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COMMISSION STAFF WORKING DOCUMENT

ECONOMIC REFORM PROGRAMME

OF

SERBIA
(2025-2027)

COMMISSION ASSESSMENT

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1. Executive summary

The Serbian economy continued to grow at a robust pace in 2024 and projections point to a further acceleration of growth in 2025-2027. According to preliminary data, real GDP grew by 3.9% in 2024, driven entirely by strong domestic demand. For 2025, the economic reform programme (ERP) projects growth to pick up further to 4.2% and range between 4.0-5.0% in 2026-2027. Growth will continue to be largely driven by increases in private consumption due to higher real disposable income, as well as strong investment, with a slightly negative contribution from net exports. Consumer price inflation returned to the central bank's target band (3±1.5%) in May 2024 but has since hovered close to the upper bound of the target range, reaching 4.5% in February. Inflationary pressures remain persistent, with core inflation in 2024 consistently higher than the headline rate. The current account deficit widened sharply to 6.3% of GDP (ERP projected 4.7%) in 2024 mainly due to a deteriorating trade balance and was for the first time in a decade not fully covered by net foreign direct investment (FDI) inflows. The ERP projections seemed overall plausible at the time of submission, but an underwhelming external environment, stubborn inflationary pressures as well as recent political domestic turmoil present heightened downside risks.

The 2024 budget deficit outcome was better than planned, but the fiscal strategy entails a loosening of the fiscal stance in the medium-term. The fiscal performance in 2024 was ultimately better than projected, with a deficit of 2.0% of GDP compared to the mid-year supplementary budget's revised target of 2.7%. This outcome was again a result of conservative budgeting. For 2025-2027, under the revised fiscal strategy, the deficit target is set to increase to 3.0% in every year; the application of the deficit component of the fiscal rules[1] set to enter into force in 2025 has de facto been postponed until 2029. The surge in expenditures is intended to make room for the full implementation of the investment cycle related to the 'Leap to the Future – Serbia 2027' programme in connection with the specialised EXPO 2027, while also providing for further increases in wages and pensions. However, the debt-to-GDP ratio is still projected to decrease gradually, from 47.5% in 2024 to 46.5% in 2027. While fiscal outcomes are set to be supported by the expected strong growth, fiscal risks such as those related to state-owned enterprises (SOEs) as well as to the ongoing political crisis due to months of nationwide protests are non-negligible.

The main challenges facing Serbia include the following:

- **Complying with fiscal rules and improving transparency are key to strengthening the fiscal framework.** The latest revision of national accounts in late 2024 has provided a significant fiscal relief for Serbia, easing compliance with the special wage and pension fiscal rules, but containing these two expenditure categories

[1] The deficit rule consists of a general government deficit ceiling set in reference to the level of debt (3% of GDP if debt is below 45% of GDP; 1.5% of GDP is debt is below 55% of GDP; 0.5% if debt is below 60% of GDP; and 0% if the debt is above 60% of GDP.

remains crucial. In recent years, in-year ad hoc spending measures have been a recurrent feature of budget execution. Such ad hoc measures, often in the domain of social protection, have been facilitated by a sizeable contingency reserve, which lacks a clear definition of its purpose as well as transparent and regular reporting. The budget also continues to lack a detailed overview of tax expenditures. The implications of an ageing population for the long-term sustainability of public finances are poorly understood in the absence of long-term projections of public pension spending.

- **In view of further large capital expenditures planned for the medium-term, improving public investment management remains a key issue for Serbia.** The new decree on capital projects adopted in late 2023 still provides for numerous exemptions. A major issue lies in the large discretion for the government to designate investments of 'particular importance' due to a lack of strict, clearly defined selection criteria.

- **A public sector wage reform is critical to attract and retain highly qualified staff.** The current wage structure is highly compressed, offering comparatively low wage levels for high-end positions, which contributes to a lack of appropriately qualified staff and in turn hamper the implementation of ongoing reforms. The wage system reform has already been postponed repeatedly. In recent years, addressing staffing challenges has become urgent, notably for the tax administration.

- **Other structural challenges hampering Serbia's growth potential remain in the areas of fundamental democratic and judicial reforms, the business environment and private sector development, human capital, and the green and digital transitions.** Serbia's business environment is hindered by several challenges, including weaknesses in the rule of law, corruption, and inconsistent State-aid and public procurement procedures that are often untransparent and subject to exemptions preventing fair competition. The widespread presence of inefficient SOEs remains an obstacle for the development of a strong corporate sector. The energy sector, which is dominated by SOEs, is in need of modernisation and remains dependent on Russia, exposing the country to geopolitical risks. Although Serbia's digital transformation is the most advanced in the region, further digital infrastructure roll-out as well as improved digital skills and literacy are needed. Human capital development is impeded by skill mismatches and brain drain. The above-mentioned challenges are gradually being tackled through the implementation of structural reforms outlined in Serbia's Reform Agenda under the New Growth Plan for the Western Balkans.

The implementation of the policy guidance jointly adopted at the Economic and Financial Dialogue of 14 May 2024 has been partial. Implementation has been substantial in the area of monetary policy and banking supervision, as the central bank kept a tight monetary stance and managed to bring back inflation to the target band, continued to promote dinarisation and achieved the establishment of a bank resolution fund. Implementation in other areas has been partial, such as on the implementation of the new SOE Law (adoption of three related by-laws) as well as on the public sector wage reform (further expansion of the public wage and employment registry). Some progress has also been made in presenting forward-looking fiscal risks in the fiscal strategy and strengthening medium-term budgeting. A new green tagging methodology was applied for the first time for the 2025 budget. The turnaround in the fiscal strategy did not contribute to enhanced credibility of the fiscal rules, but the special rules regarding wages and pensions have been enforced.

2. ECONOMIC OUTLOOK AND RISKS

GDP growth in Serbia further accelerated in 2024 on the back of strong domestic demand. After growing by 4.7% and 4.0% year-on-year (y-o-y) in the first two quarters, respectively, the economy cooled down to 3.1% y-o-y in the third quarter, in line with expectations due to a slightly higher base in the second half of the previous year. Latest preliminary data show 3.9% real growth for 2024[2] [3]. Private consumption and investment remained the key growth drivers, while the contribution of net exports to GDP expansion was negative due to import activity outperforming exports. Strong domestic demand was driven by the notable surge in real disposable income on the back of higher wages (with public sector wages up by 10% and the minimum wage rising by 17.8% in 2024) and pensions (which increased by 14.8%). The employment rate reached a record high, as the labour market has become tighter, with the unemployment rate coming down to 8.1%. At the same time, both high capital expenditures and record FDI inflows contributed to strong investment. On the production side, all economic sectors recorded positive trends, most notably the services sector, with the exception of agriculture, which suffered from a drought.

The ERP baseline scenario presents a positive outlook with an average growth rate of 4.4% for 2025-2027. GDP growth is expected to accelerate to 4.2% in 2025 and 4.0% in 2026 (slightly above last year's ERP projections), before reaching 5.0% in 2027. Growth is projected to continue to be driven by domestic demand. The investment cycle is set to continue, with gross fixed capital formation forecast to increase by 7.4% per year on average due to sustained high public capital spending combined with strong private investment. Similarly, private consumption growth is set to remain buoyant, albeit moderating somewhat, while growth in exports is forecast to start outpacing the increase in imports from 2026 onwards due to the activation of new production capacities resulting from the implementation of FDI from previous years, and the expected recovery of external demand. Despite this, while gradually declining, the contribution of net exports to GDP growth is expected to remain negative. The ERP forecasts the output gap to be neutral in 2025 and 2026, before turning positive in the year of the EXPO 2027[4],

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[2] Macroeconomic and fiscal estimates and forecasts covering the period 2024-2027 have been taken from the ERPs themselves; if available, preliminary macroeconomic and fiscal out-turn data for 2024 have been taken from the relevant national sources (Statistical Office, Ministry of Finance, Central Bank).

