exclusion of extraordinary non-tax revenues² for future budget planning (-0.7 pps. drop from the 4.6% of GDP outturn in 2020 to 3.9% of GDP throughout the rest of the programme period). The planned fiscal consolidation is accordingly almost entirely concentrated on the expenditure side, based on the non-renewal³ in 2021 of 2020 crisis-related one-off emergency expenditure and the assumption of expenditure increases below nominal GDP growth for most categories over 2021-2023. Thus the overall share of expenditure in GDP is projected to decrease by a particularly strong 5.5 pps. in 2021, supported in particular by lower subsidies (-2.4 pps.), lower other current expenditure (-1.6 pps.) and lower purchases of goods and services (-0.4 pps.). In view of the particularly high uncertainties and the ensuing potential need for further fiscal support, this substantial planned expenditure decrease in 2021 appears rather ambitious. As already confirmed by the new fiscal support package announced in February, the decrease in expenditure is expected to be more limited in 2021. Social assistance and expenditure for employees are also expected to decrease as a share of GDP in 2021 despite nominal increases. The further decrease of the expenditure ratio by around 1.5% and 0.5% of GDP in 2022 and 2023 respectively is also mainly based on expenditure increases below relatively high nominal GDP growth of around 7%. While for social transfers this downward trend is underpinned by the pension indexation formula, the strongly declining wages to GDP ratio does not appear to be backed by concrete reforms that would counter the track record of consecutive increases above nominal GDP growth. Capital spending is the only expenditure category that is projected to gradually increase its share in GDP in 2021 and throughout the programme period from a 2020 outturn of 5.4% to 5.7% in 2023.

In response to the protracted impact of the COVID-19 pandemic, the 2021 budget is going to be amended to accommodate sizeable new fiscal support measures. Mainly based on the non-renewal in 2021 of temporary crisis-mitigation measures taken in 2020, the original 2021 budget planned a surprisingly strong headline fiscal consolidation by around 5 pps. in 2021 to 3% of GDP. The revenue side does not assume major changes to the tax legislation apart from a slight further increase of the non-taxable part of gross salaries from RSD 16 300 to RSD 18 300, thereby slightly decreasing the tax wedge on labour. On the expenditure side, the budget contains a pension increase of 5.9% in line

² Regular non-tax revenues correspond to various fees, charges, revenues of bodies etc. that are generated at a steady pace during the year with some seasonal variations, while extraordinary non-tax revenues include profits of public companies and agencies, budget dividends, etc.

³ The announced partial renewal of fiscal support measures in 2021 will accordingly partially delay the expenditure consolidation by one year (see also the paragraph on the 2021 budget below).

with the indexation rule, and a minimum wage increase of 6.6%. Public sector wages were increased on an ad-hoc basis by 5% for health care workers, and by 3.5% for other public employees in January, to be followed by an additional 1.5% rise as of April, while army salaries are to increase by 10% as of April. Capital expenditure is projected to increase to 5.5% of GDP (following a 5.4% of GDP outturn in 2020), whereas close to half of the capital expenditure is earmarked for road and rail transport infrastructure while around one seventh is to be spent on defence. In view of the protracted impact of the epidemic in the winter 2020/2021, the government announced a new package of fiscal support measures in mid-February 2021 and intends to present a revised budget in spring, allowing for the implementation of the new measures as of April. The new package includes wage subsidies for all companies, lump-sum payments to all adult citizens, sectoral support measures to hospitality and transport companies and enhanced liquidity support via the extension of guarantee schemes. The direct fiscal cost of the package is estimated at around 2% of GDP and would thus mechanically bring the 2021 deficit to 5% of GDP instead of the 3% targeted in the original budget. While continued support appears adequate to preserve production capacity and support citizens as long as the recovery is not fully self-sustained, a more targeted approach tailored to the most affected sectors and groups could have improved cost-effectiveness while saving fiscal space to address potential further needs at a later stage. For instance, the employment safeguard conditionality could have been usefully complemented by measures increasing the employment chances of those unemployed⁴ and inactive workers. The efficiency of the lump sum payments to provide stimulus to the economy may also suffer from a relatively low fiscal multiplier for recipients with a lower propensity to consume. The sectoral support to the hospitality and transport sectors appears the most efficient way of supporting otherwise solvent businesses until the end of the crisis. The further extension of the guarantee scheme in 2021 should also play an important role in ensuring continued liquidity for businesses until recovery is firmly entrenched. The additional 2021 measures are again temporary, like the previous packages adopted in 2020. Assuming no further need for their renewal, they would accordingly not have an impact on the further budgetary trajectory for 2022 and 2023. As regards transparency, the application of the measures to all companies and adult citizens applying to receive them ensures a high level of transparency and equal treatment in the distribution of the support.

After a sharp rise in government debt in 2020, the ERP aims for a gradual reduction of the debt-to-GDP ratio as of 2021. As a result of the crisis and the mitigating fiscal measures, the general government debt-to-GDP ratio increased by 5.3 pps. to 58.2% in 2020 (0.8 pps. lower than the ERP estimate of 59.0%, mostly due to the 0.8 pps. of GDP lower-than-projected deficit outturn). The increase was mostly due to the primary deficit and interest costs that were partially offset by a slightly debt-reducing effect of nominal GDP growth and negative stock-flow adjustments. The ratio is projected to be on a declining path as of 2021, with annual decline gradually accelerating from 0.3 pps. in 2021 to 0.8 pps. in 2022 and finally 1.9 pps. in 2023. This trend is to be supported by relatively high nominal growth, a gradual improvement in the primary balance and decreasing interest payments, but it is partially slowed down by debt-increasing stock-flow adjustments, which are not further specified. While the end-2020 starting point of the debt trajectory has turned out more favourable than the ERP projection, the additional fiscal

⁴ An additional measure offering a one-off lump-sum payment of EUR 60 to all unemployed was announced in March 2021.

support package announced in February 2021 should mechanically, *ceteris paribus*, add another 2 pps. to the debt-to-GDP ratio in 2021, which would still keep it below 60% in 2021. Thanks to a favourable fiscal track record in recent years and the building up of fiscal space, Serbia has been able to fully cover its increased financing needs, resulting from the various fiscal support packages in 2020 and early 2021, by tapping international and domestic financial markets and without recourse to IMF or EU financial assistance. The large proportion of foreign currency-denominated debt (70%) however continues to expose government debt to the risk of potentially significant exchange rate fluctuations, as demonstrated by the ERP's debt sensitivity analysis. A sufficiently strong rules-based framework capable of effectively anchoring fiscal policy would be important to reinforce medium-term debt sustainability.

Box: Debt dynamics

Serbia

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

	2019	2020	2021	2022	2023
Gross debt ratio [1]	52.9	59.0	58.7	57.9	56.0
Change in the ratio	-1.5	6.1	-0.3	-0.8	-1.9
Contributions [2]:					
1. Primary balance	-1.8	6.9	1.1	-0.1	-0.6
2. "Snowball" effect	-1.5	1.1	-2.9	-2.1	-2.4
Of which:					
Interest expenditure	2.0	2.0	1.9	1.7	1.6
Growth effect	-2.2	0.6	-3.3	-2.3	-2.2
Inflation effect	-1.3	-1.5	-1.5	-1.6	-1.7
3. Stock-flow adjustment	1.8	-1.8	1.5	1.4	1.0

[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) 2021, ECFIN calculations.

The government debt to GDP ratio increased by 4.8 pps. in 2020. The rise was due to the primary deficit and the effects of negative real growth and interest expenditure that were only partially offset by inflation and debt-reducing stock-flow adjustments (including the receipts from the privatisation of *Komercijalna Banka*). Looking ahead, while in 2021 the primary balance will also still have a debt-increasing impact, the stock flow adjustment and interest expenditure will remain the only, albeit gradually diminishing, debt increasing factors throughout the entire 2021-2023 period. High real growth, inflation

and the return to a primary surplus ensure the accelerating downward trend of the debt ratio over 2021-2023. Issuing restitution-related debt and fluctuations in government financial assets, not included in the baseline scenario, could also have a significant impact on the debt-to-GDP ratio (of around four percentage points for the financing of restitutions, while sales or acquisitions of financial assets can have both upward and downward impacts).

Fiscal risks are non-negligible in a context of continued high uncertainty. In the short term, the main risk to the achievement of the 2021 fiscal targets (apart from the budget revision due to the announced new support package) appears to be linked to the relatively favourable baseline real growth assumption of 6% in 2021. Even assuming a fast recovery, both domestically and in main trading partners, such a strong rebound appears overly

optimistic in light of the European Commission autumn 2020 economic forecast as well as more recent forecasts by international financial institutions. A lower growth outturn would normally entail lower revenues and a higher deficit. On the expenditure side, the additional fiscal support measures announced are already set to increase the 2021 deficit outlook accordingly. Looking ahead, while the revenue projections appear to be relatively conservative in terms of elasticities, the containment of expenditure growth below the nominal growth of GDP does not seem sufficiently ensured for some expenditure categories in view of their track record, i.e. in particular for expenditure for employees and subsidies to SOEs. In view of the importance of fiscal risks stemming from inefficient SOEs, as also highlighted by the ERP's sensitivity analysis, increased transparency and effective implementation of structural reforms in this area would seem crucial to achieve the targeted 0.5 pps. of GDP reduction in subsidies within the next two years. As in previous years, the programme does not mention the upcoming restitution-related obligations of EUR 2 billion or around 4% of GDP concerning properties confiscated by the communist government after the Second World War. As the modalities for monetary compensation appear to have been confirmed in early 2021, the issuance of related specific government bonds over the coming years can be expected to increase the debt-to-GDP ratio accordingly. The guarantee schemes of an initial loan volume of EUR 2 billion i.e. around 4.3% of 2020 GDP (with a maximum state guarantee of 30% at portfolio level) set up during the COVID-19 crisis also constitute a contingent liability that may to some extent be called. However, the present estimates point to relatively low amounts estimated to be called over the programme horizon⁵. Another non-negligible fiscal risk concerns decisions by domestic and foreign courts resulting in fines and damages payable by government bodies. Such potential obligations may in particular arise from the legacy of the Socialist Federal Republic of Yugoslavia, e.g. from ongoing complaints of employees of former socially-owned enterprises.

