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EUROPEAN  
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Brussels, 20.4.2022  
SWD(2022) 124 final

**COMMISSION STAFF WORKING DOCUMENT**

**ECONOMIC REFORM PROGRAMME**

**OF**

**SERBIA  
(2022-2024)**

**COMMISSION ASSESSMENT**

The economic reform programme (ERP) was submitted on 31 January 2022.

The economic consequences of Russia’s war against Ukraine may render the macro-fiscal scenarios presented in the ERP partially obsolete. The Commission will publish its updated macroeconomic and fiscal projections for candidate countries, reflecting the expected impact of the war against Ukraine and related sanctions, in its spring economic forecast in mid-May 2022.

The short-term macro-fiscal outlook may change considerably. However, the major medium-term fiscal and structural reform challenges and priorities identified in this assessment remain valid irrespective of the short-term outlook. Appropriate policy responses are essential to ensure a sustained economic recovery, greater resilience and fiscal sustainability.

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## 1. EXECUTIVE SUMMARY

**After a strong rebound in 2021, Serbia's economic reform programme (ERP) forecasts the economy will grow more quickly in 2022-2024 than before the COVID-19 crisis.** After a relatively mild contraction in 2020, the economy rebounded strongly in 2021 thanks to higher private consumption, investment and government consumption. The ERP projects further strong GDP growth of close to 5% on average in 2022-2024, i.e. around one percentage point (1 pp.) above the pre-crisis growth rates, driven by private consumption, investment and exports. Mostly due to rising food and energy prices, consumer price inflation surged from 3% to almost 8% in the second half of 2021 but the ERP expects it to slow to more moderate levels as of mid-2022. The current account deficit broadly stabilised in 2021 and is expected to widen only slightly in 2022-2024. The financial sector has recorded further credit growth while macro-prudential risk indicators have remained sound. In a context of high uncertainty, the growth outlook for 2022 is, as elsewhere, subject to a series of downside risks associated with Russia's war against Ukraine, the future course of the COVID-19 pandemic, global inflationary pressures and potentially tightening financial conditions. War-related risks in particular could push energy and food prices even higher and affect external trade by holding back growth in Serbia's main EU trading partners.

**The fiscal strategy projects a gradual return to a budget close to balance over the medium term.** The strong economic rebound and lower fiscal support measures led to a marked decrease in the general government deficit to 4.1% of GDP in 2021, despite strong increases in capital expenditure. The 2022 budget aims to further lower the deficit, to 3% of GDP, mostly through the non-renewal of COVID-19 crisis support. Further gradual fiscal consolidation is projected to bring the budget close to balance in 2023 and 2024, mainly as a result of expenditure growing more slowly than nominal GDP. The debt-to-GDP ratio slightly decreased to 57.1% in 2021 and is expected to decline further in 2022-2024. Significant gaps in fiscal governance remain unaddressed, mainly concerning 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 backed up by reforms.** Serbia has been able to very substantially mitigate the COVID-19 crisis by using available fiscal buffers and is projected to go on achieving good macro-fiscal results. Given the high degree of uncertainty about potential further pandemic effects and the impact of Russia's war against Ukraine, standing ready to provide crisis mitigation if needed seems appropriate. A gradual return to a budget close to balance, contingent on the economic outlook, is key to rebuilding fiscal space in the medium term. For medium-term expenditure restraint, containing spending on wages continues to be a key challenge. Overall fiscal performance has been sensitive to the economic and political cycle over the last two decades, so well-designed fiscal rules could provide a more effective framework for public finances and help institutionalise sound fiscal policies.
- **There is further scope for managing fiscal risks and improving revenue administration.** Greater transparency around fiscal risks would make them easier to address. This is particularly true for state-owned enterprises, where there are governance deficiencies and incomplete restructuring and privatisation that still represent a

substantial risk to public finances. On the revenue side, there is scope for further improvements in the tax administration.

- **Serbia's business environment is improving, with the regulatory and administrative burdens easing, but significant structural challenges continue to hamper competitiveness and growth potential for the private sector and the economy as a whole.** The role of the state in the economy is decreasing but still remains widespread, with privatisation efforts and efforts to improve the management of state-owned enterprises lagging behind. Structural challenges remain for state aid, competition and public procurement, where existing legislation is good but is not implemented consistently enough and can be circumvented through special procedures. Further efforts are needed to improve the transparency, assessment and prioritisation of public investments. Business is also affected by a lack of transparency and predictability in the way business-related legislation is adopted. The shadow economy remains a major impediment to the development of a strong business sector and the consolidation of a functioning market economy.
- **Serbia remains highly dependent on coal and, though work has begun to address this, there is still no joined-up long-term strategy combining 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 is a big concern in the country. Major investment is needed to modernise the country's energy infrastructure and lower carbon emissions with a view to accelerating the green transition. More must be done to diversify supply and Serbia's overall energy mix and especially to reduce dependency on Russian gas.
- **The share of young people not in employment, education or training remains high.** School-to-work transitions are considerably more difficult than in the EU on average. The introduction of the Youth Guarantee aims to address these challenges, support labour market integration and ensure that no young person is left behind. At the same time, workers from across the occupational spectrum continue to emigrate. The low labour market participation of women remains an issue. In addition, the number of people at risk of poverty remains high, and public expenditure on social protection is not sufficient.

**The policy guidance in the conclusions of the economic and financial dialogue of July 2021 has been partially implemented.** The authorities provided substantial additional, but mostly untargeted, pandemic-related fiscal support in 2021, while the 2022 budget and medium-term fiscal strategy effectively plan a gradual return to a deficit close to balance. Following a decline in 2021 due to high nominal GDP growth, overall spending on wages as a percentage of GDP is projected to remain stable, but no wage indexation mechanism has been adopted and public-sector wage system reform has been postponed to 2025. The adoption of new fiscal rules has also been postponed by another year due to the COVID-19 crisis. Deadlines for the new model of electronic fiscalisation and transition to electronic invoicing have broadly been met. While the Ministry of Finance appears to have brought in a more robust fiscal risk analysis, the results do not seem to have been made publicly available. The first steps in the action plan for the new state-owned enterprise ownership and management strategy have been partially implemented. Serbia is still not prioritising investments in a harmonised manner based on relevant assessments, and issues remain in the areas of competition and state-aid, as well as in the area of public procurement where the special law on linear infrastructure projects remains in place. The work to develop a

long-term energy and climate strategy is only slowly progressing, and the renewable energy sources auction system has been delayed. There was no measure to increase the adequacy of benefits for individuals and families under the financial social assistance scheme to reduce poverty. Partial progress has been made to facilitate school-to-work transitions by stepping up further vocational education and training and to develop a Youth Guarantee implementation plan.

**The economic reform programme is aligned in part with the reform priorities identified by the Commission.** The macroeconomic and fiscal frameworks are sufficiently comprehensive and integrated with overall policy objectives, providing a suitable basis for policy discussions. 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 and introduces a new welcome reform measure aimed to improve the management of SoEs. The ERP also lacks ambitious reforms on the green transition including regarding clean energy transition and energy efficiency, which has been identified as one of the key structural challenges. The shared European growth model regarding green and digital transition will also have to be reinforced in the ERP process, even more so in the current geopolitical context. On digital transformation, Serbia should now focus on well-targeted reforms and improving Serbia's communications infrastructure, particularly broadband roll-out. The ERP diagnoses the challenges in the areas of social protection and poverty reduction, education, employment and social policies, but the proposed measures lack clearly defined objectives.

## **2. ECONOMIC OUTLOOK AND RISKS**

**After a relatively mild contraction in 2020, the Serbian economy recorded a strong rebound in 2021 to well above its pre-COVID-19 crisis level.** Real GDP growth in 2021, reaching 7.4%, was mostly driven by increases in private consumption, gross fixed capital formation and public consumption that were only slightly offset by a negative contribution of net exports to growth. The rebound of private consumption was particularly supported by a new fiscal stimulus programme worth around 2% of GDP and additional liquidity support measures of similar size. On the supply side, the recovery was chiefly driven by services, construction and industry. After the record harvest in 2020, which created a high base, the drought-hit agriculture sector had a negative contribution to GDP growth. Following a decrease in the unemployment rate in 2020, driven by falling labour market participation, the annual unemployment rate recorded a slight increase in 2021 as the pace of return of discouraged workers to the labour market initially exceeded the growth of employment.