[3] ERP projected full-year growth at 3.8%.

[4] Belgrade and Serbia will host a Specialised World Expo from 15 May to 15 August 2027, under the theme 'Play for Humanity: Sports and Music for All'. It is estimated that during the exhibition, Serbia will be visited by more than 4 million domestic and foreign visitors.

when the economy is expected to run somewhat above its potential. The labour market is expected to maintain positive trends, with increasing employment rates and decreasing unemployment rates (to below 8% in 2027), driven by the growth of formal employment and improvements in the business environment. Real wage growth is set to continue, albeit at a slower pace. Productivity developments are also expected to be supportive, with the implementation of the 'Leap into the Future – Serbia 2027'[5] programme and investments in human capital and innovation, aiming to enhance competitiveness and drive economic growth.

The ERP's medium-term macroeconomic scenario of strengthening growth appeared overall plausible at the time of submission, but recent developments present some notable downside risks. The projected strong growth, which is in line with estimates about potential growth, is based on a continuation of previous trends, with domestic demand remaining the main driver behind the expansion. Although the projected growth rates, especially for 2025 and 2026, seemed attainable, the ongoing political crisis in the country, the impact of the potential sanctions against Serbia's oil industry, if applied, as well as weak external demand in view of geopolitical tensions and uncertainties on the global trade market present significant risks and latest estimates already point to a slowdown in GDP growth in Q1-2025. Following the Novi Sad tragedy in November 2024, caused by the collapse of the railway station's canopy which killed 16 citizens, and which triggered nationwide protests, economic sentiment in Serbia has deteriorated notably since the beginning of the year. While the ERP expects exports to experience a strong boost over the next few years, the extent of this will largely depend on the recovery of external demand, including from Germany and Italy, the country's main foreign trade partners as well as the development of the current tensions on the global trade market. Notably the crisis in the German automotive industry threatens to weigh on the automotive parts and components sector, which in Serbia employs around 100,000 people and accounts for a significant share of Serbia's manufacturing exports[6]. External competitiveness, negatively impacted by years of strong real wage growth outpacing growth in labour productivity, coupled with persistent pressures on salaries resulting from a tight labour market, could also weigh on export growth. Although FDI was very strong in recent years, investor sentiment could take a hit amid the current political turbulence, resulting in less comfortable financing of the current account deficit, which is projected to remain elevated. A significant macroeconomic impact could also stem from the US sanctions against Serbia's majority-Russian owned oil company, Naftna Industrija Srbije (NIS). The sanctions, announced on 10 January but not yet implemented, would essentially freeze NIS's operational model and could have a severe

[5] The development plan 'Leap into the Future – Serbia 2027' provides for significant public investments, especially in anticipation of hosting the Specialised World Expo in 2027. It serves as a central framework for accelerated infrastructure modernisation. Around 18 billion euro will be invested throughout Serbia in more than 300 projects by 2027, as part of the 'Leap into the future - Serbia 2027' programme. The plan technically also includes the EXPO 2027 investments, but the two were announced at different times.

[6] Data from early 2025 point to weak external trade: in the first two months of 2025, the total value of Serbian exports decreased by 0.6% (y-o-y, expressed in EUR).

impact on the energy sector as NIS runs the country's only oil refinery and the majority of its petrol stations.

Table 1:

Serbia - comparison of macroeconomic developments and forecasts

	2023		2024		2025		2026		2027	
	COM	**ERP**	COM	**ERP**	COM	**ERP**	COM	**ERP**	COM	**ERP**
Real GDP (% change)	3.8	**3.8**	3.9	**3.8**	4.2	**4.2**	4.3	**4.0**	n.a.	**5.0**
Contributions:										
- final domestic demand	2.2	**2.1**	5.0	**5.6**	5.2	**5.0**	5.3	**4.4**	n.a.	**4.1**
- change in inventories	-1.2	**-1.0**	0.9	**0.7**	-0.1	**0.0**	-0.1	**0.0**	n.a.	**0.0**
- external balance of goods and services	2.8	**2.7**	-2.0	**-2.5**	-0.9	**-0.9**	-0.9	**-0.5**	n.a.	**1.0**
Employment (% change)	0.8	**0.2**	0.8	**1.0**	0.5	**0.4**	0.5	**0.4**	n.a.	**0.4**
Unemployment rate (%)	9.4	**9.7**	8.7	**8.9**	8.3	**8.6**	8.0	**8.0**	n.a.	**7.6**
GDP deflator (% change)	13.8	**13.8**	4.5	**5.0**	4.2	**3.2**	4.2	**3.2**	n.a.	**3.0**
CPI inflation (%)	12.4	**12.2**	4.7	**4.7**	3.7	**3.7**	3.5	**3.3**	n.a.	**3.0**
Current account balance (% of GDP)	-2.4	**-2.4**	-5.1	**-4.7**	-5.4	**-4.9**	-5.0	**-5.3**	n.a.	**-4.1**
General government balance (% of GDP)	-2.1	**-2.1**	-2.9	**-2.7**	-3.0	**-3.0**	-3.0	**-3.0**	n.a.	**-3.0**
Government gross debt (% of GDP)	48.4	**48.4**	48.5	**47.9**	48.2	**47.5**	48.0	**47.0**	n.a.	**46.5**

Sources: Economic Reform Programme (ERP) 2025, Commission Autumn 2024 forecast.

The ERP identifies the main risks for the economic outlook to be related to external factors, while no significant domestic risks are presented. The economic risk analysis highlights further geo-economic fragmentation, including global trade tensions and further escalation of ongoing conflicts in Ukraine and in the Middle East as key downside risks, potentially causing adverse impacts on global trade, energy prices, inflationary pressures and slow economic recovery of trade partners. The ERP accordingly also includes an alternative, more pessimistic economic scenario, which assumes the materialisation of such risks from the international environment, resulting in a lower growth rate of 3.1% on average per year, due to negative impacts mainly on export activity, inflation, private consumption and investments.

Inflation returned to within the central bank's target band (3±1.5%) in May 2024 and the ERP forecasts it to remain within that band, but domestic price pressures remain elevated. Averaging 12.1% in 2023, consumer price inflation came down to 4.3% in December 2024 due to a decline in all key components, especially food prices. The drop was driven by lower imported inflation, a decline in inflation expectations and past monetary tightening. Since the return of inflation within the target band, the National Bank of Serbia (NBS) lowered the key policy rate in three steps by 25 bps each to 5.75%, keeping it on hold as of February 2025. As a result, the average reverse repo rate, which de facto determines the monetary stance, decreased from 5.6% to 4.5% (February 2025). Despite the initial easing, the ERP projects monetary conditions to remain tight. Core inflation (excluding food, energy, alcohol and cigarettes), despite a significant drop, was however consistently higher than headline inflation and has stood at 5% since May 2024 as a result of rising prices of services. The ERP projects inflation to continue to gradually decrease and reach the target mid-point of 3% by 2027 due to a continued tight monetary stance, lower imported inflation and falling inflation expectations together with slower real wage growth and a potential drop in global oil prices. However, despite the sharp slowdown in inflation mainly due to external factors, domestic factors such as high domestic demand and cost pressures, caused inflation rates in Serbia to rank among the highest in Europe, resulting in consumer boycotts over soaring food prices in the beginning of 2025. Inflation bounced back to 4.6% in January 2025, slightly above the target band of the central bank and stood at 4.5% in February. Inflationary risks can be expected to remain elevated throughout 2025 as a consequence of the further loosened fiscal stance and a relatively tight labour market.