The breakdown of public expenditure is set to make progress towards stronger pro-growth orientation, especially as regards the growing share of capital expenditure. As regards the quality of public finances, the ERP forecasts a continuous increase in public investment from an already high outturn of 5.4% of GDP in 2020 to 5.7% in GDP in 2023. It however would seem important to ensure that increased infrastructure spending is cost-effective by applying the recently introduced public investment management framework to all projects, regardless of the source of financing. According to the COFOG classification, after the crisis-induced peak at 7.1% of GDP in 2020, expenditure on health will be maintained at around 6.2% of GDP over 2021 to 2023, i.e. around 1% of GDP above the pre-crisis level. Education spending is projected to be maintained at around 3.3% of GDP throughout the programme period. Notwithstanding the increased debt level, interest expenditure is set to decline by around 0.1 pps. annually, in line with favourable financing conditions. On the revenue side, the increase of the personal income tax-exempt monthly threshold contributes to the gradual reduction of the tax wedge on low income labour. To reinforce disincentives to informal labour, further increases of the threshold could be considered.

⁵ The ERP expects gross fiscal outflows related to the guarantee scheme to be limited to 0.05%, 0.21% and 0.06% of GDP in 2021, 2022 and 2023, respectively.

The budgetary process has been impacted by the crisis and the electoral cycle and the work on revision of fiscal rules has been put on hold during the crisis. The COVID-19 crisis, the general elections and the protracted formation of a new government have delayed the regular budgetary process. Consequently, the Fiscal Strategy was only adopted in November and the discussion and adoption of the 2021 budget was moved to December 2020. There was a meaningful parliamentary debate on the 2021 budget, albeit with a very limited number of MPs not belonging to the government coalition, and the authorities also submitted the final annual budget execution report for 2019 to Parliament. Work on the revision of fiscal rules, which at present do not provide sufficient anchors for fiscal policy, was put on hold in 2020 due to the crisis and is intended to resume in 2021. While wages continued to be increased via ad hoc adjustments to the budget system law, the new indexation formula for pensions entered into force in 2020 and has effectively again been applied for setting the 2021 pension increase. Due to the crisis, the implementation of the planned wage system reform has been postponed by another year, until 2022. As regards the revenue side of the budget, the implementation of the new model of electronic fiscalisation and the transition to electronic invoicing, as presented in the structural reforms part of the ERP, could significantly contribute towards reducing the grey economy, increasing VAT collection and improving the tax control process. The well-established Fiscal Council has continued to function appropriately, producing independent fiscal assessments and recommendations. The timeliness of budgetary statistical information has been ensured but budget execution reports still lack information about large one-offs.

4. KEY STRUCTURAL CHALLENGES AND REFORM PRIORITIES

Serbia has been gradually restructuring its economy, mainly by investing in the tradable sector. Exports have been a major driver of growth. Manufacturing has modernised and diversified in recent years, but traditional industry, notably the energy sector, has not undergone restructuring. Its underperformance negatively affects economic growth. Moreover, to reach higher growth rates, better use needs to be made of the opportunities offered by the internal market and services, through ensuring a level playing field for all companies. Economic growth and improvements in 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 main ones are: (i) increasing employment, in particular of young people, women and social protection against poverty; (ii) creating a more favourable business environment for investment, and (iii) greening Serbia's energy sector and fully opening the energy market.

Key challenge #1: Increasing employment, in particular of young people and women, and social protection against poverty

The labour market performance figures are largely unchanged despite the COVID-19 induced crisis. The labour market is largely resilient. The activity rate (20-64) increased slightly from 73.4% in the fourth quarter of 2019 to 74.3% in the fourth quarter of 2020. The employment rate (20-64) increased in the same reference periods from 66.3% to 66.8%. The employment rate in the EU-27 (20-64) was 73.1% in 2019.

The employment rate (20-64) of women was 59.3% in the fourth quarter of 2020 (EU 66.6%) compared with 74.3% for men (EU-27 78.3%). This leads to a gender employment gap of 15% in the fourth quarter of 2020 (EU 11.7%). The underlying reasons for the gap include lack of childcare and lack of services providing care for the elderly, plus social conventions.

The unemployment rate (15-74) increased only slightly to 10% in the third quarter of 2020, in comparison to 9.8% in the same quarter of 2019. This is, however, not a sign of high labour market resilience but rather a crisis-induced statistical effect. In fact, during the pandemic a part of the workforce was discouraged from looking actively for a job, which is a condition for being classified as unemployed in the Eurostat Labour Force Survey (LFS). The COVID-19 crisis caused a labour market slack in Serbia, where the labour supply does not meet the labour demand. At the same time jobseekers do not necessarily register as unemployed as they do not expect to receive a job offer. Generally, active labour market policies (ALMPs) address only a fraction the unemployed and fail to reach out to the majority of unemployed and inactive or vulnerably employed. In addition spending is insufficient. In fact, budget spending on ALMPs slightly increased in 2019 but decreased again in 2020. In 2021 Serbia plans to increase allocations again by 40%. Until now, their impact on the activation of the labour force remains limited. Established measures such as job-searching, training and job fairs reached only 27.6% of registered unemployed in 2019. The Serbian Economic Reform programme acknowledges the low adequacy of ALMPs, but does not propose adequate measures to address this situation.

As regards school education the lower secondary school education results of 15 year olds lag behind the EU average, although Serbia is according to the PISA ratings the best faring country of the Western Balkans. In fact, Serbia's average scores are close to those of some of EU Member States such as Bulgaria, Greece and Romania. The average score in reading is 439.5 (EU 481.7-Western Balkans 402), in mathematics 448.3 (EU 488.6-WB 414) and in science 439.9 (EU 484-WB 408).

The selection into upper secondary programmes is not equitable, since boys are twice as much likely than girls to attend vocational training programmes, a share which increases up to five times more amongst students from disadvantaged backgrounds compared to other students.

The school-to-work transition is structurally difficult leading a high rate of young people (15-24) not in employment, education or training (NEETs) of 15.3%. This is structurally higher in comparison to the EU average of 10.1% in 2019. It takes 2 years on average for a young person in Serbia to find a first stable employment against the EU average of 6.5 months. The activity rate in the fourth quarter of 2020 in the age group of 15-24 was only at 31.2%, a decrease of 0.4% compared to the same quarter of the year before. With a view to this youth employment policies need to be stepped up in Serbia.

VET schools do not adequately provide labour market skills matching employers' needs as they have only partially updated curricula and appropriate equipment. The missing labour market orientation of VET training, which is the career path of choice for 73.2% of Serbia's youth, as well as the insufficient offers for re-skilling and upskilling are key obstacles for higher youth employment and activity rates in Serbia.

Serbia has indeed made progress in work based learning with the adoption of the Law on dual education in 2017 and three new bylaws in 2018/19. The Chamber of Commerce and Industry of Serbia (CCIS) has adopted three other legal acts to facilitate implementing the above law. Two more legal acts are being prepared. The CCIS has a key role in the dual and entrepreneurship education track that started in the academic year 2019/20. While the

necessary legal framework is now in place but the rollout of dual VET will take until 2023. Serbia proposes in its ERP under Measure 20: *“Qualifications oriented to the needs of the labour market”* the rollout of the dual VET education system according to the Austrian, German and Swiss model. Unfortunately, the development of dual VET education is limited to 8.8% of all VET education by 2023. The share of school based VET education is according to plans still 91.2%. Given the difficult school-to work transitions and the partially outdated curricula this is not ambitious enough.

For now, the employment rate of Serbian VET graduates is at 53.6% still significantly lower than the employment rate of VET graduates in the EU at 76.8%. With a view to this, the further development of VET education is a necessity for the smooth integration of young people in employment. This is also the objective of the political commitments on the Riga Mid-Term deliverables, to which Serbia has committed itself. In international co-operation on VET, Serbia participates as well in the European Alliance for Apprenticeships. These are policy initiatives which aim to make the overall skills development process more relevant to the labour market and societal needs in Serbia. It is critical to re-profile VET as a good-quality option and highlight the possible paths towards personal development, careers, complex jobs, further specialisation, or starting an enterprise.

Concerning secondary education, Serbia postponed the introduction of Matura reform by one year. The reform would have allowed for more feedback on the quality of secondary education as well as for more equitable access to tertiary education.

In tertiary education, Serbia wants to introduce dual education with close ties to the labour market. As regards international frameworks Serbia joined the Bologna Process. However, the European Association for Quality Assurance in Higher Education (ENQA) concluded in February 2020 that Serbia is not fully compliant with the Standards and Guidelines for Quality Assurance in the European Higher Education Area (ESG). The membership of the Serbian National Entity for Accreditation and Quality Assurance (NEAQA) was consequently suspended, but in April 2020 received the status of an associate member. Serbia may reapply in 2022 if conditions are met. To this end, Serbia was recommended to improve its governance structures by involving all relevant stakeholders, strengthen the independence of higher education institutions from the government, and improve its internal operational aspects. The Ministry of Education, Science and Technological Development is preparing amendments on the Law on Higher Education in order to address the ENQA recommendations and to align with the latest ESG. In addition, Serbia was asked to improve the effectiveness of higher education institutions' internal quality assurance and the processes of accreditation, including the quality of processes, reviewers and outcomes of accreditation.

As regards digitalisation, more than 15% of boys in Serbia expect to work in an ICT-related profession, as compared to 8% on the OECD level. This has a potential to provide a boost to the digital transition of the economy.

In terms of financing the overall budget share for education is 3.6% of GDP which is 1 pp. less than the EU average.

In order to facilitate school to work transitions Serbia has created the “My First Salary” programme. The goal of the programme is to activate young people without prior work experience. For those who finished high school and take up an internship or employment in the public or private sector a monthly benefit of RSD 20 000 (EUR 170) is granted, and for those who graduated from college a monthly benefit of RSD 24 000 (EUR 204) is granted for an internship of nine months. In view of the difficult school to

work transitions in Serbia, this is indeed a good initiative. In 2020 some 8 000 young Serbians participated in this programme. It could become even more popular if employers topped up the salaries to the level of the minimum salary (EUR 273) or beyond. The average gross salary in Serbia in 2020 was EUR 706 equivalent to a net salary of around EUR 511.

At the same time labour migration is continuing across the occupations. The outflow of labour negatively affects the growth potential of the whole economy and notably the capacity of the public sector to provide health and utilities services. This outward labour migration exacerbates further the rural/urban divide between Belgrade and the rest of the country as the countryside is particularly affected by this outward labour migration. The Serbian ERP acknowledges the need to provide incentives for the return of the Serbian diaspora and to attract foreign experts. The Government of Serbia has adopted the Strategy on Economic Migration of the Republic of Serbia for the period 2021-2027 (“Official Gazette of the RS”, No. 21/20). The strategy covers a range of topics related to the phenomenon of economic migration, their management, the correlation of migration and development, as well as the role of the diaspora as a driver of (local) development. In this context, Serbia is proposing this in the reform Measure 22 *“Improvement of the administrative environment for encouraging, supporting and tracking circular and economic migration”*. This is a step into the right direction as it provides incentives for highly qualified individuals in key areas of the economy where there is a shortage in the labour market. The measure addresses predominantly the ICT sector whose current share of the GDP is around 5%. Rather than this structural reform measure, the crisis in Western European labour markets caused by COVID-19 pandemic led to the return of a large number of Serbian citizens to their home country. According to border control statistics, around 400 000 Serbian citizens returned home during the pandemic. Time will tell how many of the returnees will stay for good in Serbia when sanitary conditions improve and the economies in the migration destinations recover.