**The ERP baseline scenario forecasts that the pace of output expansion will significantly exceed pre-COVID-19 crisis growth rates in 2022-2024.** Following a projected 4.5% expansion in 2022 (half a percentage point (0.5 pps.) above the projection in the previous ERP), annual GDP growth is projected to accelerate further to 5.0% annually in 2023 and 2024, around 1 pp. above the pre-crisis rate (that was also the baseline projection for 2023 in the previous ERP). The strong and accelerating post-crisis expansion is expected to be mostly driven by private consumption and gross fixed capital formation and to be accompanied by better net export figures. Export growth is expected to substantially exceed import growth, by around 2 pps. annually. As a result, the contribution of net exports to GDP growth is expected to turn positive in 2022 and reach

0.4 pps. in both 2023 and 2024, in spite of the structurally higher share of imports in GDP. After closing in 2021 due to the strong rebound, the output gap is projected to remain close to balance in 2022 and thereafter as potential growth and real growth are projected at similar levels, mostly due to a sharp rise in total factor productivity. In line with the steady expansion, the annual unemployment rate is projected to resume its pre-crisis downward trend as of 2022, decreasing by 1 pp. annually to 8% in 2024.

**Some aspects of the macroeconomic scenario seem optimistic, particularly in a context of high uncertainty.** The growth outlook continues to be affected by a high degree of uncertainty around the recovery from the COVID-19 pandemic and the economic impact of Russia's war against Ukraine. Overall, before the war, the macroeconomic scenario appeared plausible for 2022 and somewhat optimistic thereafter. The projected strong growth in imports appears in line with rising investment and private consumption and the recent track record of import elasticities. However, the expected positive contribution of net exports to growth crucially hinges on a further substantial expansion of new export capacities. Potentially protracted supply chain bottlenecks in main trading partners, particularly the EU, may also weigh on export performance. As regards potential growth, while FDI inflows, domestic innovative activity, digitalisation and structural reforms may indeed increase the contribution of total factor productivity to potential growth rates, the strong projected annual increase in GDP as of 2022 nonetheless appears challenging in view of the substantially lower pre-crisis track record under similar conditions. Real growth might, accordingly, be constrained at some point by limitations in potential growth, which may then also entail additional inflationary pressures.

Table 1

**Serbia - Comparison of macroeconomic developments and forecasts**

	2020		2021		2022		2023		2024	
	COM	ERP	COM	ERP	COM	ERP	COM	ERP	COM	ERP
<b>Real GDP</b> (% change)	-0.9	<b>-0.9</b>	6.7	<b>7.0</b>	4.3	<b>4.5</b>	4.3	<b>5.0</b>	n.a.	<b>5.0</b>
<i>Contributions:</i>										
- <b>Final domestic demand</b>	-1.3	<b>-1.3</b>	7.6	<b>8.2</b>	4.6	<b>4.4</b>	4.5	<b>4.6</b>	n.a.	<b>4.6</b>
- <b>Change in inventories</b>	0.3	<b>0.3</b>	0.0	<b>-0.5</b>	-0.1	<b>0.0</b>	-0.1	<b>0.0</b>	n.a.	<b>0.0</b>
- <b>External balance of goods and services</b>	0.1	<b>0.1</b>	-1.0	<b>-0.7</b>	-0.2	<b>0.2</b>	-0.1	<b>0.4</b>	n.a.	<b>0.4</b>
<b>Employment</b> (% change)	-0.2	<b>-0.3</b>	2.0	<b>1.2</b>	1.1	<b>1.1</b>	1.0	<b>1.2</b>	n.a.	<b>1.2</b>
<b>Unemployment rate</b> (%)	9.0	<b>10.1</b>	10.7	<b>11.0</b>	10.0	<b>10.2</b>	9.2	<b>9.1</b>	n.a.	<b>8.0</b>
<b>GDP deflator</b> (% change)	2.4	<b>2.4</b>	4.8	<b>4.7</b>	4.1	<b>3.0</b>	3.0	<b>2.9</b>	n.a.	<b>2.8</b>
<b>CPI inflation</b> (%)	1.6	<b>1.6</b>	3.6	<b>4.0</b>	3.6	<b>4.9</b>	2.6	<b>3.0</b>	n.a.	<b>3.0</b>
<b>Current account balance</b> (% of GDP)	-4.1	<b>-4.1</b>	-4.4	<b>-4.1</b>	-4.3	<b>-4.4</b>	-4.1	<b>-4.4</b>	n.a.	<b>-4.8</b>
<b>General government balance</b> (% of GDP)	-8.0	<b>-8.0</b>	-4.9	<b>-4.9</b>	-2.7	<b>-3.0</b>	-1.6	<b>-1.5</b>	n.a.	<b>-1.0</b>
<b>Government gross debt</b> (% of GDP)	57.8	<b>57.8</b>	58.1	<b>58.2</b>	56.3	<b>56.5</b>	54.1	<b>55.3</b>	n.a.	<b>53.8</b>

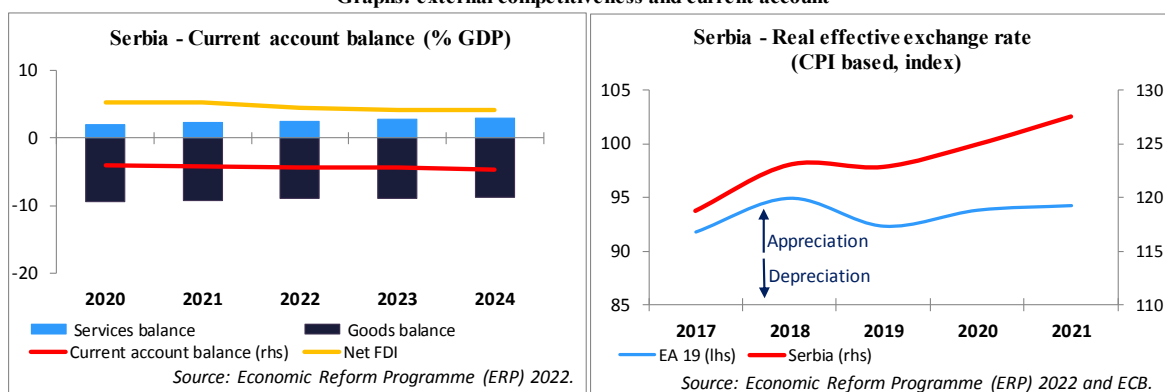
Sources: Economic Reform Programme (ERP) 2022, Commission Autumn 2021 forecast (COM).

**The ERP presents a clear and comprehensive view of economic risks prior to the impact of Russia's war against Ukraine and it includes a detailed alternative macroeconomic scenario.** The programme identifies numerous risks to the baseline scenario largely related to uncertainty about the future course of the pandemic and the effectiveness of policy responses. The chief outlined risks are: potential new waves of the pandemic, rising energy and commodity prices, persistent supply chain bottlenecks and labour market imbalances that could accelerate global inflation and potentially tighten financial conditions. Thus, risks from the international environment are considered to be tilted to the downside, while domestic risks are considered to be slightly tilted to the

upside in the short term due to Serbia's role as a net exporter of basic metals and ores, its increasing export capacities, structural reforms and improving business environment. Russia's war against Ukraine, that started around a month after the submission of the ERP, is set to hit Serbia's economy via various transmission channels, in particular via even higher energy and food prices, thereby fuelling inflation, reducing disposable incomes and private consumption. External trade, foreign direct investment and remittances are also set to be affected due to war-induced lower growth prospects in Serbia's main EU trading partners. The programme presents an alternative macroeconomic and fiscal scenario, projecting substantially lower economic growth (only 2.0% in 2020, 3.0% in 2023 and 3.5% in 2024) and less favourable fiscal performance in the event of pronounced cost pressures on inflation, in particular from higher energy and commodity prices, and a potential tightening of global financial conditions, negatively affecting investment and resulting in lower growth of private consumption due to lower real disposable income. However, though the alternative scenario very usefully points to the potential magnitude of risks related to global inflationary pressures, the ERP does not specify the scenario's underlying assumptions in sufficient detail to allow for a further assessment.