The dinar exchange rate against the euro has experienced appreciation pressures, with the central bank intervening in the foreign exchange market to maintain relative stability. In line with its practice to avoid exchange rate volatility, the NBS purchased foreign currency on the local FX market, resulting in a marginal nominal appreciation of the dinar against the euro by 0.1% in the first nine months of 2024. The NBS's foreign exchange reserves reached a record high as of September 2024, equalling EUR 28.3 billion or about seven months' worth of imports. However, while the NBS was a net buyer of EUR throughout 2024, it had to intervene in the foreign exchange market in first two months of 2025 by selling over EUR 700 million in order to prevent larger exchange rate fluctuations.

After a sharp contraction to 2.4% of GDP in 2023, the current account deficit rose significantly in 2024 following strong growth in investment and private consumption. Widening to EUR 5.2 billion or 6.3%[7] of GDP in 2024, notably higher than projected, the rise in the deficit was largely driven by the faster growth in imports than exports. Despite the resilience of goods exports in view of sluggish external demand, largely owing to past investments into tradable sectors, the goods balance deteriorated by 21.9 pps. to -9.8% of GDP following an increase in domestic demand. The services trade surplus contracted by 11.6 pps. y-o-y despite strong services exports growth (notably in the ICT sector), evidencing higher imports of tourism, intellectual property rights and transport services. The primary income deficit surged due to higher dividend and interest payments, while the secondary income surplus shrank on the back of lower government grants and remittances. The ERP expects the current account deficit to remain at around 5% of GDP in 2025-2027 as domestic demand is set to remain strong. Unit labour costs continued to rise in 2024 due to real wages growing again faster than productivity, and as pressures on wages are expected to remain strong, the continuation of this trend could start to weaken Serbia's external competitiveness.

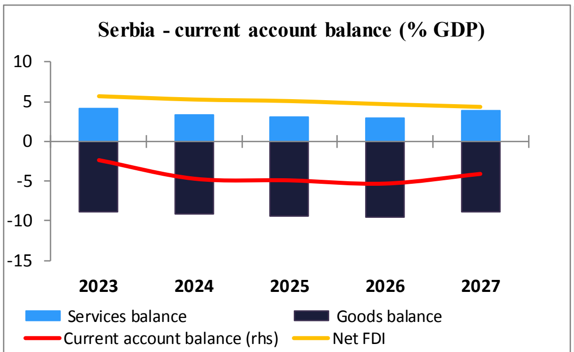
The current account deficit was for the first time in a decade not fully covered by net FDI inflows, contrary to the ERP projections. While gross FDI inflows saw a record high in 2024 and reached EUR 5.2 billion[8] (or 6.3% of GDP), net FDI inflows reached EUR 4.6 billion, hence only covering 88.5% of the current account deficit. However, since a large portion of these investments has been channelled into tradable sectors for years, inflows of FDI have contributed markedly to increasing the capacity of domestic producers. Most FDI inflows in the period from January-September 2024 have been destined to the construction sector (28.9%), followed by mining (25.1%) and manufacturing (11.8%). More than half of those inflows originated from European countries (64.6%, with 43.4% originating from the EU) in the first half of 2024, while

[7] ERP projected 4.7% of GDP.

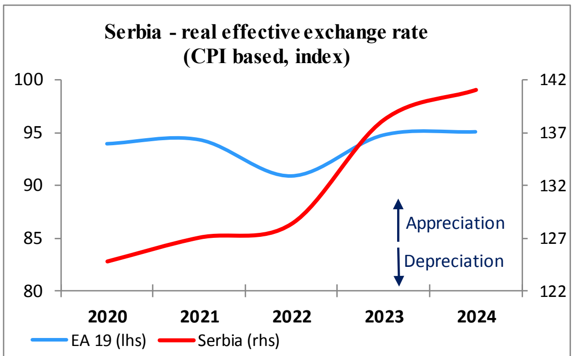
[8] ERP projected EUR 4.6 billion.

Asian countries, namely China, continued to expand their share. The ERP anticipates that Serbia will continue to attract strong FDI inflows around 2024 levels. As a result of its progress in EU integration and the increasing number of Serbia's bilateral free trade agreements, the Serbian economy is expected to become increasingly open and integrated into global trade flows, with the ERP projecting total exports and imports to reach around 130% of GDP by 2027 from 114.5% in 2023. Serbia's net international investment position (NIIP) was negative at 2% of GDP at end-Q2 2024, with FDI remaining dominant on the liability side and the stock of net FDI accounting for around 105% of the NIIP. Together with the comfortable level of foreign exchange reserves, this remains a key factor in reducing the country's vulnerability to external shocks.

Graphs: external competitiveness and current account



Source: Economic Reform Programme (ERP) 2025.



Source: Economic Reform Programme (ERP) 2025 and ECB.

Serbia's financial sector remained stable in 2024. The banking sector remains well capitalised, with a capital adequacy ratio of close to 22% as of September 2024, and highly liquid, with a liquidity coverage ratio of 195.3%. Profitability remained satisfactory, with further increases in return on assets (ROA, 2.8% as of end-December) and return on equity (ROE, 20.3%), driven by higher net interest income. The non-performing loan (NPL) ratio continued to decline, reaching a historic low in December (2.5%). Domestic loan growth accelerated to 8.2% in December amid eased credit standards, driven by both households (10.4%) and, to a lesser extent, corporate loans (4.8%). Following the NBS's efforts to promote dinar-denominated deposit and loan growth, the share of deposits in dinars reached a new record high by end-2024. These efforts included the decision to apply lower reserve requirement rates for dinar sources of financing, particularly long-term. Domestic credit growth is expected to continue, with a projected growth rate of 7% in 2025 and 2026 due to faster economic growth and more favourable financing conditions.

The NBS has continued working on the regulatory and supervisory framework. The most significant novelty was the establishment of the bank resolution fund, managed by the NBS. Fund membership will be mandatory for all banks, with contributions envisaged to start in 2026. The NBS is also preparing for the implementation of a Credit Registry to harmonise bank loan information in line with the EU-standard format. The NBS's decision to temporarily cap interest rates at around 4% for a wide range of mortgage loans, aimed at supporting people with mortgages and reducing the risk of NPLs, which was originally planned to be phased out by the end of 2024, was temporarily increased to 5% until the end of 2025. A new law on the protection of financial service consumers is set to be adopted, setting up a permanent mechanism aimed at preventing an excessive rise of mortgage interest rates. The NBS has also submitted a formal application to the EU's Single Electronic Payment Area (SEPA) in December. Once operational, SEPA would reduce settlement time and cost for euro payments, and facilitate trade, remittances, and other cross-border activity.

Table 2:

Serbia - financial sector indicators

	2020	2021	2022	2023	2024
Total assets of the banking system (EUR million)	50 775	56 748	61 122	67 271	76 074
Foreign ownership of banking system (%)	86.0	87.0	83.6	76.9	77.5 1)
Credit growth (%, average)	12.3	9.1	10.9	1.7	4.5
Deposit growth (%, average)	15.0	14.4	8.4	11.4	13.0
Loan-to-deposit ratio (end of period)	0.91	0.88	0.88	0.79	0.76
Financial soundness indicators (%, end of period)					
- non-performing loans to total loans	3.7	3.6	3.0	3.2	2.5
- regulatory capital to risk-weighted assets	22.4	20.8	20.2	21.4	21.3
- liquid assets to total assets	37.3	37.7	37.5	41.0	40.8
- return on equity	6.5	7.8	13.9	18.1	20.3
- foreign exchange loans to total loans *	64.7	63.2	65.5	59.7	57.2

* Includes both denominated and indexed positions.
1) Q3-2024
Note: data for December 2024 are preliminary.
Sources: ERP 2025, National Bank of Serbia.