Informal employment has been steadily decreasing, but remains at a high level. It fell to 16.7% in the fourth quarter of 2020, which is a decrease of 1 pps relative to the same period of 2019. The reduction of informal labour occurred mainly outside agriculture. Domestic service and care jobs in the informal sector were less available during the pandemic. Most informal work is still concentrated in agriculture, where close to two thirds of the workforce work on an informal basis.

31.7% of the Serbian population was at-risk-of-poverty-or-social-exclusion in 2019, which is a high number in comparison to the EU-27 average of 20.9%. The most vulnerable were households with three or more dependent children with the AROPE rate of 53.6% in 2018 and 51.9% in 2019. The at-risk-of-poverty threshold was RSD 19 381 (EUR 164) on average per month for a one-member household, while for a four-member household with two adults and two children up to 14 years of age this threshold was RSD 40 700 (EUR 345). The Income Quintile Ratio was 6.46 in 2019 (EU 4.99). This means that the richest 20% of the population had an income 6.46 times higher than the 20% poorest. The Gini coefficient in Serbia was 33.3 (2019), which is above the EU-27 average (30.2).

Despite being an upper middle-income country with adequate public revenues, benefits available from the FSA (Financial Social Assistance) scheme are not sufficient to make ends meet. The average cost of a consumer basket is around EUR 323 for a family of 3. The poverty threshold for 3 members is EUR 297. However, the support from FSA for a family of 3 is EUR 132 i.e. less than half of the average consumer basket and less than half of the poverty threshold for a household of this size. The impact of

social transfers (other than pensions) on poverty reduction has for years been rather small in 2019 stood at 18.02% in comparison to the EU-27 average of 32.38%.

Public expenditure on social protection and budget transfers in the GDP of Serbia has been gradually decreasing in recent years, so that it amounts to 14.5% of GDP in 2019 (a decrease of 2 pps. compared to 2015), and its consequence is a reduction in pensions and unemployment benefits. In order to address the lack of social cohesion Serbia proposes the Structural Reform Measure 23 *“Improvement of the adequacy, quality and targeting of social protection measures”*. Serbia will establish an IT based Social Card register, a single administrative network, which will allow for a mapping of beneficiaries and their individual entitlements. It is an act of modernisation through e-government. The Social Card is a vehicle to make public administration more efficient and more resistant to the abuse of benefits. However, efficiency in the delivery of social services is not Serbia’s key challenge in the area of social protection. The adequacy of social benefits and the quality of social services are still to be addressed in order to improve the social cohesion of the country.

Serbia has committed itself to the European Pillar of Social Rights and hence to social protection and inclusion and to an adequate minimum income. The gross minimum wage was increased for 2021 to EUR 273, which is still below the cost of the average consumer basket of EUR 323. 17% of all employees receive the minimum wage, i.e. EUR 273 minus taxes and social security contributions. The poverty threshold for a single person household is EUR 230. The untaxable wage base was successively increased to RSD 18 300 (EUR 155). However, this is hardly enough. Additional efforts, such as the further increasing of the untaxable wage base close to or equal to the level of the minimum salary would have a significantly bigger impact on in-work-poverty. In addition, it would contribute to the wage and consumption induced growth of the Serbian economy. The recent decrease in the social security contribution of the workers from 26% to 25.5% was not sufficient to decrease substantially the tax wedge of the low end wage earners.

Key challenge #2: Creating a more favourable business environment for investment

Serbian companies demonstrated their resilience during the COVID-19 pandemic, with more than three-quarters of businesses not changing their number of employees and 12% of companies even hiring more staff (USAID, 2020). The pandemic served to accelerate the expansion of e-commerce and the government’s ERP rightly recognises the need to strengthen its economic growth through the digitalisation of the economy, government, and society. However, key structural challenges in the business environment related to the transparency, reliability and predictability of the regulatory framework remain largely unaddressed. If tackled, they have the biggest potential for fostering the post-pandemic recovery, attracting more investments and building up economic resilience as well as boosting inclusive growth and competitiveness. The implementation of the Common Regional Market will also offer new opportunities.

The legal framework is prone to unexpected and significant changes, which is detrimental to entrepreneurial calculation. Business predictability is negatively affected by the lack of full transparency in the adoption of legislation. In particular, government decisions in a number of business-relevant areas are still often taken without proper consultation with businesses and social partners and under time constraints that do not allow businesses to organise and adapt their operations to new rules in good time. The

methodology on impact assessments, as well as the obligation for line institutions to take into account the Public Policy Secretariat's opinion prior to submitting documents to the government, have yet to be consistently applied in practice. Advice from independent state bodies, such as the Fiscal Council, is often not taken into account. The law on the planning system, adopted in 2018, provides a solid framework for policy coordination, but its partial implementation and the reluctance of decision-makers to follow evidence-based policy-making remain a problem. The lines of accountability between agencies and their parent institutions remain blurred, contributing to overlapping functions, fragmentation, and unclear reporting lines.

Over the past years, Serbia has made notable progress in reducing the regulatory and administrative burden on businesses, but more efforts are needed to reduce bureaucratic red tape and improve consistency in the implementation of legislation.

Over the past years, a number of important business procedures such as setting up a new company or obtaining a construction permit, have been significantly simplified and their cost reduced, placing Serbia high at relevant sub-indices of World Bank's Doing Business rankings for 2020 (e.g. 9th place for dealing with construction permits, 73rd place for starting a business). However, business regulations once the company starts working do not seem to always be business friendly. Administrative procedures are numerous and burdensome, often with overlapping authorities. For example, local firms have to make 33 tax payments per year, twice as many as in the regional peers. The numerous para-fiscal charges remain high and non-transparent, lacking rationalisation, thus undermining the predictability and stability of Serbia's tax system and hampering local economic development. The law on foreign exchange transactions is widely considered by the business community to be too restrictive in its design and unpredictable in its application.

The role of the state in the economy is decreasing, but remains large, hampering competition. A number of small-scale privatisations have been completed over the past years, as well as the privatisation of the largest state-owned bank. In addition, the Minister of Economy announced the privatisation of 12 to 20 public enterprises managed by the Ministry in 2021. Nevertheless, state-owned enterprises continue to dominate many sectors of the economy, including energy, transportation, utilities, telecommunications, infrastructure, mining, and natural resource extraction. This outsized presence of state-owned enterprises deters private investment and innovation, impedes overall competitiveness and poses substantial fiscal risks. Many of these companies do not apply corporate governance rules and operate with low efficiency and high costs, also due to elevated wage bills (both through the increased number of employees and higher wages). The majority of public companies continue to rely on some kind of state support, via direct or indirect subsidies (e.g. toleration of arrears, not paying taxes, etc.). Public companies account for 19% of value-added and formal employment, but receive 60% of corporate subsidies. Governance of state-owned enterprises also continues to pose problems: according to Transparency Serbia, only 9 out of 34 public companies have legally elected directors, while 22 are led by acting managers, 19 of which have expired mandates, since the law on public enterprises limits that status to 12 months. This stands in the way of a root-and-branch reform of these companies, including more professional management. The government has, however, committed to adopting an ownership policy and an action plan focusing on improving the corporate governance regulatory framework of public enterprises. Improving the efficiency of public enterprises through restructuring or privatisation would reduce the strain on public finances and improve the quality of services. Moreover, it would create a more level playing field, limiting the preferential treatment accorded to some public companies.

The legal framework in the fields of competition and state aid have been largely brought in line with the EU *acquis*, but the actual implementation remains to be strengthened. Administrative capacity of commissions for protection of competition and state aid control have been increased and are operating as legally independent bodies. The institutional independencies of both bodies should however be strengthened. The commission for protection of competition remains passive, with a low number of cases investigated and without a single negative opinion on concentration since its inception. In the area of state aid, well defined rules are not always implemented due to strong political pressure for financial assistance, which is channelled to state-owned enterprises and large foreign investors. These resources are often substantial and may have a significant impact on the local competition. State support is not sufficiently transparent (legal contracts are not publicly disclosed), which leads to allegations of corruption. The independence of the commission for state aid control is yet to be tested as businesses complain that state aid cases are not followed up.

The legislative framework for public investment management has improved, but the issues of transparency, assessment and prioritisation of investment remain to be fully addressed. Having in place a strong process for the appraisal and selection of public investment projects is a priority, given Serbia's large infrastructure needs and long pipeline of future projects. The new legislative framework for public investment management put in place in 2019 has provided a basis for a sounder project selection process, better prioritisation, stronger impact and more comprehensive planning across different tiers of the government. Yet, the new arrangement allows too many exceptions to the rule, significantly reducing the effectiveness of the legal framework. In addition, the law on special procedures for linear infrastructure projects adopted in 2020 allows linear infrastructure projects of 'special importance for the Republic of Serbia' to be exempted from public procurement rules, without providing clear guidelines for strategic prioritisation. This increases opportunities for extracting benefits by inflating prices in the absence of competition and various subcontracting contracts and creates opportunities for corruption. Due to these legal arrangements, as well as, in some cases, lack of enforcement of rules in place, a significant share of public funds for capital investment continues to be spent without proper checks to ensure compliance with public procurement, state aid and technical standards, particularly when it comes to big infrastructure projects financed by loans, often under undisclosed conditions, provided mostly by third countries. Investment decisions are frequently taken without the appropriate feasibility studies, cost-benefit analysis and environmental impact assessments necessary to ensure the sound use of public funds.

The widespread shadow economy remains a major impediment to the development of a strong corporate sector and the creation of a functioning market economy. Driving forces behind the shadow economy include high taxes and contributions on salaries, lack of financial resources and favourable loans, para-fiscal charges, hidden tax fees as well as red tape. The consequences are manifest in tax evasion, market distortion, unfair competition, and inefficient resource allocation. Notable efforts have been invested in tackling the informal sector, but reforms are being implemented at a slow pace. While the government has been careful in reducing the tax burden in view of fiscal policy needs, it has clamped down against the informal sector by stepping up tax and labour inspections. In 2019, the government adopted an action plan for the implementation of the National Programme for Countering the Shadow Economy for 2019-2021, which aims at further improvement of the work of inspection bodies, a tougher penalty policy and more efficient tax collection. In addition to boosting inspections, the government should develop a mechanism for incentivising companies to move to the formal sector.