**Consumer price inflation surged in the second half of 2021 but the ERP expects it to ease as of mid-2022 and to remain around the target in 2023 and 2024.** Following a track record of low and rather stable inflation for seven consecutive years, consumer price inflation rose strongly in 2021 to an annual average of 4.0%. This was due to a steady surge in the second half of the year, with the inflation rate reaching 7.9% year on year in December, well above the upper end of the central bank's target tolerance band of 3%  $\pm$ 1.5 pps. The strong increase in headline inflation was mostly driven by food and energy prices while core inflation (excluding energy, food, alcohol and tobacco) rose more moderately to 3.5% in December 2021. The central bank maintained the key policy rate at the record low level of 1.0% throughout 2021 but phased out extraordinary measures providing foreign exchange and dinar liquidity as of March and October, respectively. Moreover, as a further step to reduce monetary accommodation, the National Bank of Serbia also gradually increased the average rate of repurchase agreement (repo) sales of securities by around 70 basis points from 0.11% in October 2021 to 0.79% in mid-February 2022. To stabilise the exchange rate, particularly in view of some dinar appreciation pressures in the summer, the central bank continued to apply its policy of frequent interventions on both sides of the foreign exchange market, buying a net EUR 850 million up to November 2021. The ERP projects inflation will hover above the upper bound of the target tolerance band until mid-2022 and gradually return to the lower half of the band by the end of the year, resulting in an average inflation projection of 4.9% for 2022. The programme anticipates that the effects of energy and food price hikes and supply chain disruptions will wear off by the end of 2022, and does not forecast any major inflationary pressures from aggregate demand. On that basis, inflation is projected to remain around the central point of the target band in 2023 and 2024. Overall, the inflation projections appeared plausible prior to the potential additional inflationary impact of Russia's war against Ukraine. They assumed that the 2021 price surges would be temporary and supply chain disruptions promptly resolved. However, if inflation rates stay significantly above target for a prolonged period, as they may due to the impact of Russia's war against Ukraine, this could induce a series of knock-on effects for core inflation. As stated in the programme, the National Bank of Serbia stands ready to respond promptly, using all available monetary policy instruments if any of the risks materialise that would keep inflation above the upper bound of the target band for a prolonged period.

Graphs: external competitiveness and current account



**The current account deficit has slightly increased in 2021 and the ERP expects it to widen further slightly in 2022-2024.** The deficit widened from 4.1% of GDP in 2020 to 4.4% of GDP in 2021. A higher merchandise trade deficit and primary income deficit (reflecting mainly a rebound in reinvested earnings and dividends) were largely offset by a higher surplus on the secondary income (reflecting in particular a rebound in workers' remittances) and the services trade balance. According to the ERP's projections, the current account deficit is set to gradually widen to 4.8% of GDP by 2024. This is based mainly on forecasts of a higher primary income deficit, in particular from higher reinvested earnings in line with strong inward foreign direct investment and shrinking remittances in percentage of GDP. These balance-deteriorating factors are expected to be partially offset by improving goods and services trade balances (reflecting in particular a foreign-direct-investment-driven increase in export capacities). However, the strong projected growth in domestic demand may lead to a less favourable differential between export and import growth.

**Net inflows of foreign direct investment continue to play a central role for external sustainability and competitiveness.** In 2020, net inflows had fallen substantially to EUR 2.9 billion or 6.3% of GDP, despite the privatisation of *Komercijalna Banka*, which alone attracted an inflow amounting to 0.8% of GDP. In 2021, however, net inflows rebounded strongly, largely recovering their 2019 record level of EUR 3.6 billion (6.8% of 2021 GDP). They thus continued to fully cover the current account deficit. After the rebound in 2021, the ERP projects that net foreign direct investment will decrease to EUR 2.9 billion in 2022 and increase only moderately to EUR 3.3 billion by 2024. On these projections, despite a gradual decrease in GDP terms, it will still cover the current account deficit in full. Inflows of foreign direct investment are also considered crucial for the ongoing structural transformation of the economy towards tradable sectors. With continued government support for foreign investors, the sustained inflow of foreign direct investment appears plausible, provided macroeconomic stability is maintained and the business environment is further improved. Thanks to the very high net inflow in 2021, the stock of net foreign direct investment in Serbia's net international investment position increased its share to 96% (as of Q3-2021) despite the simultaneous increase in net portfolio debt from high external public debt issuance in the COVID-19 crisis. This reduces Serbia's vulnerability to external shocks, though the net foreign liability position is relatively high at 82% of GDP in Q3-2021 (down by 9 pps from the end of 2020 thanks to very high nominal GDP growth). The relatively high level of foreign exchange reserves, which helped cushion the impact of the crisis in 2020, rose further in 2021. It is expected they will continue to cover at least five months' worth of imports throughout the programme's lifetime.

**The financial sector recorded further credit growth while maintaining sound macro-prudential indicators.** Lending activity continued to grow in 2021, supported by accommodative monetary policy, the extension of government guarantee schemes and the continuation of COVID-19 crisis-related regulatory forbearance measures. Up to September the pace of credit growth was somewhat slower due to the strong base effect of the 2020 credit moratoria, but it picked up in the fourth quarter to 10.3% year on year for households and 8.3% year on year for business in November. A large share of the growth in business lending was not for investment but for liquidity and working capital, which still suggests some vulnerabilities. After a slight increase to 3.9% in the first quarter, the non-performing loan ratio declined slightly in the second quarter to 3.6% and remained broadly stable in the third quarter of 2021. Though the profitability indicators recorded a fall in 2020 in the crisis, they seem to have broadly stabilised in 2021.

*Table 2*

**Serbia - Financial sector indicators**

	2017	2018	2019	2020	2021
<b>Total assets of the banking system (EUR million)</b>	37 676	41 514	45 838	50 775	56 792
<b>Foreign ownership of banking system (%)</b>	76.9	75.4	75.7	86.0	86.0
<b>Credit growth (aop)</b>	2.4	4.3	9.7	12.3	9.1
<b>Deposit growth (aop)</b>	7.9	7.4	12.9	15.0	14.4
<b>Loan-to-deposit ratio (eop)</b>	1.00	1.00	0.96	0.91	0.88
<b>Financial soundness indicators (eop)</b>					
- non-performing loans	9.8	5.7	4.1	3.7	3.6
- net capital to risk-weighted assets	22.6	22.3	23.4	22.4	20.8
- liquid assets to total assets	35.1	35.7	36.0	37.3	37.7
- return on equity	10.5	11.3	9.8	6.5	7.8
- forex loans to total loans* (%)	67.5	68.5	67.1	64.7	63.2

\* Includes both denominated and indexed positions.

Note: Data for December 2021 are preliminary.

Sources: ERP 2022, National Central Bank.

### 3. PUBLIC FINANCE

**The economic rebound and the scaling back of fiscal support measures helped to substantially improve the budget balance in 2021, notwithstanding strong increases in capital expenditure.** As a result of very good revenue performance from the economic rebound, the general government deficit almost halved from 8.0% of GDP in 2020 to 4.1% of GDP in 2021. It thus approached the original 2021 budget deficit target of 3.0% despite very substantial expenditure increases for a new COVID-19 crisis support package, increased healthcare and capital expenditure, that were included in two amending budgets in April and October, and substantial liquidity support to Srbijagas at the end of the year. At the beginning of the year, in view of the protracted impact of the pandemic, the government announced a new package of fiscal support measures that was included in a first amending budget in April 2021. The package included 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 package was later complemented by a vaccination bonus, further lump-sum payments to all citizens and limited specific support to unemployed people. The planned direct fiscal cost of the additional 2021 support measures amounted to 2.3% of GDP (compared to 8.4% of GDP of discretionary fiscal support in 2020). While continued fiscal support appears adequate 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. The further extension of the existing and the setup of a new guarantee scheme to support the most affected sectors/enterprises have also contributed to ensure continued liquidity for businesses. The additional 2021 measures were 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 beyond. The application of the measures to all companies and adult citizens applying to receive them ensured a high level of transparency and equal treatment in the distribution of the support. On top of the additional support package, the April amending budget also included a substantial increase in capital expenditure, both for infrastructure and new arms purchases, and higher healthcare expenditure, bringing the revised 2021 deficit projection to 6.9% of GDP which was reduced to 4.9% of GDP in a second 2021 amending budget in October. Despite high budget support to Srbijagas of around 0.5% of GDP at the end of the year, the overall 2021 general government budget deficit then turned out at 4.1% of GDP, supported in particular by lower implementation of capital expenditure and a surplus of local administration.

**Very strong revenue performance more than offset further expenditure increases in 2021, allowing for a substantial reduction in the general government deficit outturn.**

Overall revenue increased by 20.3% year on year while overall expenditure increased by 10.1% year on year. Expressed as a share of GDP, total revenue increased by 2.3 pps, while total spending decreased by 1.6 pps due to very high nominal GDP growth. The most significant revenue increases were from social security contributions (+1.6 pps) and VAT (+0.5 pps). On the expenditure side, only capital spending increased faster than nominal GDP (+2.1 pps). As a result of the very high rise in nominal GDP (up 13.9%), the *ex post* share of public wages in GDP fell from 10.5% in 2020 to 10.0% in 2021. In addition to the measures with direct budgetary impact, the 2021 fiscal support packages also included the extension of the 2020 guarantee scheme and the setting up of a new guarantee scheme for loans with a total new volume of 1.9% of GDP in 2021.<sup>1</sup> This brought the total planned size of the package of fiscal and liquidity-support measures in 2021 to 4.2% of GDP (see overview table below).