3. PUBLIC FINANCE

Compared to the ERP's projection of 2.7%, preliminary data show that the fiscal deficit stood at 2.0% of GDP in 2024. The supplementary budget, adopted at the end of September 2024, had projected an increase of 0.5 pps. over the original budget plan of 2.2%. The increase in the deficit, despite better-than-expected revenue collection, was supposed to accommodate higher capital expenditures (18.7% higher than the original plan) as well as increases in subsidies for agriculture and some current expenditures related to social assistance and transfers. However, according to the Ministry of Finance, the deficit came out 0.7 pps. lower than projected due to lower expenditures, mainly in the category of goods and services (by 0.4 pps.), interest payments (0.1 pps.) and other current expenditures (0.2 pps.). Revenues were also slightly higher than expected, namely from personal income tax (0.1 pps.) and corporate income tax (0.1 pps.). Overall, capital expenditure remained very high (at 7.3% of GDP), subsidies increased slightly to 2.5% of GDP due to additional agricultural subsidies, and spending on employees and pensions both increased notably vis-à-vis 2023.

The ERP projects a loosening of the fiscal stance for the period 2025-2027 as the application of the deficit rule has been postponed. This constitutes a notable shift towards a more expansionary fiscal policy, as the original plan to reduce the deficit to 1.5% of GDP in the medium-term, outlined in last year's ERP, has been changed in order to accommodate the new investment cycle under the 'Leap into the Future' development plan as well as further pension and public wage increases. However, according to the

ERP this is consistent with a declining trajectory of public debt, albeit at a slower pace than previously planned. The envisaged loosening of the fiscal stance, while not posing a threat to medium-term fiscal sustainability, comes with some downside risks to disinflation efforts and appears to be pro-cyclical. The cyclically adjusted primary balance is set to deteriorate over the course of the programme, notably in 2027. The ERP predicts that the revenue ratio to decline mildly after a one-off boost in 2025 due to the expected strong growth in GDP. The expenditure ratio will similarly reach a high point in 2025 before gradually declining towards the elevated 2024 level.

Table 3:

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

	2023	2024	2025	2026	2027	Change: 2024-27
Revenues	39.4	40.8	41.3	40.9	40.5	-0.4
- Taxes and social security contributions	34.9	36.2	36.3	36.4	36.3	0.1
- Other (residual)	4.5	4.6	5.0	4.5	4.1	-0.5
Expenditure	41.4	43.6	44.3	43.9	43.5	-0.1
- Primary expenditure	39.8	41.6	42.2	41.8	41.5	-0.1
of which:						
Gross fixed capital formation	6.4	7.4	7.4	7.2	7.4	0.0
Consumption	15.9	16.8	17.8	17.6	17.6	0.7
Transfers & subsidies	14.9	15.6	15.4	15.4	15.1	-0.5
Other (residual)	2.5	1.9	1.6	1.6	1.5	-0.4
- Interest payments	1.7	2.0	2.2	2.1	2.0	0.0
Budget balance	-2.1	-2.7	-3.0	-3.0	-3.0	-0.3
- Cyclically adjusted	-2.1	-2.6	-3.0	-3.0	-3.2	-0.6
Primary balance	-0.4	-0.8	-0.9	-0.9	-1.0	-0.2
- Cyclically adjusted	-0.4	-0.7	-0.9	-0.9	-1.2	-0.5
Gross debt level	48.4	47.9	47.5	47.0	46.5	-1.3

Sources: Economic Reform Programme (ERP) 2025, Commission calculations.

For 2025, the budget targets an increase in the deficit to 3.0% of GDP due to higher current spending. While the revenue ratio is set to increase by 0.5 pps. compared to the ERP's projected outcome for 2024 (or by 0.3 pps. compared to latest data indicating a better-than-projected outcome), expenditures are also projected to increase notably, by 0.7 pps. (or even more strongly, by 1.3 pps., compared to the preliminary 2024 outcome). Although capital spending is projected to remain high (at 7.4% of GDP), the rise in the expenditure ratio is planned to be driven by increases in almost all categories of current expenditure, namely on public wages (by 0.3 pps. compared to the 2024 projected outcome), goods and services (by 0.5 pps.), interest payments (by 0.2 pps.) and pensions (by 0.4 pps.). Some of these increases were unavoidable due to statutory obligations regarding pension indexation (which follows the Swiss formula relying on both inflation and average wage growth) or higher nominal debt and less favourable borrowing conditions resulting in higher interest expenses. The special fiscal rules also permit further increases in public wages, with stronger raises for the Ministry of Education and Culture and the Ministry of Defence. The inclusion of revenues and expenditures of indirect users in the general government sector coverage will slightly boost the public wage bill and impact the spending on goods and services (by 0.4% of GDP). Revenues on the other hand are projected to be boosted by a sizeable one-off revenue related to the auction of 5G technology licences. Other than that, higher revenues from social contributions and VAT are expected, while revenues from corporate income tax and excises are expected to decrease slightly as a per cent of GDP (by 0.2 pps. and 0.1 pps. respectively).

The 2025 budget implements only small changes in tax policy. Revenues from wage taxes, the main form of personal income taxes, will be positively affected by a 13.7% increase in the minimum wage and the expected overall growth in wages and employment. At the same time, the non-taxable threshold will also increase by 13.7% in order to reduce the tax burden on lower incomes, resulting in a small revenue loss of some 0.14% of GDP. Social contribution revenue is also set to be boosted by the assumed growth in the wage mass, resulting in a 0.3 pps. increase in such revenue as a share of GDP. Efforts to fight against the grey economy, although expected to continue, have not been included in the projections. From 2026 onwards, the ERP anticipates the introduction of an excise tax on natural gas used for heating and powering motor vehicles.

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

	2023	2024	2025	2026	2027
Gross debt ratio [1]	48.4	47.9	47.5	47.0	46.5
Change in the ratio	-4.5	-0.5	-0.4	-0.5	-0.4
Contributions [2]:					
1. Primary balance	**0.4**	**0.8**	**0.9**	**0.9**	**1.0**
2. 'Snowball effect'	**-6.2**	**-1.9**	**-1.1**	**-1.1**	**-1.5**
Of which:					
Interest expenditure	1.7	2.0	2.2	2.1	2.0
Growth effect	-1.7	-1.7	-1.9	-1.8	-2.2
Inflation effect	-6.2	-2.2	-1.4	-1.4	-1.3
3. Stock-flow adjustment	**1.3**	**0.6**	**-0.1**	**-0.4**	**0.1**

[1] End of period, in accordance Government debt as defined by the national methodo
This includes all government-guaranteed debt and non-guaranteed local governme
It differs from government debt according to the national methodology (set out in the
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) 2025, Commission calculations.

Despite the higher deficit targets, the ERP projects the public debt ratio to continue falling. Another major revision of national accounts took place in October 2024, the third revision within ten years, with each one revising GDP upwards by 5% to 7%. The latest data published by the Ministry of Finance show that public debt dropped from estimated 52% of GDP before the revision to 47.5% of GDP[9] at the end of 2024. Due to the significant upward revision of nominal GDP data, the projected debt path has shifted downward compared to last year's ERP, which expected the debt ratio to reach 50.0% by 2026. The downward trend in the debt ratio is expected to continue in spite of the higher deficit targets and the negative primary balance of around 1% of GDP in the medium-term. The ERP expects the debt ratio to decrease slightly, to 47.5% in 2025 and further to 46.5% in 2027. The gradual decline (0.4 pps. to 0.5 pps. per year) is projected to be largely driven by strong economic growth and a lower, but still noticeable inflation effect. Higher interest expenditures due to tighter borrowing conditions are on the other hand expected to partly offset the above-mentioned debt-decreasing factors. The impact of stock-flow adjustments, which last year was estimated above 1 pp. of GDP, is for 2025 slightly negative and remains small until 2027. A large share (78.1%) of public debt remains denominated in foreign currency, therefore exposing Serbia's public debt stock to foreign exchange rate risks, which is however mitigated by the de facto stabilised exchange rate arrangement. The ERP includes an analysis of the impact of different exchange rate scenarios on debt trends for the central government level. The analysis compares the baseline projection with alternative scenarios of up to 10% appreciation or depreciation of the dinar exchange rate against a specific currency basket. For those scenarios, the projected public debt-to-GDP ratio for the central government level ranges from 42.4% to 49.7% in 2027, compared with the baseline scenario of 46.0%.