Further efforts are needed to improve the quality, independence and efficiency of the justice system. An efficient and independent judicial system is a prerequisite for a predictable investment and business-friendly environment, and is necessary to encourage innovation, attract FDI and secure tax revenues. International sources describe the judiciary as prone to political influence (World Economic Forum ranks Serbia as 101st out of 141 countries in its Global Competitiveness Report 2019, while the World Justice Project ranks it as 75th out of 128 countries for 2020). Courts are slow and inefficient, with an average court case length of 622 days, and litigation incurs very high costs - over 40% of the claim at hand (World Bank, Doing Business 2020). Businesses also raise the issue of the lack of reliability in contract enforcement, as well as lack of expertise among judges, particularly in complex areas of law such as competition, intellectual property, or taxation, which leads to incoherence in rulings.

Businesses identify corruption and problems in the exercise of the rule of law as key obstacles to investment climate and economic development. Serbia's legal framework to fight corruption and in relation to economic crime and abuse of office is largely in place. However, its implementation should be strengthened. Surveys show that corruption is believed to be prevalent in many areas; Serbia is ranked 94th in Transparency International's 2020 Corruption Perceptions Index (down from 91st place the year before), well behind the EU Member States. A particularly critical area of corruption is public procurement. The level of competition in the public procurement process remains limited: the average number of bids per tender fell from 3.0 in 2017 to 2.5 in 2019 (and even 2.1 for bids at the local level). A new procurement law was adopted in 2019 to strengthen the transparency of the public procurement processes and their resilience to corruption. However, the institutions supervising the process (Public Procurement Office, Commission for the Protection of Rights in Public Procurement Procedures, State Audit Institution, Anti-corruption Agency, prosecution, etc.) lack staff capacity and do not always coordinate effectively with the view of fighting corruption in a systematic manner. The adoption of a specific law on special procedures for linear infrastructure projects allowing for their exemption from public procurement rules raised serious concerns regarding its potential for corruption. Companies claim to often refrain from using legal remedies due to lack of trust in the system and fear of being blacklisted by the relevant authorities.

The ERP reform measures in the area of business environment target the high administrative and regulatory burden, but do not sufficiently address the underlying structural weaknesses. *Reform measure 9 ("Improvement of the quality of public services through optimisation and digitalisation of administrative procedures – e-paper")* is repeated from past years' ERPs. It has the potential to significantly reduce administrative costs, reduce opportunities for corruption and in general increase the attractiveness of Serbia as investment destination. However, the measure has so far given rather limited results, with only four procedures out of 2 600 being abolished. Significant efforts are needed to speed up the reform. The new *Reform measure 13 ("Improvement to spatial development management through establishment of e-space digital platform")* aims to improve the efficiency of planning and the quality of planning documents in order to further reduce number of days and costs of obtaining location conditions and construction permits. *Reform measure 12 ("Improvement of geospatial sector through development of digital platform in support of decision-making for investments")*, rolled over from previous ERPs, should help further clarify ownership, thereby helping to make the investment decision-making process easier. This measure was only partially implemented in the past year as activities slowed down due to the COVID-19 pandemic. Most activities are therefore now concentrated in 2021, which seems unrealistic and may cause additional

delays. Risks outlined in previous years, in particular regarding cooperation, communication and overall coordination, remain high among stakeholders.

The ERP presents ambitious tax-related reforms, but the implementation of ongoing reforms remains to be strengthened. *Reform measure 10* (“Transformation of tax administration”) remains one of the most significant structural reforms in this year’s ERP as well. However, the desired changes in terms of predictability and fairness in the implementation of tax rules are yet to fully materialise. The transformation started in 2015 and while some targets were met, such as the separation of core and non-core activities and number of field offices, the overall improvement is limited and the process needs to accelerate. The work on the new programme for 2021-2025 is ongoing. The permanent problem of lack of inadequate human resources is regrettably not addressed by the measure. The ERP has for the first time introduced *Reform measure 11* (“introduction of a new fiscalisation model and transition to electronic invoicing”), which on the one hand aims to improve tax control and thus increase VAT collection and reduce grey economy, and on the other hand to modernise invoicing by replacing paper invoices by digital ones. Although ambitious, the activities under the reform measure are largely unclear, which may hinder its effectiveness.

Key challenge #3: Greening Serbia’s energy sector 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. It is characterised by high energy/carbon intensity due to losses in distribution, outdated infrastructure, intensive use of coal and low energy efficiency at end-user level. Most energy companies are state-owned and have through the years relied to a varying degree on support from the budget. In 2019, the country paid direct subsidies worth about EUR 41 million to support coal-fired power generation, sustaining unprofitable and inefficient thermal power plants and coal mines. The retail electricity market, though fully liberalised, remains highly concentrated. For example, despite the liberalisation, the state-owned utility Elektroprivreda Srbije (EPS) remains the single most dominant supplier, with around 98% of participation in the electricity market. Entry barriers to the sector are high due to direct or indirect regulation of energy prices.

Serbia remains highly dependent on coal and lacks a coherent long-term strategy that combines energy and climate targets. Serbia relies on domestic coal-fired electricity production provided by outdated power plants. About 66.4% of domestic electricity production comes from coal (lignite), 28.4% from hydropower, 1% from gas, and only 4.2% from wind, small hydro, biomass and solar together (AERS, 2019). Despite existing climate and environmental challenges, Serbia continues to prioritise investments in new coal power plants. Currently, Serbia is building a new lignite power plant (Kostolac B3) with a capacity of 350 MW. Serbia adopted a new climate law in March 2021, which is a step in the right direction. However, the country still lacks a coherent long-term strategy which is consistent with the EU 2030 framework for climate and energy policies. Serbia is lagging behind in the region in developing a National Climate and Energy Plan to make its energy sector fit for the future in line with Europe’s green energy ambitions.

Coal power generation adds to already alarming air quality levels in Serbia. According to the World Health Organization, nearly 3 600 premature deaths in Serbia every year are attributed to air pollution (WHO, 2019). The energy sector is the main source of pollution in Serbia, responsible for 80% of the country’s greenhouse gas emissions. Thermal power plants and heating account for 57% of total PM10 emissions and for 75% of total PM2.5 emissions. Energy generation and distribution is also the most significant contributor to acidifying gases (49.2% of all nitrogen oxides emissions and

91.4% of all sulphur dioxide emissions) (Health and Environment Alliance, 2017). Several of the most polluting coal power plants in Europe are located in Serbia, with Kostolac B being the continent's most notorious sulphur dioxide polluter. A desulphurisation unit built in 2017 was only put into operation in the fourth quarter of 2020. Serbia adopted a national emission reduction plan in January 2020, but it is not implemented in practice for sulphur dioxide and dust.

Inefficient energy use represents a major concern in the country. Serbia has the second-highest energy intensity in the region, nearly four times higher than the EU average. Lack of efficiency in the energy sector critically impacts the country's overall economic competitiveness. A more strategic approach is urgently needed to address all aspects of energy efficiency. Serbia needs to improve financial, institutional and human resource capacities and better coordinate energy efficiency action with all relevant stakeholders, including at local level. Implementing consumption-based metering and billing in district heating on a large scale and establishing a sustainable financing mechanism is necessary to boost investment in energy efficiency. Serbia should also allocate income from the recently introduced energy efficiency fee in full to finance energy efficiency measures.

Major investments are needed to modernise Serbia's energy infrastructure and lower carbon emissions. Serbian energy infrastructure is generally old and outdated, resulting in high energy losses, particularly in distribution. Given Serbia's reliance on coal-based energy supply, major investments are needed to implement the necessary transition from fossil fuels to renewable sources of energy. Investments in renewable energy have only recently increased. In 2019, Serbia achieved a 21.44% share of renewables in gross final energy consumption, which is below the 25% median trajectory and just above the renewable energy share of 21% in the 2009 baseline year. Domestic demand for electric power is expected to outgrow production capacities significantly in the next 5-10 years, necessitating investments in new capacities. The Fiscal Council estimates that Serbia would need to invest EUR 5.6 billion to meet its future needs for electricity and adhere to environmental legislative requirements (Fiscal Council, 2020).

Greening Serbia's energy sector is paramount in view of Serbia's obligations under the Energy Community Treaty and its EU membership ambitions, but also the sustainability and profitability of the sector. The EU Green Deal and the Green Agenda for the Western Balkans have put in place a new policy framework for the coming period, to be also incorporated in the Energy Community Treaty. With decreasing global prices for renewable energy and increasing efforts to address carbon leakage in Europe, Serbia risks locking itself into an increasingly unprofitable carbon-intensive energy system if it does not tackle this challenge head-on. Recent energy legislation introduced a competitive auction system instead of current feed-in tariffs for renewable energy sources. This is important measure to attract much-needed private investment into the renewables sector and should be implemented swiftly.

The currently low electricity prices do not provide incentives for investing in energy efficiency and energy saving in Serbia. Compared to other economies in the region, electricity prices in Serbia are particularly low (approximately EUR 0.06 per kWh for households without taxes and VAT). They are considered to be among the lowest in Europe (Fiscal Council, 2020). The current electricity tariffs do not reflect real costs covering investments in the network and consequently guaranteeing the security of supply. Moreover, they do not include investment needs for Serbia's energy and climate reforms. Increase in electricity prices should be accompanied by appropriate social programmes to

mitigate possible adverse effects, bearing in mind that a considerable proportion of the population falls within the status of absolute poverty and energy poverty.

Increased efforts are necessary to diversify supply and Serbia's overall energy mix.

Ensuring security of supply for the domestic natural gas market remains a challenge, despite the recent works on the diversification of gas supply routes. Serbia is dependent on imported natural gas for almost 80% of its total needs, which it receives from a single supplier. Locally produced electricity comes primarily from lignite. Such a supply mix, characterised by high direct and indirect costs, is converted inefficiently and transported to sectors and industry at a price that does not allow for full cost recovery. In this regard, Serbia should make the best use of the Economic and Investment Plan for the Western Balkans (European Commission, 2020) to embark on its coal-phase out and start building a climate neutral economy, by replacing fossil fuels with renewable energy, and gas as a transitional fuel, avoiding stranded assets.

Proper regulation of the electricity and gas markets is key to improving the sector's efficiency and effectiveness. Serbia's primary legislation is compliant with the third energy package, but implementation is lagging behind, particularly in the gas sector. The government mostly completed the liberalisation of the electricity market and established an operational electricity wholesale market. However, the gas sector remains largely unreformed. There is no third-party access to the gas network and none of the three transmission system operators is unbundled. The lack of competition results in high prices for business and citizens.