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<sup>1</sup> The 2022 ERP does not provide any updated estimates on potential guarantee calls from the guarantee schemes. At a maximum call rate at portfolio level of 30%, the guarantee schemes would entail a contingent liability of around 0.6% of GDP. However, the 2021 ERP estimated that calls on the similar-sized 2020 guarantee scheme would not exceed a cumulative total of around 0.3% of GDP over 2022-2023.

**Box: Review of the package of fiscal and liquidity-support measures to support the economy and the population in 2021 (planned amounts)**

2021	Planned	
	in bill of RSD	in % of GDP
<b>Direct support to private sector</b>		
Direct support to private sector – 3 months 50% of minimum salary for all entrepreneurs, micro, small and medium enterprises	52	0.8
Direct support to hotels in urban areas	1.2	0.0
Direct support to industries - hospitality, travel agencies, hotels and car agencies	4.1	0.1
Independent artists	0.3	0.0
Direct support to industries – transport of passengers in road traffic and bus operators – EUR 600 per bus	2.7	0.0
<b>Total</b>	<b>60.3</b>	<b>1.0</b>
<b>Measures to preserve private sector liquidity</b>		
Extension of the existing guarantee scheme to support the economy during the COVID-19 crisis	60	1.0
Establishment of a new guarantee scheme to support the most affected sectors / enterprises	60	1.0
<b>Total</b>	<b>120.0</b>	<b>1.9</b>
<b>Other measures</b>		
Fiscal incentives – incentives to promote domestic demand	73.1	1.2
Vaccination bonus	7.1	0.1
<b>Total</b>	<b>80.2</b>	<b>1.3</b>
Estimated effects of fiscal measures	140.5	2.3
<b>Total, package of measures</b>	<b>260.5</b>	<b>4.2</b>

Source: Economic Reform Programme Serbia 2022-2024

Table 3

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

	2020	2021	2022	2023	2024	Change: 2021-24
<b>Revenues</b>	41.0	43.5	42.2	41.4	41.1	-2.3
- Taxes and social security contributions	36.2	38.9	38.1	37.4	37.3	-1.6
- Other (residual)	4.8	4.6	4.2	4.0	3.8	-0.8
<b>Expenditure</b>	49.0	48.4	45.3	42.9	42.1	-6.3
- Primary expenditure	47.0	46.6	43.5	41.2	40.4	-6.2
<i>of which:</i>						
Gross fixed capital formation	5.3	7.8	7.3	6.9	6.9	-0.8
Consumption	18.5	18.2	17.8	17.5	17.2	-1.1
Transfers & subsidies	19.2	17.4	16.3	15.0	14.6	-2.8
Other (residual)	3.9	3.2	2.0	1.8	1.7	-1.4
- Interest payments	2.0	1.8	1.8	1.8	1.7	-0.1
<b>Budget balance</b>	-8.0	-4.9	-3.0	-1.5	-1.0	4.0
- Cyclically adjusted	-7.1	-5.0	-3.0	-1.6	-1.1	3.9
<b>Primary balance</b>	-6.0	-3.1	-1.2	0.2	0.7	3.8
- Cyclically adjusted	-5.1	-3.1	-1.2	0.1	0.6	3.7
<b>Gross debt level</b>	57.8	58.2	56.5	55.3	53.8	-4.4

Sources: Economic Reform Programme (ERP) 2022, Commission calculations.

**A gradual return to a budget close to balance is a welcome objective of the ERP's fiscal strategy over the medium-term.** Following the spring 2021 decision to renew substantial COVID-19 crisis support and significantly increase capital spending, the fiscal consolidation path planned by the previous ERP 2021-2023 has broadly been postponed by one year and included accordingly in the ERP 2022-2024. With the projected reduction of the deficit to 3% of GDP in 2022, 1.5% in 2023 and 1.0% in 2024, the debt-to-GDP ratio is expected to continue falling in 2022. The overall planned fiscal stance appears appropriate to ensure medium-term fiscal sustainability. On the revenue side, the ERP expects most categories to keep their share of GDP broadly stable over the programme period. However, some one-off factors that boosted revenue in 2021 are not projected to recur in 2022 and 2023, leading to a declining revenue share in GDP by -1.3 pps. and -0.8 pps. respectively in those two years. Having received a particular boost from deferred corporate income tax payments in 2021, the revenue ratio is forecast to decline by 0.3 pps. in 2022 (compared with the 2021 outturn). Following very favourable collection in 2021, VAT is also projected with a very conservative elasticity in 2022, leading to a 0.2 pps. decline in the revenue ratio in 2022. As in previous years, the programme uses low estimates for non-tax revenue based on the conservative exclusion of extraordinary non-tax revenues<sup>2</sup> for future budget planning (entailing a -0.5 pps drop in 2022). In 2023, though VAT, business and personal income tax are projected to increase broadly in line with nominal GDP, revenue as a share of GDP is still expected to decrease by 0.8 pps. overall, chiefly due to the phasing-out in 2021 and 2022 of the deferred payment of 2020 social contributions (inducing a 0.3 pps. annual drop in revenue as a share of GDP in 2023) and the conservative assumption of a yearly decrease of tobacco sales (inducing a 0.2 pps. annual drop).

**Under ERP plans, the improving fiscal balance will be chiefly driven by a frontloaded decrease in expenditure-to-GDP ratios,** largely due to waning COVID-19 crisis support, while the projected containment in later years appears not to be fully backed by concrete measures. The planned fiscal consolidation is entirely concentrated on the expenditure side, to be achieved by not renewing crisis-related one-off emergency expenditure in 2022 and containing expenditure growth below nominal GDP growth for most categories over 2022-2024. The overall share of expenditure in GDP is projected to decrease by 5.3 pps by 2024 as compared to the 2021 outturn<sup>3</sup>, supported in particular by decreases in subsidies (-1.4 pps.), other current expenditure (-1.1 pps.), social assistance (-1.0 pp.), purchases of goods and services (-0.7 pps.), net budget loans (-0.7 pps.) and capital expenditure (-0.5 pps.). As they mostly reflect the phasing-out of crisis support measures, the decreases in spending ratios are mostly frontloaded. The share of the public wage bill, interest payments and activation of guarantees are expected to broadly stabilise over the programme period. For social transfers, the general downward trend is underpinned by the pension indexation formula, while the particularly sharp fall in 2023 appears to be mostly due to the one-off lump sum pension payments in 2022 (worth 0.5% of GDP). The sharp fall in subsidies-to-GDP ratio does not appear to be backed by

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<sup>2</sup> Regular non-tax revenues comprise various fees, charges, revenues of bodies, etc. generated at a steady pace over the year with some seasonal variations, while extraordinary non-tax revenues include profits of public companies and agencies, budget dividends, etc.

<sup>3</sup> Projected public expenditure as a share of GDP for 2024 is even down by 6.3 pps on the ERP estimate for 2021.

concrete reforms that would explain the projected decrease below pre-crisis levels. After reaching a record 7.4% of GDP in 2021, the gradual decrease in capital spending as a share of GDP to 7.3% in 2022 and 6.9% thereafter appears plausible.

**The 2022 budget aims to reduce the deficit significantly, mostly by not renewing COVID-19 crisis support.** With no provision for renewing the temporary crisis-mitigation measures taken in 2021, the 2022 budget plans strong headline fiscal consolidation by around 2 pps in 2022, to 3% of GDP (a decrease of 1.1 pps even compared to the 2021 deficit outturn of 4.1% of GDP). The 2022 budget's revenue side does not assume major changes to tax legislation. The sole exceptions are: the planned slight further increase in the non-taxable part of gross salaries from RSD 18 300 to RSD 19 300, which will slightly reduce the tax wedge on labour (though only in nominal terms given increased inflation); and a 0.5 pps rate decrease in social security pension contributions for employers. On the expenditure side, the budget contains a pension increase of 5.5% in line with the indexation rule, and a minimum wage increase of 9.4%. Public-sector wages have been increased on an ad hoc basis by 8% for defence, healthcare and social welfare workers, and by 7% for all other public-sector employees, resulting in an overall average increase by 7.3%. Capital expenditure is projected to decrease to 7.3% of GDP (following a 7.4% of GDP record outturn in 2021), which mostly reflects a fall in arms purchases. Shortly after the adoption of the 2022 budget in late November 2021, the government announced some new fiscal measures that may require an amending budget for implementation in due course. This concerns in particular insufficiently targeted lump sum payments to all young people aged between 16 and 30, increased premiums for childbirth and young families, and increased payments to farmers. Following budget support provided to Srbijagas in December 2021, further support to the energy sector for energy price mitigation was provided at the beginning of 2022 even prior to the impact of Russia's war of aggression against Ukraine.