Overall, fiscal risks appear relatively balanced, but the outlined fiscal scenario is subject to some non-negligible challenges. Both revenue and expenditure projections in the ERP seem sound and credible. Revenues do not rely on the shrinking of the grey economy, although efforts will continue, and the ERP expects current tax collection efficiency levels to be maintained. The revenue expectations are however contingent on continued increases in wages and employment. Spending may be impacted by the recent major upward revision of national accounts which created significant room for more generous pension indexation and a higher public wage bill, as both items are capped at 10% of GDP. Despite the already higher deficit target, further non-budgeted ad hoc expenditure measures could be announced over the course of the year if additional spending pressures arise, notably in the context of the ongoing political crisis in the country, which led to the resignation of the Prime Minister in late January and could result in early elections unless a new government is formed by 18 April. Additionally, the looser fiscal policy stance might generate inflationary pressures, which could give rise to demands for higher spending such as on social benefits. The US sanctions against NIS, if applied, could pose another fiscal challenge that appeared only recently. The ERP acknowledges potential fiscal risks arising from court decisions and natural disasters. Expenditure on fines and damages caused by state authorities has seen a notable upward trend in the past years. Potential obligations may also arise from court decisions based on complaints filed by workers of former social enterprises in the Socialist Federal Republic of Yugoslavia (e.g. unpaid wages, interests, social security contributions). In terms of fiscal risks arising from natural disasters (earthquakes and floods), the ERP presents the

[9] ERP projected 47.9% of GDP.

results of a specific model developed in cooperation with the World Bank and providing quantified estimates of potential effects on GDP, deficit and debt.

Fiscal risks arising from SOEs remain significant, although reform efforts continue. Overall, many SOEs in Serbia (not only energy related) do not achieve significant profitability and therefore pose a fiscal risk if market conditions deteriorate. A significant contribution to the reduction of fiscal risks and the improvement of performance of SOEs is expected to stem from the new Law on SOE governance, which came into effect in September 2024, if fully implemented. Some corresponding by-laws have already been adopted, with the remaining three to be adopted by March 2025. The full implementation of the Law will require further capacity building, which will be supported by the European Bank for Reconstruction and Development. Besides the reform and restructuring of SOEs as an important step toward mitigating fiscal risks, the government has also taken steps to limit the issuance of new guarantees, of which SOEs are the prime beneficiaries. The share of guarantees in the state sector debt has declined slightly to 4.7% as of 30 September 2024 (5.0% in 2023). In 2024, only one new state guarantee for liquidity support to SOEs was issued. The ERP includes an assessment of fiscal risks of a number of SOEs, which estimates the total fiscal risk at RSD 5.1 billion and a gradually declining trend for the medium-term (reaching RSD 4.6 billion).

The Ministry of Finance continues its efforts to improve monitoring and assessing fiscal risks. The fiscal risk monitoring process is based on a methodology developed together with the World Bank, which differentiates four types of fiscal risks (arising from SOEs, local self-government units, court proceedings and natural disasters). In terms of risks arising from responsibilities of local government units, a working model has been developed and is expected to be implemented in the upcoming period. The Ministry of Finance is also working to improve the public finance control system for local governments to ensure compliance with established rules, including planning and budget execution at the local level. While the new Fiscal Risks Monitoring Department within the Ministry of Finance has expanded the coverage of its reporting on fiscal risks in the fiscal strategy for 2025-2027, it does not currently publish comprehensive reports or a stand-alone Fiscal Risk Statement.

With high projected capital expenditures of over 7% for the entire ERP period, improving public investment management and public procurement remain key challenges for Serbia. While efforts to improve the legal framework, including the adoption of the Decree on Capital Projects and four corresponding by-laws, have taken place, a genuine single project pipeline has yet to be achieved. A major deficiency in the system remains the large discretion for the government in designating investments of 'particular importance', allowing for those projects to skip the essential preparatory phase, as the definition of relevant criteria is too vague. As a result, investment decisions are still often made without the appropriate consultations, feasibility studies, cost-benefit analyses and environmental impact assessments necessary to ensure the sound use of public funds, and transparency is consistently lacking. At the same time, the system has resulted in arbitrary sectoral allocation of capital expenditures, giving less priority to important sectors such as education, environmental protection and communal infrastructure. The revised fiscal strategy 2025-2027 included for the first time a list of public investments for projects exceeding EUR 20 million, excluding defence and security. While this constitutes a first step towards increased transparency, further obligations especially regarding improved long-term planning and regular monitoring of public investments are yet to be fulfilled. Notably, it will also be important to properly budget future liabilities arising from the maintenance of public investment projects.

The public sector wage reform, according to last year's ERP scheduled for 2025 after already numerous delays, continues to be postponed. With a currently strong built-in wage compression, both the attraction and retention of especially highly qualified employees in the public sector are impaired, which could lead to a significant brain drain if reform efforts continue to be postponed. At the same time, competition from the private sector is growing, as salaries are comparatively more attractive and have seen further real growth in recent years, especially among foreign companies present in Serbia. An important preparatory step, the roll-out of the central electronic public wage and employment registry, Iskra, has progressed somewhat, with the inclusion of local government units and their indirect budget users in the system. The remaining sectors not yet included are defence, security and internal affairs as well as higher education institutions. According to the ERP, their inclusion will however only be completed by 2027. Based on the data from Iskra, it would be possible to analyse different reform scenarios and use this as a basis for specific reform steps.

A large recruitment campaign has been launched in the tax administration to address the urgent staffing needs. The campaign includes significant changes in the job classification system and an eased hiring system to allow for the recruitment of highly qualified staff in a timely manner, which has so far been hindered by inadequate salaries for some categories of employees compared to the private sector. Further progress has also been made regarding reform of the tax administration, including the re-launch of a tender for the procurement of a new information system with the support of the World Bank. Conditions for cross-analysis of personal property and income have been created and first audit cases have been completed in 2024. Ongoing analysis of the VAT gap and corporate tax gap focuses currently on data shortcomings and adjusting analytical tools.

Box: Sensitivity analysis

The ERP presents a sensitivity analysis of both the deficit and the debt in line with the presented alternative macroeconomic scenario featuring lower growth rates compared to the baseline. The alternative scenario refers to the materialisation of negative risks from the international environment, such as trade restrictions and the escalation of the conflicts in Ukraine and the Middle East. Additional domestic risks have not specifically been considered for the analysis. The analysis shows that slower growth, mainly due to its impact on revenues, especially from income and consumption taxes, would result in a public debt ratio of 49.0% in 2027 (instead of 46.5%) and a higher deficit of 4.4% (instead of 3.0%).