Serbia's ERP for 2020-2022 does not seem to be sufficiently ambitious regarding the clean energy transition and energy efficiency. The reform measures proposed in the ERP fall short of providing concrete plans for making clean energy transition a core direction of the economic reform path. In addition, important outstanding reform steps, such as the unbundling of the gas sector and properly addressing energy poverty, are missing. *Reform Measure 1 ("Energy market development coupled with energy infrastructure construction")* is rolled over from four previous ERPs. It represents a continuation of Serbia's efforts in electricity market development coupled with new infrastructure investment through the Western Balkans Investment Framework, most notably the completion of all sections of the Trans-Balkan corridor. The reform lacks ambition, however, particularly in the gas sector, as the required unbundling of gas sector utilities and third party access to existing gas infrastructure are not addressed. *Reform measure 2 ("Improvement of conditions for enhancing energy efficiency through harmonisation of the legislative framework and establishing a sustainable mechanism for financing energy efficiency project")* correctly identifies the need to improve the legal framework and secure sustainable funding for energy efficiency projects. However, the measure falls short of effectively incentivising energy efficiency investments. Targets for energy savings could be more ambitious (currently 20%). Concrete policy measures, such as steps to implement consumption-based metering and billing in district heating or a large-scale renovation wave in Serbia are missing. Further alignment with EU legislation on energy efficiency and renewable energy sources represents important progress. Establishing a funding mechanism for energy efficiency is a good step but the model proposed will not allow engaging the necessary staff and building and managing the necessary pipeline of energy efficiency projects. Regardless of these shortcomings, the reform measure remains highly important and relevant for raising the country's competitiveness and long-term growth potential.

The economic recovery from the COVID-19 pandemic should be used as an opportunity to accelerate the transition to a low-carbon economy. Carbon pricing

should be at the core of the policy response: it encourages people and firms to reduce energy use and shift to cleaner alternatives. It also generates revenues that can be used as part of a fiscal package that is both efficient and equitable. Other key measures could include reducing subsidies or tax incentives for emission-intensive activities, and investing in clean energy infrastructure, which can create new jobs, and likely crowd in private sector investment. A green recovery approach will allow Serbia to make full use of the Economic and Investment Plan for the Western Balkans (European Commission, 2020) and its three energy flagships on renewable energy, transition from coal and a renovation wave (energy efficiency).

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 concerning equal opportunities and access to the labour market, fair working conditions, and social protection and inclusion for the benefit of 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 alignment of their labour markets and welfare systems with those of the EU.

SERBIA		
Equal opportunities and access to the labour market	Early leavers from education and training (% of population aged 18-24)	Better than EU average, deteriorating
	Gender employment gap	Worse than EU average, no change
	Income quintile ratio (S80/S20)	Worse than EU average, improving
	At risk of poverty or social exclusion (in %)	Worse than EU average, improving
	Youth NEET (% of total population aged 15-24)	Worse than EU average, improving
Dynamic labour markets and fair working conditions	Employment rate (% of population aged 20-74)	Worse than EU average, improving
	Unemployment rate (% of population aged 15-64)	Worse than EU average, improving
	GDP per capita growth	N/A
Social protection and inclusion	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, no change
	Individuals' level of digital skills	Worse than EU average, improving

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 Scoreboard⁶. 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.

Women in Serbia have a significantly lower employment rate than men. The gender employment gap is wider than the EU-27 average (13.9 pps. vs 11.7 pps. in 2019) with a slight improvement between 2018 and 2019. 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 (10.1% 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 stands around 23.2%, among the highest in Europe. Children and young people below 25 years of age face an at-risk of poverty rate of 27.0%. The at-risk-of-poverty-or-social-exclusion rate was very high in 2019 (31.7%) and significantly above the EU-27 average (20.9%). Disposable income of individuals in the top income quintile is on average almost nine 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.

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.

⁶ 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 indicators are also compared for the Western Balkans and Turkey, with one small adjustment in the age bracket for the unemployment rate (reducing the upper age limit to 64 instead of 74) for Albania and Kosovo* due to data availability. The assessment includes the country's performance in relation to the EU-27 average (performing worse/better/around the EU-27 average; generally 2019 data are used for this comparison) and a review of the trend for the indicator based on the latest available three-year period for the country (improving/deteriorating/no change). Data from 2017-2019 are used and can be found in Annex A.

5. OVERVIEW OF THE IMPLEMENTATION OF THE POLICY GUIDANCE ADOPTED AT THE ECONOMIC AND FINANCIAL DIALOGUE IN 2020

Overall: Partial implementation (55.6%) ⁷	
2020 policy guidance	Summary assessment
<p>PG 1:</p> <p>Allow automatic fiscal stabilisers to accommodate crisis-induced economic fall-outs and further mitigate the impact on growth and employment by appropriate discretionary fiscal measures.</p> <p>To reinforce the medium-term sustainability of public finances, contain overall spending on wages as a percentage of GDP, while allowing for due reinforcement of healthcare spending during the crisis, also by taking concrete steps towards implementing an appropriately designed public sector wage system reform.</p> <p>Adopt a credible and binding system of fiscal rules underpinning fiscal sustainability.</p>	<p>There was partial implementation of PG 1</p> <p>1) Full implementation: the authorities have allowed for very substantial crisis mitigation on growth and employment via fiscal stabilisers and particularly by comprehensive packages of fiscal (8% of GDP) and liquidity-enhancing (4% of GDP) support to businesses and citizens. The substantial support has significantly contributed to the overall relatively mild contraction of GDP by 1% and the stabilisation of employment in 2020.</p> <p>2) Limited implementation: while the overall spending on wages as percentage of GDP is projected to decline under favourable growth assumptions in 2021, this comes after a very strong ex-post increase in 2020 due to the quasi-stagnation of nominal GDP. While recruitment rules in the public sector have been made somewhat more flexible, no concrete steps towards implementing an appropriately designed public sector wage system reform seem to have been taken. The reform has been postponed by another year.</p> <p>3) No implementation: the adoption of a credible and binding system of fiscal rules has been postponed by another year due to the crisis.</p>

⁷ 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>PG 2:</p> <p>To support economic recovery, further increase growth-enhancing capital spending as a share of GDP in 2020 and over the medium term.</p> <p>Increase the transparency of the fiscal impact of state-owned enterprises by reinforcing fiscal risk analysis and by publishing quarterly reports on SOEs' financial performance.</p> <p>To reduce fiscal risks, improve the governance of state-owned enterprises including via further restructuring.</p>	<p>There was partial implementation of PG 2.</p> <p>1) Full implementation: notwithstanding the crisis context, capital expenditure implementation was further increased to a record level of 5.4% of GDP in 2020 and is planned to further increase in 2021-2023.</p> <p>2) Partial implementation: while the fiscal risk analysis appears to have been reinforced within the Ministry of Finance, the results of the work do not appear to have been made available via quarterly reports.</p> <p>3) Partial implementation: while the fiscal risk department in the MoF appears to have ensured some monitoring of SOEs, the precise implications and timeframe of savings remain unclear. A strategic document on SOE ownership including restructuring has been adopted recently and a corresponding action plan is planned to be adopted in early 2021.</p>
<p>PG3:</p> <p>Closely monitor financial stability challenges arising as a result of the coronavirus pandemic and take appropriate action if needed.</p> <p>Further implement the measures included in the 2018-2020 NPL strategy and related action plan, including those aimed at preventing the accumulation of new non-performing loans such as reforms of the bankruptcy frameworks.</p> <p>Enhance further the use of the local currency by fostering the development of secondary markets for government and corporate dinar securities, and support the use of hedging instruments.</p>	<p>There was substantial implementation of PG3:</p> <p>1) [Substantial] implementation: The NBS closely monitored the impact of the pandemic on the financial sector. It implemented prompt and forceful policies to support the sector and contain risks, including borrower relief measures such as loan moratoria and facilitating restructuring as well as providing liquidity. The full impact of the crisis in particular on asset quality is yet to become visible, likely requiring further adjustments.</p> <p>2) Partial implementation: A KMPG/FinSaC report on corporate indebtedness and problem loan prevention has been completed, there was further progress in resolving the Deposit Insurance Agency's NPL portfolio and the bankruptcy framework was also improved. However, progress on reducing structural obstacles to NPL resolution, such as enabling the sale of retail NPLs or improving judiciary processes, remained slow. Further progress requires work by all key stakeholders on improving the legal and judicial framework.</p> <p>3) Substantial implementation: Policy has supported the development and use of local government bond and corporate bond markets and has encouraged greater dinar-denominated deposit and loan growth in the banking sector, which has not seen setbacks related to the pandemic crisis. However, currency substitution remains high and sustained efforts are needed, e.g. to further expand the use of hedging instruments.</p>
<p>PG 4:</p>	<p>There was a partial implementation of PG 4:</p>

<p>With a view of mitigating the economic consequences of the COVID-19 pandemic and stimulating economic recovery, ensure effective, transparent and non-discriminatory support to businesses affected by the crisis, in particular micro, small and medium-sized enterprises and self-employed.</p> <p>Extend social protection coverage and provide incentives for businesses and employees in the informal economy sector to register and to facilitate their transfer to the formal economy.</p> <p>Include monitoring and evaluation of measures introduced and further improve the public consultation process by consulting businesses and social partners on the adoption and implementation of all new legislation concerning their operations.</p>	<p>1) Full implementation: Support of approximately RSD 690 billion (12.5% of GDP) was extended to support economy and population. This included tax policy measures, direct support to the private sector, measures aimed at preserving liquidity of the private sector, and incentives to all adult citizens.</p> <p>2) No implementation. A new strategy for social protection in Serbia for 2019-2025 and amendments to the Law on Social Welfare are still pending. Regulation defining that if employed person automatically loses right to social welfare benefits is still in place.</p> <p>3) Partial implementation: Legal framework for the process of consultation is put in place but the process is still not fully implemented and businesses continue to complain about inappropriate procedures that include no consultation or very limited time given to impact on the final outcome.</p>
<p>PG 5:</p> <p>Ensure cross-sectoral coordination within the government and across public administration to effectively respond to COVID-19.</p> <p>Take measures to preserve employment including through short-time work schemes and ensure increased provision of effective active labour market policies to the unemployed.</p> <p>Provide adequate unemployment compensation schemes for laid off workers in order to mitigate the social impact of the economic downturn.</p>	<p>There was a partial implementation of PG 5:</p> <p>1) Substantial implementation: The Government established a cross-sectoral Crisis Team with the aim of monitoring the situation, managing and coordinating actions and activities and proposing measures to the Government and competent authorities.</p> <p>2) Partial implementation: Serbia rolled out short-term work schemes to preserve employment. In addition, progress was made by the launch of a two-year “My First Salary” youth employment promotion programme in August 2020 and by the 40% increase in the budget for implementation of the planned programmes and measures of active employment policy in 2021 compared to 2020. However, allocations for active employment policy remain insufficient, limited in scope (i.e. mainly one-off actions such as job-search training sessions and job fairs) and reach (i.e. only 27.6% of those registered unemployed benefited from such activities in 2019).</p> <p>3) Partial implementation: Besides significant and mostly effective measures to prevent layoffs in the public and private sector due to the COVID-19 outbreak, no special measures regarding unemployment compensation schemes for laid off workers have been adopted throughout the period.</p>