**The public debt ratio is set to decline gradually, helped by high nominal GDP growth and an improving primary balance.** After a sharp increase by 5.0 pps to 57.8% in 2020, the general government debt-to-GDP ratio has decreased to 57.1% in 2021 (1.1 pps lower than the ERP estimate, reflecting the lower-than-projected deficit outturn and higher-than-expected nominal GDP growth). The debt ratio is projected to fall by 1.5 pps annually on average in 2022-2024, supported by high nominal growth, a further gradual improvement in the primary balance and slightly decreasing interest payments, whose effects are only partly offset by debt-increasing stock-flow adjustments, which are not further specified. Thanks to a favourable fiscal track record and the build-up of fiscal space in the years before the COVID-19 pandemic, Serbia has been able to fully cover its increased financing needs, resulting from the various fiscal support packages in 2020 and 2021, by tapping international and domestic financial markets at favourable conditions and without recourse to financial assistance from the International Monetary Fund or the EU. On 1 July 2021, dinar bonds were included in JP Morgan's GBI-EM index, a benchmark index for local currency bonds in emerging economies, thereby facilitating foreign portfolio investments. However, the still large proportion of foreign currency-denominated debt (70%) 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.

## Debt dynamics

### Serbia

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

	2020	2021	2022	2023	2024
<b>Gross debt ratio [1]</b>	<b>57.8</b>	<b>58.2</b>	<b>56.5</b>	<b>55.3</b>	<b>53.8</b>
Change in the ratio	5.0	0.4	-1.7	-1.2	-1.5
<i>Contributions [2]:</i>					
<b>1. Primary balance</b>	<b>6.0</b>	<b>3.1</b>	<b>1.2</b>	<b>-0.2</b>	<b>-0.7</b>
<b>2. "Snowball" effect</b>	<b>1.2</b>	<b>-4.2</b>	<b>-2.3</b>	<b>-2.4</b>	<b>-2.3</b>
<i>Of which:</i>					
Interest expenditure	2.0	1.8	1.8	1.8	1.7
Growth effect	0.5	-3.6	-2.5	-2.6	-2.6
Inflation effect	-1.3	-2.4	-1.6	-1.5	-1.4
<b>3. Stock-flow adjustment</b>	<b>-2.3</b>	<b>1.5</b>	<b>-0.6</b>	<b>1.4</b>	<b>1.6</b>

[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) 2022, ECFIN calculations.*

While the ERP projected a 0.4 pps increase, the government debt-to-GDP ratio decreased by 0.7 pps in 2021. The decline resulted from the effects of strong real growth and higher inflation easily offsetting the debt-increasing impact of the primary deficit, interest expenditure and positive stock-flow adjustments. Looking ahead, in 2022, the primary balance will still have a debt-increasing impact (partially offset by a debt-reducing stock-flow adjustment following higher borrowing in 2021 to cover part of the 2022 liabilities) while in 2023 and 2024 the stock-flow adjustments and interest expenditure are

projected to remain the only debt-increasing factors. High real growth, inflation and the return to a primary surplus ensure the clear downward trend of the debt ratio over 2022-2024. 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 4 pps. for the financing of restitutions, while sales or acquisitions of financial assets can have both upward and downward impacts).

**Some short-term upside fiscal risks from conservative revenue estimates tend to be offset by ad hoc measures, energy price mitigation and potential further fiscal impact of Russia's war against Ukraine, with the medium-term structural downside fiscal risks set to persist.** In the short term, despite high uncertainty surrounding the economic outlook, there are some upside risks to the achievement of 2022 fiscal targets: budget revenues have been forecast using conservative assumptions and are set to rise with inflation higher than projected in the budget and the ERP. However, the impact of non-budgeted ad hoc measures (birth premiums, child benefits, lump sum payments to all young adults, additional payments to farmers) will weigh on the balance. Moreover, the prolonged partial energy price freeze (in particular for gas and electricity) will most likely require higher-than-planned budget transfers to the state-owned electricity company, Elektroprivreda Srbije, and Srbijagas. Further inflationary pressures from the Russian war against Ukraine may give call for further fiscal mitigation measures. Looking ahead, revenue projections appear relatively conservative in terms of elasticities but 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, in particular for expenditure for employees, subsidies and transfers to state-owned enterprises. Given the scale of fiscal risks stemming from inefficient state-owned enterprises, highlighted by the ERP's sensitivity analysis, more transparency and effective

implementation of structural reforms in this area seem crucial to achieving the targeted 0.6 pps. of GDP reduction in subsidies from 2022 to 2024. As in previous years, the programme does not mention the restitution-related obligations of EUR 2 billion, or around 4% of GDP, concerning properties confiscated by the communist government after the Second World War. The arrangements for monetary compensation were confirmed in 2021 and the first government bonds specifically relating to this were issued in January 2022, worth EUR 69 million (0.1% of GDP). The issuing of further specific government bonds over the coming years can be expected to increase the debt-to-GDP ratio accordingly. The guarantee schemes set up during the COVID-19 crisis in 2020 also constitute a contingent liability that may to some extent be called. The schemes had an initial loan volume of EUR 2 billion, around 4.3% of 2020 GDP, with a maximum state guarantee of 30% at portfolio level. In 2021, the original 2020 scheme was topped up with an additional EUR 500 million (1% of GDP) and complemented by a new guarantee scheme worth the same amount to support the most affected sectors and enterprises. However, initial estimates for the first guarantee scheme pointed to relatively low default rates until 2023<sup>4</sup>. 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.

**Recent improvements in the quality of public finances are set to be consolidated.**

Thus, the breakdown of public expenditure is projected to confirm the progress made towards stronger pro-growth orientation, especially as regards the share of capital expenditure. After the record outturn of public capital expenditure at 7.5% of GDP in 2021, the ERP forecasts a slight decrease to 7.3% of GDP in 2022 followed by a stabilisation at 6.9% of GDP in 2023 and 2024. However, it would seem important to ensure that increased infrastructure spending is cost-effective by applying the same selection and management framework to all projects, regardless of the source of financing.

After the COVID-19 crisis-induced peak of 7.1% of GDP in both 2020 and 2021, health expenditure is expected to stay as high as 6.6% of GDP in 2022 and ease off only slightly to 6.4% of GDP in 2023 and 6.3% in 2024 – i.e. still 1% of GDP above the pre-crisis level<sup>5</sup>. The share of education spending in GDP is projected to decrease slightly from 3.3% in 2021 to 3.0% of GDP throughout the remaining programme period. Interest expenditure is projected to broadly stabilise at around 1.8 to 1.7% of GDP in 2021-2024, in line with the decreasing debt level and the assumption of still favourable financing conditions. On the revenue side, increasing the tax-free allowance for personal income tax and lowering employers' pension contributions by 0.5 pps. help to gradually reduce the tax wedge on low-income earners. To make informal labour less attractive, there may be grounds for raising the threshold further, above the inflation rate.

**While work on some structural fiscal reforms has slowed down or been postponed during the COVID-19 crisis, the budgetary process has improved and efforts are**

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<sup>4</sup> The ERP 2021 expected gross fiscal outflows related to the guarantee scheme to be limited to 0.05% of GDP in 2021, 0.21% in 2022 and 0.06% in 2023.

<sup>5</sup> Using the classification of the functions of government (COFOG) classification.

**ongoing to mobilise revenue.** The 2022 budget was adopted broadly in line with the normal legislative procedure. There was a meaningful parliamentary debate on the 2021 budget, albeit with very few MPs not belonging to the government coalition, and the authorities also submitted the final annual budget execution report for 2020 to Parliament. Work to revise the fiscal rules, which at present do not provide sufficient anchors for fiscal policy, has been put on hold since 2020 as a result of the crisis and is set to resume in the first half of 2022. While wage increases were still implemented through ad hoc adjustments to the budget system law, the new indexation formula for pensions that entered into force in 2020 has now been used to set pension increases in three consecutive years, though occasionally with some lump-sum bonus payments too. Implementation of the planned wage system reform, which had been further delayed by the crisis, has been postponed beyond the end of the programme to 2025. This is so that parameters can be reconsidered on the basis of a more comprehensive new payroll information system. On the revenue side of the budget, the new electronic fiscalisation model is currently being rolled out and is presented, alongside transition to electronic invoicing, in the structural reforms part of the ERP. They are set to make a significant impact in shrinking the grey economy, increasing VAT collection and improving the tax control process, which means they constitute an upside fiscal risk. The well-established Fiscal Council has continued to function appropriately, producing independent fiscal assessments and recommendations. Budgetary statistics have been delivered on time, 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 and further integrating it with the EU.** 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 sufficient restructuring. Its underperformance continues to undermine Serbia's competitiveness and economic growth potential. Moreover, to reach higher growth rates in the longer term, Serbia will need to make better use of the opportunities offered by the single market and the service sector, and to ensure a level playing field for all companies. Further 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 key structural challenges to competitiveness and inclusive growth, drawing on Serbia's own ERP and other sources.** It identified three key challenges:

- (i) increasing employment, in particular of young people, women and vulnerable groups, and social protection to combat poverty;
- (ii) creating a more favourable business environment for investment, and
- (iii) greening Serbia's energy sector and fully opening the energy market.