Budgetary practices need improvement to strengthen the transparency and quality of public finances. The 2024 supplementary budget has again been adopted using the fast-track procedure. The repeated use of this practice has once again been justified by Serbia as necessary to guarantee the timely payment of government expenses. The fast-track procedure results in limited time for analysis as well as for meaningful debate and hence lacks sufficient involvement of the Parliament and the general public. The consistent use of this practice in almost every year cannot be seen as justified. Similarly, the debate on the annual budget for 2025, while broadly in line with the procedure, also lacked inclusion of the opposition and quality of debate. In addition to that, the 2025 budget was supposed to include for the first time a presentation of tax expenditures; however, this has been postponed by two years according to the amended Budget System Law. The lack of these data complicates understanding of how revenue foregone through the tax code affects overall revenue and the distribution of related benefits. Another common practice impacting the quality of public finances in Serbia remains the use of the contingency reserve, which is legally capped at 4% of budget revenue. This cap, which in the past stood at 2% (and then 2.5%), is comparatively high and allows therefore for substantial ad hoc spending decisions during the year. At the same time, restrictions on the use of the contingency reserves are lacking and the funds are often spent in an untransparent way due to inadequate reporting. The Ministry of Finance has also not started to provide in-year reports on budget execution per budget beneficiary, although this is required by the amendments to the Budgetary System Law.

Postponing the application of the deficit component of the fiscal rules until 2029 risks undermining the credibility of the recently adopted fiscal governance framework. The new set of fiscal rules was adopted in December 2022, with the deficit rule only set to enter into force in 2025 since specific deficit targets for 2023 and 2024 had already been agreed in the Stand-By Arrangement with the IMF. Under the new Policy Coordination Instrument concluded on with the IMF in the end of 2024, new deficit targets have also been set for the periods from 2025 to 2027 (3.0%) and from 2028 to 2029 (2.5%). The resulting postponement of the application of the deficit rule until 2029 threatens to leave the door open for further delays. While continued high public capital spending is justified because of high investment needs, the loosening fiscal stance coincides with robust economic growth projected for the years ahead and could further add to inflationary pressures and external imbalances. In addition to that, as the ERP acknowledges, higher borrowing costs require also caution in conducting fiscal policy. On the positive side, the well-established Fiscal Council continues to function properly, and a new president has been elected as well as the mandate of one member renewed, in line with the procedures. The Fiscal Council has continued to closely monitor fiscal policies in the country, producing independent reports and recommendations.

4. MAIN MACRO-RELEVANT STRUCTURAL CHALLENGES

The Commission approved the Reform Agenda of Serbia in October 2024. In its Reform Agenda, Serbia commits to socio-economic and fundamental reforms to spur growth and convergence with the EU under the Growth Plan during the period from 2024 to 2027. Subject to the implementation of these reforms, under the Reform and Growth Facility[10], the allocation for Serbia amounts to EUR 1.58 billion with EUR 455.3 million planned in grants and EUR 1.13 billion in concessional loans. Serbia's Reform Agenda is aligned with the structural reforms that are part of the 2024 ERP as well as the Policy Guidance jointly agreed upon at the Economic and Financial Dialogue of May 2024. In

[10] https://eur-lex.europa.eu/eli/reg/2024/1449/oj/eng

this context and with a view to ensuring an integrated surveillance of Serbia's economy, this chapter briefly outlines the main structural challenges facing the country.

Substantial structural challenges persist in fundamental areas such as rule of law, the justice system and the fight against corruption, with adverse impacts on Serbia's business environment. Businesses continue to be affected by a lack of transparency and predictability regarding the adoption of business-related legislation, including through unexpected and non-transparent changes in the legal framework, often without consultation procedures. This general lack of predictability of policy and political decisions is currently being exacerbated by various ad hoc policy responses to the ongoing protests in Serbia (in themselves a reaction to the many unaddressed structural issues in the fundamental area in particular). Similarly, shortcomings remain in the quality, independence and efficiency of the justice system, exemplified by unreliability in contract enforcement and inconsistency in rules, hence making it difficult to create a predictable investment- and business-friendly environment in Serbia. Staffing issues remain, with a considerable number of vacancies for judges and prosecutors yet to be filled. Red tape, political interference and limited public administration efficiency constitute further barriers. In terms of fighting corruption, in 2024 Serbia continued its trend of steady deterioration by one place, ranking 105th out of 180 countries in the corruption perception index compiled by Transparency International, down from 87th in 2018. The legal framework on the fight against corruption is in place but shortcomings exist regarding preventive measures and law enforcement. A national anti-corruption strategy for the period from 2024 to 2028 was adopted in July 2024, aimed at strengthening the track record in fighting corruption, including for high-level cases. The accompanying action plan for 2024-2025 was adopted in December 2024. However, an action plan for the remaining period up to 2028 is pending. Dispelling doubts about Serbia's strategic direction, including by improving its low alignment with the EU's common foreign and security policy, and advancing on the EU accession path would also greatly contribute to improving the business and investment climate.

Further issues hampering the business environment and private sector development include public investment management, public procurement procedures and State aid as well as large and inefficient SOEs. Deficiencies in the transparency, appraisal, and prioritisation of public investment continue to exist. For example, Serbia continues to fall short of developing a genuine single pipeline for all capital investment management due to several critical exemptions maintained in the decree on capital projects and has committed to amend its legal framework under the Reform Agenda. Public procurement processes similarly lack transparency and fair competition and continue to be marked by numerous exemptions from standard procedures including through intergovernmental agreements and special laws. In particular, the Law on special procedures for the implementation of EXPO-related projects, adopted in October 2023, exempts projects from the application of the Law on public procurement. The public budget for the organisation of EXPO 2027 also lacks transparency. In April 2024 a new EXPO 2027 module was launched on the public procurement portal, aimed at providing more transparency for EXPO-related procurement procedures. However, this concerns only smaller contracts as most of the infrastructure is contracted under Serbia's governmental agreement with China. Under the Reform Agenda, Serbia has committed to publish contracts of projects conducted under intergovernmental agreements starting from December 2024, and to repeal all special laws by June 2027. State-aid rules, while well-defined, lack consistent implementation due to strong political pressure to provide financial assistance to SOEs and large foreign investors. SOEs continue to dominate many structurally important sectors such as energy, transport, telecommunications and finance, which affects resource allocation and impedes overall competitiveness. Many of them operate with low efficiency and high costs, often relying on direct or indirect government subsidies which creates major fiscal risks. Corporate governance rules are often not applied properly. First steps have been taken to implement the new Law on SOE governance, including by drafting several necessary by-laws. However, reforms concerning the ownership and management of SOEs are advancing at a slow pace and outstanding by-laws need to be adopted in line with the new Law and implemented in line with Serbia's commitments in the Reform Agenda.

The energy sector struggles with largely outdated infrastructure, overreliance on coal and high dependency on Russia in the gas and oil sectors. Dominated largely by SOEs, the inefficient energy sector continues to weigh on the state budget. The outdated energy infrastructure needs major investments, and energy supply continues to rely on carbon-intensive and highly polluting coal, with slow progress on the regulatory and green transitions. The national energy and climate plan was adopted in July 2024, setting goals for a higher share of renewables in final energy consumption and reduced greenhouse gas emissions. Serbia is taking steps to introduce a carbon tax by 2027 as a step towards reducing its carbon intensity, and progress has been achieved with the monitoring, reporting, verification and accreditation obligations. However, introducing the EU's Carbon Border Adjustment Mechanism will still require Serbian exporters to further reduce the carbon footprint of their exports to the EU. To move energy tariffs toward cost recovery, the fixed electricity price introduced in the unregulated sector during the energy crisis was removed in May 2024 and a new pricing system by EPS (the main, state-owned, electricity producing company), based on regional market prices, was implemented in November 2024. Similarly, in the gas sector, Srbijagas adopted a new gas pricing system for the unregulated sector, with implementation starting in late 2024. Important steps have been taken to diversify gas import sources, with the completion and licensing of the gas interconnector with Bulgaria. However, dependence on Russia, including in the ownership structure of critical infrastructure, is still too high. This dependency exposes Serbia to notable risks, as demonstrated by the possible imposition of US sanctions on oil company NIS due to its Russian ownership. At the same time, a new long-term gas contract between Serbia and Russia is being negotiated.