<p>PG 6:</p> <p>Step up social transfers to ensure adequate income support for people at risk of poverty and social exclusion.</p> <p>Reduce the tax wedge considerably for low wage earners to ensure living wages and to incentivise the formalisation of employment.</p> <p>Ensure adequate and sustainable funding to strengthen the health care sector with an aim to improve access to quality public health care for all citizens</p>	<p>There was a partial implementation of PG 6.</p> <p>1) Limited implementation: The Government adopted a law on social card in January 2021 but did not increase any benefits or the step up income support. Social cards allows only for better mapping and control of beneficiaries of benefits. Social benefits remain insufficient for decent living.</p> <p>2) Partial implementation: Law on Personal Income Tax increased the non-taxable personal income from RSD 16 300 to RSD 18 300 per month, thus decreasing tax wedge, but more needs to be done to avoid in-work poverty.</p> <p>3) Substantial implementation: The Government undertook a series of measures and activities that contributed to adequate and sustainable financing of the health sector in the pandemic. Procurement of necessary equipment and medicines was performed and new laboratories and hospitals were built in order to provide quality healthcare services. All resources shifted into the sector are in response to the COVID-19 crisis; while some have a benefit for the system as a whole, they are largely reaction-driven with limited strategic planning towards long-term improved access to quality public healthcare, especially for the vulnerable groups and chronic patients.</p>
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6. ASSESSMENT OF OTHER AREAS AND STRUCTURAL REFORM MEASURES INCLUDED IN THE ERP 2021-2023

Informal economy

The informal economy has been slowly shrinking over the years, but remains extensive, in terms of both its share of total output and in the number of people employed, and thus constitutes a major burden on business. Undeclared labour remains a persistent issue, despite some improvements in the labour market. Agriculture, construction and various types of household services have particularly high labour informality. The driving forces behind the large informal economy are corruption, high taxes and contributions on salaries, lack of financial resources and favourable loans, para-fiscal charges, hidden tax fees and red tape. Notable efforts have been invested in tackling the informal sector, but reforms are being implemented at a slow pace. While the government has been careful in reducing the tax burden in view of fiscal policy needs, it has clamped down against the informal sector by stepping up tax and labour inspections. In 2019, the government adopted an action plan for the implementation of the National Programme for Countering the Shadow Economy for 2019-2021, which aims at further improvement of the work of inspection bodies, a tougher penalty policy and more efficient tax collection. In addition to boosting inspections, the government should develop a mechanism for incentivising companies to move to the formal sector.

The ERP once again does not contain any reform measures specifically addressing the issue of informality. However, the newly introduced **Reform measure 11 (“introduction of a new fiscalisation model and transition to electronic invoicing”)**, if properly implemented, may lead to improvement in tax control, with a positive impact on the informal economy. The reform measure is however unclear in terms of concrete actions and targets, although ambitious in scope.

Research, development and innovation

Investment in research, development and innovation is weak. Industrial innovation, in particular, needs more support to increase the added value of exports. Although the country has a relatively good scientific base, investment in research and development remains at 0.89% of GDP (half the EU average of 2.2% of GDP in 2019) and nearly 40% of this amount comes from the private sector. The country lacks human resources for research and development. Only 3 308 (2019) workers per one million inhabitants are employed in this sector, significantly below the EU average of 6 300 recorded in 2019. Cooperation between businesses and academia remains weak and is not systematically supported. The Science Fund, established in 2019, provides support to scientific research activities by announcing public calls and performing the complete procedure and management of competitive project calls. Infrastructure for science and technology parks is being expanded, but support services for these institutions need to be further expanded. Similarly, the Innovation Fund, which provides grants for industrial research, needs to play a more prominent role in the national funding system. In 2020, Serbia adopted its first Smart Specialisation Strategy, an Industrial Policy Strategy, and a Strategy for the Development of Artificial Intelligence. However, only the latter has started being implemented.

Measure 14: “Support for scientific research activity through strengthening scientific research capacities”

The measure, rolled over from the previous ERP, remains very relevant as it addresses crucial questions in the area of research and development, including insufficiently high investments in research and the lack of human resource capacities. The measure however falls short of adequately addressing the necessity to reform the public sector R&D institutes. Some challenges are not identified and addressed, such as the lack of technology transfer facilities. The measure overall lacks clarity and ambition in certain areas.

Measure 15: “Improvement of institutional support for the development of smart specialisation and innovations”

The reform measure is clear and relevant. It however does not outline significant support provided to the innovative companies and start-ups by the Science and Technology Park Belgrade, Novi Sad, Nis and Cacak, and the existing incubators and hubs are also not mentioned as if they are not part of the innovative ecosystem. The measure fails to provide a link between the Smart Specialisation Strategy and the Industrial Policy Strategy. Regrettably, as in the previous years, there are no plans or commitments to increase the percentage of GDP invested in science and research and to catch up with the EU member states average.

Digital economy

Serbia has made notable progress on digital transformation and the Government has kept it as a key priority for the country. Serbia’s communications infrastructure requires systematic improvement in both regulation and investment. The broadband roll-out has continued to slightly grow, but remains below the EU average. The lack of broadband prevents uptake of e-government and business services and as a consequence is slowing down the transformation of the economy. Investment by the ICT sector in research is above the national average, but still low compared to EU averages. Exports of ICT services have recorded a continuous growth of over 20% per year in the period from 2015-2019. The 2025 Serbia Programme, adopted in December 2019, announced well-needed investments in infrastructure in the tune of EUR 14 billion by 2025. However, staff capacity remains an issue: employees in the ICT sector represent only 2.6% of total registered employment. There are only about 25 000 of ICT experts in Serbia, with an additional 3 000 professionals added annually. Expert estimate that Serbia needs at least 15 000 additional computer scientists to preserve the currently high annual growth of the sector. The challenge remains to ensure there are links between the ICT sector and traditional industries so as to speed up modernisation in traditional sectors.

Measure 16: “Increasing the availability of e-government by improving infrastructure and introducing new technologies”

The reform measure is very relevant, particularly in view of the current circumstances of the COVID-19 pandemic, which have clearly demonstrated that the investments in e-government made in the past have to a great extent facilitated the response of the Serbian administration to the pandemic. The measure is transferred from the previous ERP. However, the ERP does not provide clear information on what has been achieved so far and the bottlenecks encountered in the previous period. The measure mainly relates to the development of the data centre in Kragujevac and introduction of the concept of a ‘smart city’, while the connection with other measures of the Programme for the Development of e-Government of the Republic of Serbia necessary for increasing availability of the e-government is not clearly presented. The measure is therefore rather limited in scope.

Measure 17: “Development and improvement of the national information and communication infrastructure”

The measure is rolled from the previous ERP and remains relevant in the context of providing fast broadband connectivity to under-served regions in Serbia. The measure is expected to have a favourable impact on competition, development and better connection of innovation/industry/services (benefit to businesses, online work) as well as providing further education possibilities (access to schools) and better household access to internet in general. Its significance lies in being the first digital connectivity investment implemented by Serbia with the support of the EU after the launch of the Digital Agenda for the Western Balkans and the adoption of the Economic and Investment Plan.

Investment activity

Despite the increase in public investments, particularly in roads and railways, it is still not at a level commensurate with the economy’s needs. The institutional framework supporting new investment is weak. Even though a new legislative framework for public investment management was established in July 2019, issues with transparency, assessment and prioritisation of investment remain and need to be seriously addressed. Public procurement practices are not always fully compliant with the legislation, nor are they always fully compatible with EU standards, particularly where large infrastructure projects financed through government-to-government agreements are concerned. Serbia’s economy continued to attract significant FDI (EUR 3.6 billion in 2019), well above the region's average. FDI has risen gradually in recent years. Investment is spread across many sectors, with more than a quarter going into manufacturing. The top 15 exporters are mainly foreign-owned, jointly securing about a quarter of total exports. 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. Existing programmes for the internationalisation of SMEs need to be stepped up to reach a higher number of beneficiaries.

The reform measure on the establishment of a sustainable system for funding environmental protection, present in previous ERPs, has not been transferred to this year’s ERP cycle.

Trade performance

The growth of Serbia’s foreign trade is accompanied by an increase in the foreign trade deficit. Exports of EUR 17.5 billion in 2019, recorded a growth of 7.7% year-on-year, while imports grew at a rate of 8.9% (EUR 23.9 billion). The foreign trade deficit (EUR 6.3 billion) increased by 12.5% y-o-y, and exports covered 73.4% of imports in 2019 (74.3% in 2018). The wide dispersion of exports is ensured by the diversification of FDI in a large number of sectors that produce tradable goods. In the first eight months of 2020, the COVID-19 virus pandemic had an adverse effect on trade flows. Serbia’s exports amounted to over EUR 10.6 billion (which is a decrease of 7.6% compared to the same period last year), and imports amounted to almost EUR 14.5 billion (decrease of 6.5%). The foreign trade deficit (EUR 3.8 billion) is lower by 3.2% compared to the same period last year, while the coverage of imports by exports remained at 73.4%. Metals, cars, car parts and electric appliances remain the most significant export sectors.

Serbia continued its participation in the Central Europe Free Trade Agreement (CEFTA) and at the Sofia Summit in November 2020 it adopted together with the other Western Balkan partners an action plan to develop a Common Regional Market. The new initiative is structured around the four freedoms (free movement of

goods, services, capital and people) and covers aspects of digital, investment, innovation and industry policy. This makes it the most ambitious regional integration effort to date in the Western Balkans. Serbia remains the region's only net exporter and CEFTA remains the country's second-largest trade partner after the EU. Regional cooperation has so far delivered concrete results, including the regional roaming agreement, an agreement on trade facilitation, a regional investment reform agenda, a decision on authorised economic operators, a decision to liberalise trade in services and an agreement to facilitate trade in fruit and vegetables. Further efforts are needed to continue with the ongoing implementation of the CEFTA Additional Protocol (AP) 5 on Trade Facilitation; the implementation of AP 6 on Trade in Services; and playing a constructive role in ensuring the finalisation of negotiations on the CEFTA AP 7 on Dispute Settlement in 2021. These priorities are correctly identified in the ERP, notably in *Reform measure 18* ("*Improving conditions for and removing obstacles to trade*"). In addition, other aspects of the Common Regional Market Action Plan should be implemented without delay, such as the free movement of people with IDs, the regional development of e-commerce or the mutual recognition of professional qualifications. That would contribute to unleashing the regional potential of trade in services. It is important that regional initiatives include all Western Balkan partners and are in line with EU rules, building on existing commitments.