**While the Serbian economy continues to experience several obstacles to inclusive growth and competitiveness especially in the context of the Covid-19 pandemic crisis, tackling the three key structural challenges through properly targeted reforms offers the biggest potential for post-pandemic recovery, economic resilience, and inclusive**

**growth and competitiveness.** The Commission welcomes that Serbia identified the same three key structural challenges in Chapter V of its ERP. However, there are some differences in substance, chiefly for key structural Challenge 1 on increasing employment, in particular of young people, women, and social protection against poverty, and in key structural Challenge 3 on greening Serbia's energy sector and fully opening the energy market. For Challenge 1, the aspect of social protection is not analysed. For Challenge 3, the ERP does not sufficiently focus on the greening aspects of this challenge, which the European Commission considers key to reforming the sector. It also does not recognise that the energy market should be *fully* opened. These discrepancies will be further analysed below.

Serbia needs to tackle corruption, improve the rule of law and strengthen institutions in order to promote competitiveness. Addressing these fundamental concerns is a prerequisite for a successful transformation of the economy. The Commission is closely following the issues of strengthening the rule of law and fighting corruption in the annual Serbia report.

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

**The labour market has shown resilience during the COVID-19 induced crisis.** At 76.4%, the activity rate (20-64) was higher in the third quarter of 2021 than in the third quarter of 2019 (73%). The same applies to the employment rate (20-64 age group), which increased by 2.4 pps. in the same period to 68.4%. While both indicators remain below the EU-27 average, Serbia is moving towards it at a steady pace. The first key challenge in Serbia's ERP is similar to the Commission's, mainly addressing the skills mismatch in the labour market: 'Increasing employment, particularly of young people, and alignment the qualification with the labour market needs'. Though Serbia's ERP also recognises the challenges concerning social protection to reduce poverty, it does not address them with suitable measures.

**The gender employment gap remains wider than in the EU.** The female employment rate (20-64) was 59% in the second quarter of 2021 (67.5% for EU-27) compared to 73% for men (78.4% for EU-27). This produces a gender employment gap of 14% in the second quarter of 2021 (10.9% for the EU-27). The employment rate of women is approaching that of men but the gender gap is still relatively wide. The underlying reasons for the gap include a lack of childcare, a lack of care services for elderly people, and social conventions.

**After a temporary drop in 2020, unemployment increased again in 2021 as demand started attracting workers again.** The unemployment rate (15-74) rose to 11.1% in the third quarter of 2021, up from 10.4% in the same quarter of 2020; spending on active labour market policies is insufficient. The rise in the unemployment rate comes after a decrease in 2020, when the pandemic-induced economic slowdown discouraged people from looking for a job. The unemployment rate gradually increased as more people entered the labour market in 2021, which can be interpreted as a sign of a recovery. Spending on active labour market policies has increased, following a period of decrease between 2019 and 2020. However, spending remains insufficient at around 0.1% of GDP (EU-27 average in 2019: 0.39%). Active labour market policies have reached only a fraction of the unemployed and their impact on the activation of the labour force remains limited. The

ERP acknowledges the shortcomings but does not propose adequate measures to address this situation.

**Lower-secondary school education results for 15 year olds lag behind the EU average, although Serbia has the highest PISA rating in the Western Balkans.** Serbia's average scores are close to those for some EU Member States (Bulgaria, Greece and Romania). The average score in reading is 439.5 (against the EU average score of 481.7 and the Western Balkans average score of 402), in mathematics 448.3 (EU 488.6 and WB 414) and in science 439.9 (EU 484 and WB 408). The selection procedures for upper secondary programmes are not equitable, with boys twice as likely as girls to attend vocational training programmes.

**The school-to-work transition is structurally difficult.** The share of young people (15-29) not in employment, education or training (NEETs) was 20.0% in 2020, significantly above the EU-27 average (13.7%), but the lowest among all candidate countries. It takes two years on average for a young person in Serbia to find their first stable employment, against the EU average of 6.5 months. In the third quarter of 2021, the activity rate for the 15-24 age group was just 35.5%, compared to 41.0% in the EU. To ease 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. Since 2020, more than 8 000 young Serbians participated in this programme.

*Reform measure 1* in the ERP focuses on the 'Establishment of a Framework for the Introduction of the Youth Guarantee in the Republic of Serbia'. The government will start with preparatory activities, including drafting the implementation plan. Then it will start gradually rolling out the Youth Guarantee in several regions in the fourth quarter of 2024. The measure only partially addresses the key challenge, but will likely contribute to facilitating the integration of young people in the labour market. However, the Youth Guarantee will be available only for a limited number of young school-leavers; to significantly reduce Serbia's NEET rate, further steps are needed, especially in the field of education.

**Vocational education and training (VET) schools do not adequately provide skills to match employers' needs as they have only partially updated curricula and lack appropriate equipment.** Chosen by 73.2% of Serbia's youth, the VET pathway is not sufficiently labour-market-oriented, and does not offer enough re-skilling and upskilling opportunities for adults. These are key obstacles for higher youth and adult employment and activity rates in Serbia. Serbia has made progress in work-based learning with the adoption of the Law on dual education in 2017 and three new by-laws in 2018/19. The Chamber of Commerce and Industry of Serbia has adopted three further legal acts to help implement the Dual Education Law. Two more legal acts are being prepared. The Chamber has a key role in the dual and entrepreneurship education track that started in the 2019/20 academic year. Though the legal framework is now in place, the roll-out of dual VET will take until 2023.

*Reform measure 2*, 'Qualifications oriented to the needs of the labour market' proposes the roll-out of the dual VET system in line with the Austrian, German and Swiss model. The measure has been rolled over from last year. Unfortunately, dual VET is not scheduled to grow in scale beyond 10.9% of all VET by 2024, with school-based VET still accounting for 89.1% under the plans. This measure does not seem ambitious enough in

light of the magnitude of the school-to-work transition challenges and the partially outdated curricula.

**In 2020, the employment rate among recent Serbian VET graduates stood at 62.3%, still significantly lower than the employment rate for VET graduates in the EU (78.7%), but higher than for Western Balkan peers.** VET education requires further development to ensure that young people are smoothly integrated in the labour market. The draft law on apprenticeships that has been put up for public discussion could help ease young people's transition into the labour market. In addition, Serbia has adopted a strategy for the development of education lasting until 2030, with an accompanying action plan for 2021 to 2023. The goals of the strategy are as follows: improve pre-university and higher education (1), increase the coverage of children's education at all levels (2), prevent dropout of vulnerable groups from education (3), better student achievement (4), quality program - including the response of the educational system to the demands of the labour market (5) - and better support for teachers (6).

**In tertiary education, Serbia wants to bring in dual education with close ties to the labour market.** The European Association for Quality Assurance in Higher Education (ENQA) recommended that Serbia improve its governance structures by involving all stakeholders, strengthen the independence of higher education institutions from the government, and improve its internal operational aspects. 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 a profession related to information and communications technology, compared to 8% in the OECD level. This has the potential to provide a boost to the digital transition in the economy. In terms of financing, the budget allocated for 2020 is 3.3%, 1.7 pp. less than the EU-27 average.

**Labour migration is continuing across the occupations.** The outflow of labour undermines the growth potential of the whole economy and notably the capacity of the public sector to provide health and utilities services. Around 14% of people who were born in Serbia live abroad (ETF 2021). This outward labour migration further exacerbates the rural/urban divide between Belgrade and the rest of the country as the countryside is particularly affected by migration. According to the Serbian Statistical Office, the population rate decreased slightly in 2020 by 0.67%, indicating a continuing depopulation trend. The Serbian ERP acknowledges the need to provide incentives for the return of the Serbian diaspora and to attract foreign experts. The Serbian government has adopted an economic migration strategy for 2021-2027 (Official Gazette of the Republic of Serbia, No 21/20) and an action plan to put it into effect. The strategy covers a range of topics relating to economic migration and its management, the correlation of migration and development, and the role of the diaspora as a driver of (local) development. In this context, Serbia is proposing *reform measure 3, 'Improvement of the environment for encouraging, supporting and monitoring circular and economic migration'*. The measure is rolled over from the previous year. It 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 chiefly addresses the ICT sector which currently accounts for around 5% of GDP.