Serbia's digital transformation across the economy is well under way, but some obstacles remain. Rural areas remain underdeveloped in terms of digital connectivity infrastructure, but the ultra-fast broadband communication infrastructure roll-out has progressed somewhat. A law on broadband, aimed at aligning Serbia with the Gigabit Infrastructure Act, is yet to be adopted. Digital government services are already well developed, and Serbia has continued to introduce new e-government services and upgraded the government service information portal. Preparation for the roll-out of an interoperable Digital Identity Wallet is ongoing in line with Serbia's commitments in the Reform Agenda. Likewise, preparation for the 5G frequency auction and creation of necessary preconditions for the deployment of 5G have taken place, with Serbia yet to adopt implementing legislation on minimum conditions for issuing individual operator licences for spectrum use for the 5G frequency auction. Improving digital skills and literacy among adults remains key for addressing skills mismatches on the labour market.

Although labour market outcomes have continued to improve, skills mismatches and brain drain continue to pose challenges for Serbia. The unemployment rate fell to 8.6%[11], near historic lows, while employment reached 51.4%. However, youth unemployment (ages 15-24) still stood high, at 25.8% compared to the EU average of 15.0%[12]. The share of young people neither in employment nor education or training (NEET) remained also relatively significant[13]. Ongoing reform efforts committed to in the Reform Agenda are consequently aimed at improving the employability of young people, including improving the legal framework for internship programmes as well as the implementation of the Youth Guarantee programme, which offers subsidised employment, training and internships. So far, a pilot Youth Guarantee scheme has started in three employment offices in January 2024. At the same time, the quality and relevance of education and training still needs improvement to meet labour market needs. The implementation of the education strategy for 2030 is ongoing, which includes the current modernisation of vocational education and training. Emigration also remains a long-standing problem, which Serbia has attempted to address by offering incentives such as tax relief for employers who hire highly skilled diaspora. Overall, budget allocations for active labour market policies in 2024 remained low at around 0.1% of GDP. Both unemployment benefits and subsidised job activation measures are relatively low compared to the EU average.

5. Consistency of the Reform Agenda with the ERP's macro-fiscal framework

Serbia's efforts to provide estimates for the expected impacts of several key reforms outlined in the Reform Agenda are commendable. Despite acknowledging the challenges in quantifying the specific effects of many reforms due to their often-intangible nature, Serbia included expected economic impacts of four key reforms in the ERP. The presented estimates have been prepared in cooperation with the Centre of Excellence in Finance in Ljubljana, Slovenia. Notably, the estimates only refer to macro impacts such as the impact on GDP growth, job creation and employment, while no estimates for fiscal impacts have been made yet.

The reforms included are linked to three of the four main areas of the Reform Agenda. The first identified key reform, as part of fostering private sector development, refers to the development of an advanced scientific and innovation ecosystem, namely by financing 3 400 researchers and 600 innovative companies to increase the private sector's share in total research and development (R&D) investment from 43.7% in 2022 to 50% by the end of 2026. Referring to empirical studies' findings of a positive correlation between R&D investment and GDP growth, the ERP estimates an effect on long-term GDP growth from 0.067 pps. to 0.137 pps. A second estimate has been made for the

[11] All labour market data refer to Q4 2024.

[12] Source: Eurostat. EU average for December 2024.

[13] 15.9% for ages 15-29.

impact of new capacities to produce green energy, namely the installation of at least 1.5 GW of solar and wind energy by December 2026. Citing an investment multiplier of 1.12 to 1.73 for the estimated investment value of RSD 230 billion, the ERP suggests a contribution to potential GDP growth of 2.4 pps. to 3.6 pps. and the creation of 15 thousand jobs. A third reform, as part of the digital transformation, focuses on digital infrastructure. In reference to empirical studies and based on an estimated investment value of around RSD 15 billion in 5G infrastructure, the ERP projects a contribution of 0.35 pps. to GDP growth and the creation of roughly 12 thousand jobs. Lastly, the ERP includes impact estimates for a reform aimed at improving the employability of young people by improving the legal framework for internship programmes and strengthening the Youth Guarantee programme. With the target of reaching 30% of current NEETs by 2027, the measure is expected to create around 17 thousand new jobs and an increase in total employment by 0.6%.

The macro impacts provided in the ERP seem broadly plausible, with one exemption. The estimates for the reform aimed at increasing the private sector's spending R&D predict a positive contribution to long-term GDP growth of 0.011 pps. to 0.022 pps. per one per cent increase in the private sector's share in total R&D investment. This seems prudent given that empirical studies[14] suggest that an increase of one per cent in overall business R&D generates 0.13 pps. in productivity growth. Similarly, the estimated impact for the roll-out of digital infrastructure is in line with the findings from the literature[15], which specifically refers to digital transformation in Serbia and other Western Balkan countries. The reform on improving the employability of young people, whose targets are in line with the steps agreed under the Reform Agenda, does not yet provide estimated effects on GDP, but focuses on job creation and employment growth. The estimates would be the result of successful implementation of the targets set out in the Reform Agenda. While estimates for the above-mentioned reforms seem broadly sound, the suggested impact from the reform on increased production of green energy seems fairly optimistic. However, the applied investment multiplier of 1.12 to 1.73 seems to be broadly in line with empirical research, which suggests a multiplier for spending on green energy to range between 1.1 to 1.5[16]. Nevertheless, it is important to point out that the outlined numbers cannot be understood as a net effect on GDP growth, as the estimate does not consider lower electricity production from other sources. The overall net impact on output is therefore significantly lower than described. Importantly, none of the presented macro impacts are included in the current ERP projections since most of the investments will take time to be concluded.

There is sizeable scope for the analysis to be further developed. Notably, next year's ERP could also elaborate on the links between the Reform Agenda and the fiscal framework as for 2025 no estimates for fiscal impacts have been presented. There is also

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14 OECD (2001). R&D and Productivity Growth: Panel Data Analysis of 16 OECD Countries.

15 digital WB6+ (2018). The Impact of Digital Transformation on the Western Balkans: Tackling the Challenge towards Political Stability and Economic Prosperity.

16 IMF (2021). Building Back Better: How Big Are Green Spending Multipliers?.

scope for Serbia to include estimates for several additional reforms from all four areas covered by the Reform Agenda, notably including ones from the area of fundamentals, as well as further reforms aimed at improving the business environment and private sector development. While immediate quantification of the expected effects of those reforms is admittedly more challenging, the successful implementation of some of them has significant potential to contribute positively to both macro and fiscal outcomes. In next year's ERP, it would therefore be beneficial to address these gaps and provide additional quantitative analysis, as well as explicit discussions of the methodologies used to estimate the impacts of the reforms.

ANNEX 1: OVERVIEW OF THE IMPLEMENTATION OF THE POLICY GUIDANCE ADOPTED IN THE PREVIOUS YEAR

Every year since 2015, the Economic and Financial Dialogue between the EU and enlargement partners has adopted targeted policy guidance for all partners. The guidance represents the participants' shared view on the policy measures that should be implemented to address macro-fiscal vulnerabilities and structural obstacles to growth. The underlying rationale of the guidance is similar to that of the country-specific recommendations usually adopted under the European Semester for EU Member States. Implementation of the guidance is evaluated by the Commission in the following year's ERP assessments.

The following table presents the Commission's assessment of the implementation of the 2024 policy guidance jointly adopted at the Economic and Financial Dialogue between the EU and the Western Balkans Partners, Türkiye, Georgia, Republic of Moldova and Ukraine at ministerial level on 14 May 2024.