Measure 18: "Improving conditions for product safety and removing barriers to trade"

This measure has been rolled over from previous ERPs. Reducing barriers to trade is important to strengthen the competitiveness of the economy and boost economic growth, in both the short and the long term. Businesses continue to face systematic inspections at the border because of the non-recognition of EU certificates. Cumbersome inspections hampering trade could be classed as measures having an effect equivalent to quantitative restrictions. The activities planned under CEFTA are appropriate and credible. Serbia should continue to play a constructive role within CEFTA. Regrettably the progress on the finalisation of WTO accession has been minimal in the past years. In this regard, Serbia is committing to making certain amendments to provision in its law on genetically modified organisms that constitute a major stumbling block in the accession process. Serbia's announcements need to be followed up rapidly and resolutely, which has so far not been the case.

Transport

As Serbia keeps expanding its transport infrastructure, compliance with EU standards, interoperability, costing, planning and maintenance become increasingly relevant to ensure that these investments provide maximum benefit to Serbia's economy. An updated transport strategy leading to an EU *acquis*-compliant transport sector still needs to be put in place in Serbia. Critical improvements are needed in traffic management, maintenance, road safety and the transparency of transport investments. The reform of the railway system is ongoing and progress is being maintained. Improvements regarding inland waterways are underway; the potential of river ports as important trade channels needs to be further examined and their full interoperability with roads and railways needs to be secured.

Structural Reform 3: Reform of railways through harmonisation of the regulatory framework and enhancement of rail transport safety

Serbia's railway reforms are steadily progressing. The measures proposed in the ERP are further steps to advance the reform process and align the regulatory framework with EU rules. The focus on rail transport safety (modernisation of level crossings) and access

charges is well chosen. The new methodology for track access charges is an important element for the further liberalisation of the rail market in Serbia. However, the measure has a narrow focus. Other important aspects of rail reform that Serbia should advance are the facilitation of border crossing procedures, the granting of train driving licences and safety certificates to foreign operators and mutual recognition of the rolling stock. Serbia needs put more focus on railway infrastructure maintenance, in particular with a view to the upcoming opening of new railway lines. Using rail to export and import goods should be more systematically encouraged to reduce pressure on the environment and on roads.

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 6% of gross added value, but employs around one-fifth of the labour force. Together, agriculture and exports of food products contribute significantly to employment and the balance of payments (18.5% of all exports in 2019). Weather conditions continue to have a strong influence on the sector's performance. Other difficulties facing the agricultural sector are (i) land fragmentation, (ii) low productivity due to outdated technologies, (iii) small economic size and (iv) low utilisation of agricultural land per farm. Moreover, the sector faces the challenge of meeting EU obligations in the areas of food safety, veterinary and phytosanitary regulation, strengthening responsible authorities in those areas, and a need to improve border inspections as regards risk analysis and risk-based performance. Finally, 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.

Measure 4: “Improvement of the land consolidation process”

This reform measure is partially deducted from the reform measure 5 of last year's ERP. Land consolidation is a timely and financially demanding process and the measure is therefore appropriate. However, there was no progress reported in this area for 2020 due to the COVID-19 outbreak and the ERP does not provide concrete information on the current state of play and the baseline scenario. Considering that no progress has been made over the past year, it is unclear whether the timeline for the fulfilment of the given tasks is realistic. Some activities (e.g. land consolidation in Smederevo area) are unclear in terms of achievability due to the lack of legal basis. Delays in the adoption of the legal framework may cause further delays in the whole process. The measure could be more ambitious (e.g. it envisages hiring only one employee in 2021 and an additional four in 2022).

Measure 5: “Improvement of the financial support system for agriculture through digitisation and process automation”

The measure involves optimising and digitalising the procedures for submitting and processing applications for entry in the register of agricultural holdings and national approvals of incentives in agriculture. The reform is closely linked with a pre-condition for EU accession – the existence of a functional Integrated Administration and Control System (IACS). The measure has been rolled over from the previous year, with limited progress reported for 2020. The measure remains relevant and the risks outlined in the last year's ERP assessment, most notably related to the long procedure for the adoption of the necessary legislation and the lack of human resources, remain valid.

Measure 6: “Improvements in the competitiveness of agriculture”

The measure represents a continuation of activities under reform measure 5 from the last year’s ERP, for which reportedly very limited progress was made in 2020. The measure is relevant, but faces the risk of the further postponement in the necessary legislative process, in particular regarding the adoption of the Law on Quality Schemes for Agricultural and Food Products and the Law on Organic Production (originally planned for two years ago and repeatedly postponed). The Commission’s comments in the last year’s ERP remain valid.

Industry

The competitiveness of industry is key to growing the economy. Support for incoming FDI is principally geared towards attracting manufacturers. After years of declining industry, its share in GDP has now stabilised. Industry accounts for a quarter of value added. Industrial production recorded a growth of 0.3% in 2019 (with manufacturing growth of 0.2% y-o-y). Lack of imported raw materials, disruption of retail chains and reduced demand contributed to the decline in business in the industrial sector during the COVID-19 pandemic. Industrial production in the period January-June 2020 was 1.8% lower compared to the same period in 2019. While manufacturing is stable, the performance of traditional industries such as mining and electricity generation varies considerably. Serbia adopted a new industrial policy strategy in March 2020, but is yet to adopt an action plan for its implementation. 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. Measures of these kinds should be stepped up and their full compliance with state aid rules should be ensured. The ERP is regrettably lacking a substantive measure for green growth of industry.

Measure 7: “Boosting industrial competitiveness”

The reform aims at improving efficiency of instruments for implementation and better coordination of the industrial policy as defined by the strategy for the period 2021-2030 adopted in 2020. The reform seems to be broad, covering numerous areas (digitalisation, attracting investments and encouragement of export-oriented industries) and therefore not sufficiently focused. The Action Plan for implementation of the Strategy has been drafted and is currently in the process of consultation. The amount planned for the improvement of the technological structure of exports (approx. EUR 80 000 per year) does not look sufficient to carry out the planned activities. Activities under the measure should be further clarified as the ERP does not give details on sequencing or prioritization. In particular, all activities are planned for all quarters of three years.

Measure 8: “Introduction of the circular economy concept”

The last year’s ERP introduced for the first time a measure to promote the circular economy. The reform is very welcome as it recognises the benefits of circular economy for the environment, innovation, economic growth and job creation. This is particularly important in view of Serbia’s need to improve in resource savings, energy efficiency and environmental protection. However, though it is a first step in the right direction, the measure lacks ambition. It does not include any immediate practical steps towards a circular economy, which would need to be underpinned by appropriate budgetary allocations and robust performance indicators. The ERP provides no data on the level of

allocations from the Serbian budget for any of the three years. The adoption of an action plan has been delayed.

Measure 19: “Safe and quality product - industry development factor”

The measure involves linking together and improving the databases of all quality infrastructure institutions and ministries responsible for adopting technical regulations on industrial products, standards, conformity assessment, accreditation, etc. The measure is rolled over from the last year’s ERP and provides roughly an equal timeline for the planned activities. The importance of this measure, designed to reduce technical barriers to trade, lies in its potential for making the economy more competitive and freeing up the free movement of goods flow between the EU and Serbia. It plans financial support to businesses, mainly SMEs, in subsidising products certification, the accreditation process and use of standards, and especially to those that were highly impacted by the COVID-19 crisis.

Services

Services account for over half of the economy and nearly 30% of total exports. About half the value added by services comes from retail, real estate and healthcare. Services have been increasing their share of total exports and have the potential to expand further. Despite the double growth of the surplus (net exports) of services in 2019 compared to 2014, the share of the services surplus of GDP is still at a relatively modest level of 2.3% in 2019 (increase by 1 pp. compared to 2014). Service exports are dominated by tourism, transport and ICT services. To further expand these fast growing and competitive services, investment in infrastructure and skills needs to be tailored to their needs. Targeted efforts are also needed to slow down the ongoing brain drain in most skilled labour. The Stabilisation and Association Agreement with the EU, does not provide for a 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, if enough progress were made towards achieving mutual recognitions of qualifications and certificates. Belgrade is well-positioned to function as a hub for the regional provision of many skill-intensive services.

Education and skills

This sector and the relevant reform measures 20 and 21 are analysed above in section 4 under key challenge #1.

Employment and the labour market

This sector and the relevant reform measures 22 are analysed above in section 4 under key challenge #1.

Social dialogue

Social dialogue needs further development, in particular in the private sector. Collective agreements are mostly concluded in the public sector. Only few agreements at branch level exist in the private sector. The social partners need to improve their co-operation in order to accommodate labour and employment challenges as e.g. imposed by the COVID-19 pandemic. Foreign investors should also participate in the social dialogue in Serbia as they represent a significant part of the employers in Serbia. The tripartite Economic and Social Council of Serbia should be consulted in good time on policy initiatives and draft laws. In addition the Economic and Social Council needs appropriate resources for its work.

Social protection and inclusion

This sector and the relevant reform measures 23 are analysed above in section 4 under key challenge #1.

Measure 24: “Digitalisation of the Healthcare system”

The reform is good for more transparency and efficiency in healthcare. The single electronic health card will establish an electronic health file with patient information accessible for health sector workers and patients. It will contribute to better diagnosis and treatment through centralised and instantaneously available patient and treatment information. The initiative is a step forward towards digital transformation of the health sector and contributes to the SDG 3 good health and well-being. However, the measure does not alleviate the shortage and emigration tendencies of medical staff.