**In 2020, 29.8% of the Serbian population was at risk of poverty or social exclusion, a high figure compared to the EU-27 average of 21.9%.** The most vulnerable were

households with three or more dependent children, of which of 37.2% were at risk in 2020. The at-risk-of-poverty threshold was on average RSD 22 000 (EUR 191) per month for a single-person household. For a four-person household with two adults and two children below 14, the threshold was RSD 46 200 (EUR 393). The income quintile ratio was 6.1 in 2020 (compared with 5.24 for the EU in 2019). This means that the richest 20% of the population had an income 6.1 times higher than the 20% poorest. The Gini coefficient in Serbia was 33.3 (2020), above the EU-27 average of 30.2 in 2019. According to research carried out for the 2020 youth participation index, 25% of young people in Serbia is at risk of poverty, and a similar percentage use some form of social assistance.

**Despite being an upper middle-income country with adequate public revenues, benefits available from the financial social assistance (FSA) scheme are not sufficient to make ends meet.** The average cost of a consumer basket is around EUR 323 for a family of three. The poverty threshold for a three-person household is EUR 297. However, FSA support from for a family of three is EUR 132, less than half the cost of the average consumer basket and of the poverty threshold for a household of this size. The impact of social transfers (other than pensions) on poverty reduction has for many years been rather small and in 2020 it stood at 18.73% in comparison to the EU-27 average of 32.68%.

**Public expenditure on social protection and budget transfers as a share of GDP has been gradually decreasing in recent years.** It amounted to 14.8% of GDP in 2020, down almost 2 pps from 2015. In addition, the pension system is faced with a challenging demographic situation. The ratio of employees per pensioner is stuck at the low level of 1.3. Serbia adopted the Social Card Law aimed at a fairer distribution of social benefits to those below the poverty line. The law will take effect in March 2022. However, expenditure remains insufficient, including spending on social assistance (2.9% of GDP in 2020). No new legislation on social protection has been announced.

**In-work-poverty remains high and the untaxable wage base still differs significantly from the minimum salary.** In 2021, Serbia raised the minimum wage to EUR 273. The minimum wage is received by 17% of all employees. The poverty threshold for a single-person household is EUR 230. The untaxable wage base has been gradually increased to RSD 19 300 (EUR 164) but this is hardly enough. To make a significant impact on in-work poverty, additional measures are needed, such as further increasing the untaxable wage base until it is close or equal to the minimum salary. This would also contribute to the wage- and consumption-induced growth of the Serbian economy.

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

**Serbia's business environment is improving, but significant structural challenges have still to be addressed if Serbia is to achieve its potential for economic growth and competitiveness.** Serbia has made notable progress in reducing the regulatory and administrative burden on businesses. The pandemic also accelerated the pace of digitalisation, including the expansion of e-commerce, although the impact on SMEs was limited. However, key structural challenges remain largely unaddressed, relating to the transparency, reliability and predictability of the regulatory framework, and unfair competition from state-owned enterprises.

**Addressing the remaining issues would help encourage both domestic and foreign investment, including in industries with a key role in sectors crucial to move forward in digitalising and greening the economy in line with the Green and the Digital**

**Agendas for the Western Balkans.** It would also boost competitiveness, medium-term growth potential and job creation. The economic and investment plan for the Western Balkans and the further development of the common regional market will help increase the competitiveness of the economy backed by a digital and green transition, but to achieve the economy's full potential, a conducive business and investment climate is crucial. The government's ERP therefore rightly recognises the importance of improving the business environment and attracting investment to further boost Serbia's economic growth and competitiveness as one of the three structural challenges in this year's ERP.

**The role of the state in the economy is shrinking, but remains large, hampering competition.** Outside the financial sector, privatisation and restructuring efforts have largely stalled and state-owned enterprises continue to dominate many sectors, including energy, transport, utilities, telecommunications, infrastructure, mining, and natural resource extraction. This outsized presence 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. Most public companies continue to rely on state support, via direct or indirect subsidies. Governance of state-owned enterprises also continues to pose and a large share of the directors are in acting capacity, many having expired mandates as the law on public enterprises limits the tenure of acting directors to 12 months. This stands in the way of a root-and-branch reform of these companies, including more professional management. Improving the efficiency of public enterprises would reduce the strain on public finances and improve the quality of services, level the playing field, and limit the scope for preferential treatment and politically influenced decisions.

**The legal framework in competition and State aid is largely in line with the EU *acquis*, but implementation still needs to be improved.** The commission for protection of competition and the commission for state aid control have both had their administrative capacity increased and are operating as legally independent bodies. However, the track record of the commission for protection of competition is not sufficiently consistent and transparent. Though it has continued to investigate a significant number of anti-trust cases, it has not issued a single negative opinion on concentration since it began work. In the area of State aid, well defined rules are not always implemented due to strong political pressure for financial assistance, channelled to state-owned enterprises and large foreign investors. These resources are often substantial and may have a significant impact on competition. State support is not sufficiently transparent, which has led to allegations of corruption. The independence of the commission for State aid control has yet to be demonstrated through a consistent and transparent track record.

**The legislative framework for public investment management has improved but more needs to be done on transparency, assessment and prioritisation of investment.** A strong process for transparent appraisal and selection of public investment projects is a priority, given Serbia's large infrastructure needs and long pipeline of future projects, including projects for the green and digital transition. The new legislative framework for public investment management from 2019 still allows too many exceptions to the rule. In addition, the law on special procedures for linear infrastructure projects adopted in 2020 allows certain linear infrastructure projects 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. As a result of these legal arrangements, and, in some cases, a lack of enforcement of rules, a significant share of

public funds for capital investment is still spent without proper checks to ensure compliance with public procurement, State aid and technical standards. This is particularly true for big infrastructure projects financed by loans mostly from non-EU 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.

**In recent years, Serbia has reduced the regulatory and administrative burden on businesses, but more efforts are needed.** A number of heavy business procedures have been significantly simplified and their cost reduced. However, administrative procedures are still numerous and burdensome especially for small and medium-sized enterprises (SMEs). Local firms have to make 33 tax payments per year, twice as many as in the regional peers. The numerous parafiscal 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 legal framework is prone to unexpected and significant changes, which can be detrimental to business.** Business predictability is negatively affected by the lack of full transparency in the adoption of legislation. Government decisions in a number of business-relevant areas are still often taken without proper consultation with businesses and social partners and under too short time constraints.

**Further efforts are needed to improve the quality, independence and efficiency of the justice system.** An efficient and independent judicial system is a pre-requisite for a predictable investment- and business-friendly environment, and is necessary to encourage innovation, attract foreign direct investment and secure tax revenues. 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 inconsistency in rulings.

**Serbia's legal framework for fighting corruption and dealing with economic crime and abuse of office** is largely in place. However, its implementation should be strengthened. A particularly critical area is public procurement. The level of competition in the public procurement process remains limited: the average number of bids per tender remains very low (2.6 in 2020). The supervisory institutions (Public Procurement Office, Commission for the Protection of Rights in Public Procurement Procedures, State Audit Institution, Anti-corruption Agency, prosecution, etc.) lack staff and do not always coordinate effectively for fighting corruption in a systematic manner.

**The widespread shadow economy remains a major impediment to the development of a strong corporate sector and the consolidation 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, parafiscal charges, hidden tax fees and red tape. The consequences are manifested in tax evasion, market distortion, unfair competition and inefficient resource allocation. Notable efforts have been invested in reducing the size of the informal sector, but the pace of reforms is slow.

**The ERP reform measures in the area of business environment target the high administrative and regulatory burden, the management of state-owned enterprises and the functioning of the capital markets, but do not sufficiently address the main underlying structural weaknesses.** *Reform measure 4, '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 for businesses, reduce opportunities for corruption and in general increase the attractiveness of Serbia as an investment destination. However, the measure has so far yielded rather limited results, with only 13 procedures out of over 2 600 being abolished. Significant efforts are needed to speed up the reform. The new *reform measure 5 ('Sustainable and efficient management of business entities owned by the Republic of Serbia')* aims at setting up a system of corporate governance including a centralised database. As the measure aims to improve the management of state-owned enterprises it is very relevant. The new reform measure 6 ('Development of the domestic capital market through the introduction of new legal mechanisms and provisions of a greater level of investor protection') sets out to increase the competitiveness of the capital market by making it more efficient and transparent, based on the capital market development strategy for 2021-2026. While the measure might have a positive impact on the capital market and help attract further investment, it does not directly aim to address any of the most significant underlying structural challenges.