Overall: Partial implementation (61.1%) [17]	
2024 policy guidance (PG)	**Summary assessment**
PG 1: Keep an appropriately tight fiscal stance in 2024 to help disinflation and strictly adhere to the new fiscal rules in order to enhance their credibility.	There was **partial implementation** of PG 1: **1) Limited implementation**: In the supplementary budget for 2024, the government increased the deficit target from 2.2% to 2.7% of GDP due to the allocation of significant funds to defence and public investments. However, the preliminary budget outcome was better, with the deficit standing at 2% of GDP. Additionally, in agreement with the IMF, Serbia has loosened its medium-term fiscal ceiling to a deficit of 3% of GDP until 2027 in order to accommodate the planned public investments under the 'Leap into the Future - Serbia 2027' programme. The implementation of the deficit component of the fiscal rule has as such been postponed from 2025 to 2029. That said, the fiscal rule with regard to pension and public wage expenditures has been enforced. Despite the higher deficit targets, public debt is not expected to rise in 2025-2027.
Implement the action plan for 2023- 2026 to	**2) Partial implementation**: The good practice that

[17] 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. This is available at https://ec.europa.eu/info/publications/economy-finance/2017-economic-reform-programmes-commissions-overview-and-country-assessments_en.

strengthen medium-term budgeting, inter alia by developing tools and methodology for a stable strategic fiscal planning. Appoint members of the Fiscal Council following the recent expiry of some of their mandates.	started with the 2024 Budget Law of including information on ceilings set for budget users for the year in question as well as estimates for the next two years, has continued with the 2025 Budget Law. The indicative limits for the outer two years served as starting point for budget discussions with line ministries. Work on strengthening the budget baseline estimation methodology is continuing. The authorities announced a completion of the multi-year commitment registry in SPIRI (budgeting and accounting system). A new green tagging methodology was applied for the first time for the 2025 budget. However, the three year fiscal strategy, which constitues a medium-term fiscal framework for budget preparation, is subject to frequent changes, even within weeks after adoption and after it is analysed by the Fiscal Council, undermining the credibility of this strategic fiscal document. **3) Full implementation:** A new President of the Fiscal Council's was appointed in July 2024, as well as a new mandate given to one of the current members of the Council whose mandate had expired. The Fiscal Council as such is again in its full mandate.
PG 2: Adopt the necessary by-laws to fully implement the new SOE Law and strengthen SOE governance, reducing the associated fiscal risks. Reinforce fiscal risk analysis and management capacity, fully implement the risk methodology and publish comprehensive fiscal risk reports.	There was **partial implementation** of PG 2: **1) Partial implementation:** The Law on Governance of state-owned enterprises (SOEs) came into force on 16 September 2024. As per the Law, a structural benchmark under Serbia's IMF programme and developed in line with OECD guidelines, the government adopted three related by-laws to support its implementation. The regulations include detailed stipulations regarding the required qualifications, appointment procedures, training requirements and other details for SOE management; the requirement and criteria under which all SOEs are to transform into either a limited liability company or a joint-stock company within 30 days; and a list of classification of SOEs which will be put under the newly established 'central management system'. This has marked 42 companies as being of national interest (e.g. electricity & gas utilities, railways), 75 companies as being of special interest (e.g. national parks, property management, rehabilitation centres) and 15 companies in which the government will maintain a minority share (e.g. Belgrade Waterfront, NIS, Zijin copper). A total of 11 by-laws are expected to be adopted to fully implement the new legislative framework. **2) Partial implementation:** The Fiscal Risk Monitoring unit has been integrated into the budget department and the methodological work has progressed. Although authorities report on challenges with data and models, efforts were invested in improving, standardising and further expanding fiscal

	risk reporting in the fiscal strategy for 2025-27. Forward-looking elements to the fiscal risk section were added in the revised fiscal strategy for 2025-27 and intentions are to continue to further quantify fiscal risks to support fiscal planning. The treatment of fiscal risks (public companies, lost court cases), and the introduction of new informative items, e.g. detailed listing of subsidies to public companies and (for the first time) medium-term projections for expenditures on fines and penalties formerly presented as 'other current expenditures' are improvements in the 2025 fiscal strategy. Consultations with the World Bank on risk quantification, modelling and structuring reports on risk monitoring have continued. MoF intends to continue using the recently developed methodology for managing fiscal risks associated with the state-guarantee schemes.
Building on progress with the electronic public wage and employment registry, implement the preparatory steps towards an appropriately designed public sector wage system reform.	**3) Partial implementation:** The government has continued to expand the Iskra registry, which now also includes local self-government units including indirect beneficiaries. The authorities intended to publish an initial report on the structure of public wages and employment by end-March 2025 (as part of Serbia's IMF arrangement) which is to serve as the basis for a wider public wage reform. However, the publication of this report has so far been delayed.
PG 3: Ensure a sufficiently tight monetary policy stance as long as necessary to anchor inflation expectations at levels consistent with price stability, underpinned by a thorough assessment of possible second-round effects.	There was **substantial implementation** of PG 3: **1) Full implementation:** The central bank has continued to carefully assess price developments and has managed to bring inflation back to the target band via a sufficiently tight monetary policy stance.
Further enhance risk-based supervision in line with best international and European practices, including by further strengthening the reporting framework across the banking system, phase out temporary measures affecting market mechanisms in setting mortgage interest rates and foster NPL resolution including by further developing the secondary market for NPLs.	**2) Partial implementation:** The authorities have continued to enhance the regulatory and supervisory framework. The most significant novelty was the establishment of the Bank Resolution Fund, a protective mechanism for the recovery and resolution of credit institutions and investment firms. However, there was no progress on reducing remaining obstacles to NPL resolution, such as further facilitating the sale of retail NPLs or improving judiciary processes, but asset quality continued to improve. Temporary measures affecting market mechanisms in setting mortgage interest rates are still in place.
Continue efforts to promote the use of the domestic currency, including by enhancing long-term financing in domestic currency, further encouraging forex hedging and raising awareness of risks related to forex lending.	**3) Substantial implementation:** The authorities continued fostering the development of local bond markets and encouraged dinar-denominated deposit and loan growth. Nevertheless, currency substitution remains high.

ANNEX 2: COMPLIANCE WITH PROGRAMME REQUIREMENTS

The government adopted the economic reform programme (ERP) on 26 December 2024 and formally submitted it to the Commission on 15 January 2025. The programme is in line with the medium-term fiscal strategy and the 2025 budget and covers 2025-2027.

Inter-ministerial coordination

Preparation of the 2025-2027 ERP was coordinated by the Ministry of Finance. Deputy Prime Minister and Minister of Finance Siniša Mali remained as national coordinator and head of the Working Group for the development and monitoring of ERP implementation. The membership of the Working Group was renewed and includes representatives of the Ministry of Finance, the National Bank of Serbia, the Ministry of Economy, and the Statistical Office of the Republic of Serbia.

Stakeholder consultation

The national authorities involved stakeholders in the preparation of the document. For the duration of two weeks, from 29 November to 13 December 2024, the draft ERP document was made available for public review via the Ministry of Finance's website. Stakeholders were invited to provide comments through an online e-consultation portal. Comments were submitted by Transparency Serbia and have been annexed to the ERP and accepted. A large number of suggestions and comments of interested parties from the previous cycle were taken into account in the current ERP cycle.

Macro framework

The programme presents a clear and concise picture of past economic 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 present at the time of writing are clearly outlined and recognised. The programme presents an alternative macro-fiscal scenario that results in lower economic growth and higher budget deficit and debt levels. The alternative scenario appears very relevant in view of the identified risks in a context of high global uncertainty.

Fiscal framework

The fiscal framework, which is based on the baseline medium-term macroeconomic scenario, is sufficiently comprehensive and integrated with the overall policy objectives. Most revenue and expenditure measures are sufficiently explained, although the budgetary 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 that the fiscal data are compatible with the European System of Accounts 2010.