ANNEX A: OVERVIEW OF THE MAIN INDICATORS PER AREA/SECTOR OF THE ECONOMY

Area/Sector	2016	2017	2018	2019	EU-27 Average (2019 or most recent year)
Energy					
Energy imports dependency (%)	29.7%	33.8%	34.6%	35.6%	60.62%
Energy intensity: Kilograms of oil equivalent (KGOE) per thousand Euro	418.39	418.01	394.50	375.78	112.92
Share of renewable energy sources (RES) in final energy consumption (%)	21.15%	20.29%	20.32%	21.44%	19.73%
Transport					
Railway Network Density (meters of line per km ² of land area)	42.55 ^w	42.53 ^w	42.53 ^w	42.52 ^w	49.0 ⁽²⁰¹⁸⁾
Motorization rate (Passenger cars per 1000 inhabitants)	266.3	278.2	284.1	297.6	519 ⁽²⁰¹⁸⁾
Agriculture					
Share of gross value added (Agriculture, Forestry and Fishing)	8.2%	7.2%	7.7%	7.2%	1.8%
Share of employment (Agriculture, Forestry and Fishing)	18.6%	17.2%	15.9%	15.6%	4.3%
Utilised agricultural area (% of total land area)	39.1% ^w	38.8% ^w	39.4% ^w	39.3% ^w	40.0% (2017, EU-28)
Industry					
Share of gross value added (except construction)	26.4%	26.5%	25.4%	24.0%	19.7%
Contribution to employment (% of total employment)	20.2%	21.2%	22.5%	22.6%	18.1%
Services					
Share of gross value added	60.7%	61.3%	61.5%	61.9%	73.0%
Contribution to employment (% of total employment)	57.0%	57.5%	57.2%	57.0%	70.8%

Business Environment					
Rank in WB Doing Business (Source: World Bank)	54	47	43	48	N/A
Rank in Global Competitiveness Index (Source: World Economic Forum)	94	78	65	72	N/A
Estimated share of informal economy in GDP (as % of GDP) (Source: IMF)	Up to 34.5%	N/A	N/A	25-30%	N/A

Research, Development and Innovation					
R&D intensity of GDP (R&D expenditure as % of GDP)	0.84%	0.87%	0.92%	N/A	2,2%
R&D expenditure – EUR per inhabitant	43.6€	48.6€	56.3€	N/A	688.6€

Digital Economy					
Percentage of households who have internet access at home	64.7% ^w	68%	73%	80%	86% ⁽²⁰¹⁸⁾
Share of total population using internet in the three months prior to the survey [NB: population 16-74]	67.1%	70%	73%	77.4%	85% ⁽²⁰¹⁸⁾

Trade					
Export of goods and services (as % of GDP)	48.6%	50.5%	50.4%	51.0%	49.4%
Import of goods and services (as % of GDP)	53.3%	57.1%	59.1%	61.0%	45.7%
Trade balance (as % of GDP)	-6.8%	-8.1%	-10.3%	-11.7%	N/A

Education and Skills					
Early leavers from education and training (% of population aged 18-24)	7.0%	6.2%	6.8%	6.6%	10.2%
Youth NEET (% of population aged 15-24)	17.7%	17.2%	16.5%	15.3%	10.1%
Formal child care - children aged less than 3 years (% of total)	18.1%	14.5%	13.3%	17.2%	35.3%
Individuals' level of digital skills (% of individuals aged 16-74 who have basic or above basic overall digital skills by sex)	N/A	39%	N/A	46%	56%

Employment					
Employment Rate (% of population aged 20-64)	59.1%	61.4%	63.1%	65.2%	73.1%
Unemployment rate (% of labour force aged 15-74)	15.4%	13.6%	12.8%	10.5%	6.7%
Gender employment gap (Percentage points difference between the employment rates of men and women aged 20-64)	14.4 pps.	14.0 pps.	14.7 pps.	13.9 pps.	11.7 pps.
Social Protection System					
% of population at risk of poverty or social exclusion	38.5%	36.7%	34.3%	31.7%	20.9%
Impact of social transfers (Other than pensions) on poverty reduction	21.28%	18.67%	17.91%	18.02%	32.38%
Self-reported unmet need for medical care (of people over 16)	4.5%	4.8%	5.8%	4.8%	1.7%
Income quintile share ratio S80/S20 for disposable income by sex and age group (Comparison ratio of total income received by the 20% with the highest income to that received by the 20% with the lowest income)	11.02	9.38	8.58	6.46	4.99

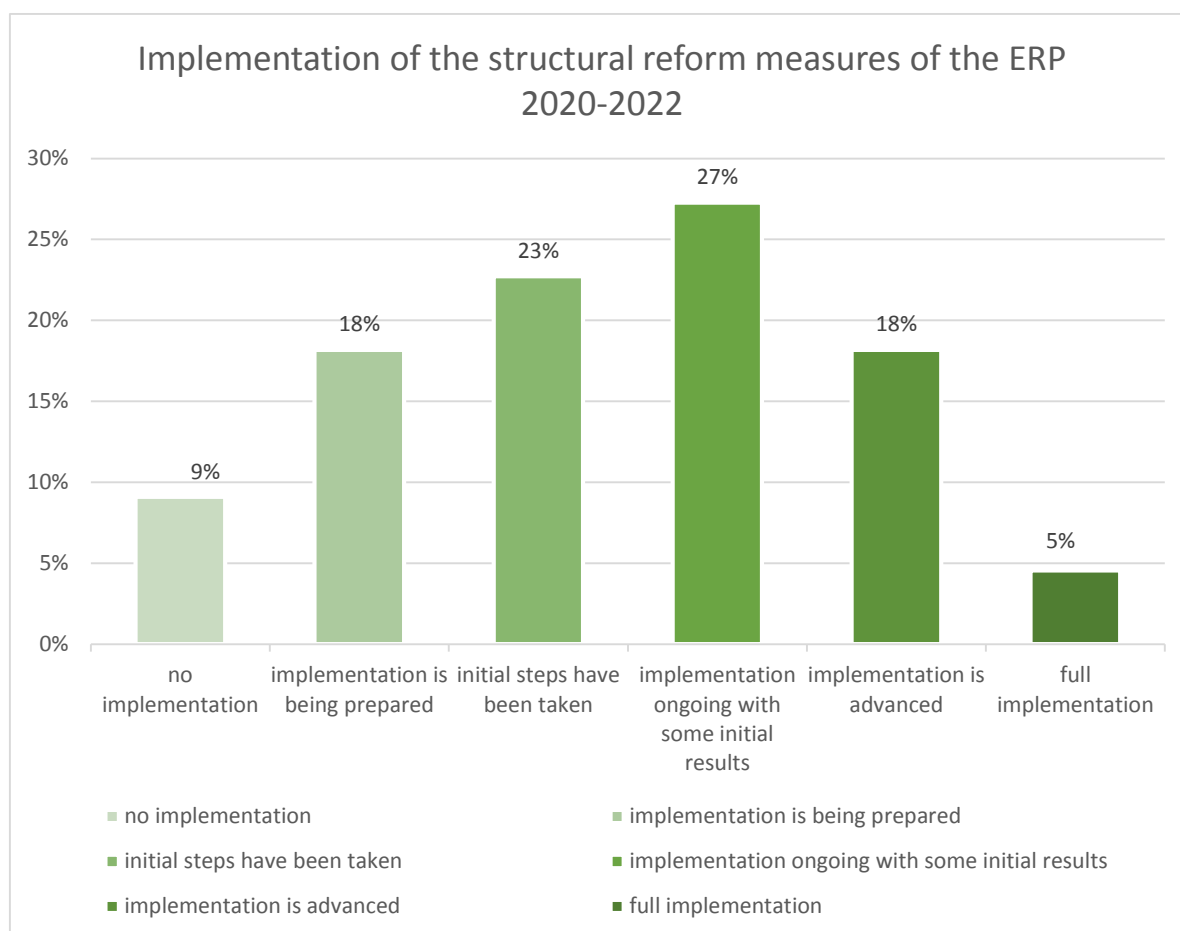
w: data supplied by and under the responsibility of the national statistical authority and published on an "as is" basis and without any assurance as regards their quality and adherence to EU statistical methodology'

Source of data in Annex A: EUROSTAT unless otherwise indicated

ANNEX B: PROGRESS WITH STRUCTURAL REFORM MEASURES FROM ERP 2020-2022

There was some progress in implementing the measures in 2020, with an average score of 2.8 out of 5 (down from 3.3 in 2019). 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.

As in the previous years, the highest level of implementation involves the measures on business environment, in particular the improvement of the access to finance and digital transformation of SMEs and further reduction in administrative and regulatory burden. However, for a number of other measures, particularly complex ones, the implementation rate drops significantly, often to below 50%. As in the previous years, the pace of implementation in the area of governance of public enterprise is slow. The slow implementation has also been noted in the areas of environmental protection, financing and competitiveness of agricultural producers and processors, and improving road transport capacity and quality.



ANNEX C: COMPLIANCE WITH PROGRAMME REQUIREMENTS

The government adopted and formally submitted the Economic Reform Programme on 31 January 2021. The programme is in line with the medium-term fiscal strategy and the 2021 budget and covers 2021-2023.

Inter-ministerial coordination

Preparation of the Economic Reform Programme (ERP) 2020-2022 was coordinated by the Ministry of Finance (Minister of Finance was appointed as a national coordinator) and the Secretariat for Public Policies. National Bank of Serbia (for macro-fiscal part) and a number of line ministries (for structural reform measures part), together with some other relevant institutions, were also contributing through a working group established specifically for this exercise. Taking into account that the exercise was repeated for the seventh time, there has been accumulated "know-how" and "lessons learnt" from previous rounds, which further improved the overall process. Several trainings, in particular by the Centre of Excellence in Finance (CEF) and GIZ, were organised for those involved in preparation of the document.

Stakeholder consultation

The national authorities involved stakeholders in the process of the preparation of the document. Several rounds of consultations with a wide range of stakeholders were organised, as well as a meeting with the National Convention, which gathers about 700 social partners, NGOs, business associations and other relevant stakeholders in Serbia. National Convention established an inter-sectorial working group which examined the proposed reform measures and submitted comments and suggestion. The participants were given sufficient time to comment in writing and the draft was made available on-line. Comments received from stakeholders were included in the annex of the Economic Reform Programme document.

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 resulting in lower economic growth and higher budget deficit and debt levels. While the alternative scenario appears very relevant in view of the identified risks in a context of high uncertainty, the underlying assumptions do not appear to be sufficiently detailed and quantified to allow for further assessment.

Fiscal framework

The fiscal framework, based on the baseline medium-term macroeconomic scenario, is sufficiently comprehensive and integrated with the overall policy objectives. In general, most revenue and expenditure measures are sufficiently explained, although the medium-term impact of some of them is not covered in sufficient detail. The programme does not contain any long-term projections of population trends or of the implications of an ageing population for the labour market and public finances, notably as regards health and pension systems. Significant further efforts would be needed to ensure the fiscal data are compatible with ESA 2010.

Structural reforms

Reporting on implementation of the 2020-2022 structural reform measures is detailed and up-to date. The ERP presents 24 reforms, 4 more than the maximum suggested by the guidance. The quality of measures vary. In some cases, measures are narrow in scope, well targeted and planned in good detail, while in others they are overly ambitious and wide in scope. The annexed tables are filled in appropriately.

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