The ERP once again does not contain any reform measures specifically addressing the issue of the informal economy. However, *Reform measure 9 ('tax administration transformation')* and *measure 10 ('introduction of a new fiscalisation model and transition to electronic invoicing')* have been carried over from last year's ERP but moved from the business environment to public financial management. They may, if properly implemented, lead to improvements in tax inspections, with a positive impact on the informal economy. These reform measures are further analysed in Section 6 under public financial management.

### ***Key challenge 3: Greening Serbia's energy sector and fully opening the energy market***

**Despite recent good progress, particularly on renewables and energy efficiency, a polluting, and inefficient energy sector is not fully compliant with the Energy Community Treaty or with the EU *acquis*, and continues to hamper competitiveness.** Energy infrastructure is largely outdated: the energy supply continues to rely mostly on lignite, energy production from coal is still heavily subsidised and a high number of individual heating systems use wood and coal as fuel. The energy sector is the main source of air pollution in Serbia, with health costs for the economy. Licensing rules are rarely applied. In addition, the underperformance of the energy sector and the slow progress on the green energy transition negatively influence Serbia's economic growth potential, especially in the long term. The lack of efficiency in the energy sector also undermines the country's overall economic competitiveness. As EU Member States move towards greener economies, it is important that Serbia moves in the same direction in order to be competitive upon accession.

**Addressing remaining issues in this area will stimulate both domestic and foreign investment.** This will benefit sectors that are crucial to digitalising and greening the economy in line with the green agenda for the Western Balkans and backed by the economic and investment plan. It would also boost economic competitiveness, the medium-term growth potential and the creation of new jobs. The government's ERP

therefore rightly recognises the importance of greening Serbia's energy sector and fully opening the energy market.

**Serbia's energy sector, accounting for 4% of GDP, has a high energy and carbon intensity.** This is 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, inefficient and highly polluting 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 95% 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. Work on a joined-up long-term strategy that combines energy and climate targets is ongoing but progress is too slow.** Serbia relies on domestic coal-fired electricity production provided by outdated power plants. About 69.6% of domestic electricity production comes from coal (lignite), 25.7% from hydropower, 2% from gas, and only 2.6% from wind, and solar together (SORS, 2022). The country continues to invest in new coal power plants. Currently, Serbia is building a new lignite power plant (Kostolac B3) with a capacity of 350 MW. However, in early 2021, Serbia suspended the new Kolubara B 350 MW power plant project. Serbia adopted a new climate law in March 2021, which is a step in the right direction. It is currently drafting its national integrated energy and climate plan with public consultations planned.

**Coal power generation adds to already alarming air quality levels in Serbia.** According to the European Environment Agency's latest estimates, air pollution from PM2.5 particles in Serbia caused a total of 14 600 deaths in Serbia in 2020 (EEA, 2020). The energy sector is the main source of pollution in Serbia, responsible for 80% of the country's greenhouse gas emissions. 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. In 2020, SO<sub>2</sub> emissions were six times higher than the national ceiling and higher than 2019 levels. Serbia adopted a national emission reduction plan in February 2020, but it is not implemented in practice for sulphur dioxide and dust.

**Inefficient energy use in Serbia is a major concern.** Lack of efficiency in the energy sector critically undermines the country's overall economic competitiveness. In 2021, Serbia made major progress in aligning with the EU *acquis* on energy efficiency. Serbia created a new Directorate for Energy Efficiency and launched a housing renovation programme. Priorities are to continue improving financial, institutional and human resource capacities and better coordinate energy efficiency actions with all relevant stakeholders, including at local level. Boosting investment in energy efficiency require large-scale consumption-based metering and billing in district heating and the setting up of a sustainable financing mechanism. Serbia should also allocate all income from the new 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 are increasing, but at a slow pace. In 2020, Serbia achieved a 26.3% share of renewables in gross final energy consumption, which is just below the 27% objective 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 capacity.

**Greening Serbia's energy sector is paramount if Serbia is to meet its obligations under the Energy Community Treaty, its EU membership ambitions, and ensure 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, which is also being incorporated into the Energy Community Treaty. With decreasing global prices for renewable energy and increasing efforts to address carbon leakage in Europe, Serbia needs to avoid locking itself into an increasingly unprofitable carbon-intensive energy system and to tackle this challenge head-on. Recent energy legislation introduced a competitive auction system instead of feed-in tariffs for renewable energy sources. This is an important measure to attract much-needed private investment in the renewables sector and it should be implemented swiftly.

**Currently, low electricity prices in Serbia do not provide incentives for investing in energy efficiency and energy savings.** 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). Current electricity tariffs do not cover the real cost of the investment needed to guarantee security of supply. Moreover, they do not include the investment needs for Serbia's energy and climate reforms. Increasing electricity prices should be accompanied by appropriate social programmes to mitigate potential adverse effects, bearing in mind that a considerable proportion of the population suffers from 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 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, creating security of supply risks. In January 2022, work started on the Serbia-Bulgaria gas interconnector. 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.** Serbia's primary legislation is compliant with the EU's third energy package, but implementation is lagging behind, particularly in the gas sector. The government has mostly completed liberalisation of the electricity market and created an operational electricity wholesale market. However, plans to reform the gas sector are yet to be implemented. There is still no third-party access to the gas network and none of the three transmission system operators has been unbundled. Serbia adopted an action plan on gas unbundling in May 2021 but key elements have been delayed, including the certification of

Transportgas Srbija. The unbundling of Yugorosgaz Transport cannot proceed until the Russia-Serbia Intergovernmental Agreement has been ratified. The implementation of Serbia's action plan on gas unbundling also depends on further amendments to the Energy Law. The lack of competition results in high prices for business and households.

**Serbia's ERP for 2022-2024 is not sufficiently ambitious regarding the clean energy transition and energy efficiency.** The reform measures proposed in the ERP fall short of providing decisive plans for making clean energy transition a core component of economic reform. In addition, major outstanding reforms, such as the unbundling of the gas sector and properly addressing energy poverty, are missing. *Reform Measure 7 ('Energy market development coupled with energy infrastructure construction')* is rolled over from previous ERPs. This represents a continuation of Serbia's efforts to develop its electricity market 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 does not go far enough in the gas sector, where we see positive steps regarding unbundling but regrettably a lack of action on third-party access to existing gas infrastructure. *Reform measure 8 ('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 in line with the EU *acquis*, which includes the newly adopted Energy Efficiency Directive (part of the Clean Energy package) under the Energy Community, and secure sustainable funding for energy efficiency projects. However, the measure falls short of effectively incentivising energy efficiency investments, including in both the manufacturing and housing sectors.

**Targets for energy savings could be more ambitious (currently 20%).** Concrete policy measures are lacking, such as steps to implement consumption-based metering and billing in district heating or a large-scale renovation wave in Serbia. Setting up a funding mechanism for energy efficiency is a good step, but the model proposed cannot not accommodate the recruitment of the staff needed or the building and management of the pipeline of energy efficiency projects that will be required. Regardless of these shortcomings, the reform measure remains highly relevant for boosting Serbia's competitiveness and long-term growth potential.

### Box: Monitoring performance in light of the European Pillar of Social Rights<sup>6</sup>

The European Pillar of Social Rights, proclaimed on 17 November 2017 by the European Parliament, the Council and the European Commission, sets out 20 key principles and rights on equal opportunities and access to the labour market, fair working conditions, and social protection and inclusion for the benefit of citizens in the EU. The European Pillar of Social Rights Action Plan, adopted on 4 March 2021, aims at rallying all relevant forces to turn the principles into actions. Since the 20 principles provide a compass for upward convergence towards better working and living conditions in the EU, 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.

**Relative to the EU-27 average, there is scope for improvement in most available indicators of the Social Scoreboard supporting the European Pillar of Social Rights.**

SERBIA		
Equal opportunities and access to the labour market	Early leavers from education and training (% of population aged 18-24)	Better than EU avg., improving
	Individuals' level of digital skills	Worse than EU avg., improving
	Youth NEET (% of total population aged 15-29)	Worse than EU avg., no change
	Gender employment gap	Worse than EU avg., no change
	Income quintile ratio (S80/S20)	Worse than EU avg., improving
Dynamic labour markets and fair working conditions	Employment rate (% of population aged 20-74)	Worse than EU avg., improving
	Unemployment rate (% of population aged 15-64)	Worse than EU avg., improving
	Long term unemployment rate (% of population 15-74)	Worse than EU avg., improving
	GDHI per capita growth	N/A
Social protection and inclusion	At risk of poverty or social exclusion (in %)	Worse than EU avg., improving
	At risk of poverty or social exclusion rate for children (in %)	Worse than EU avg., improving
	Impact of social transfers (other than pensions) on poverty reduction	Worse than EU avg., improving
	Disability employment gap	Worse than EU avg., no change
	Housing cost overburden	Worse than EU avg., improving
	Children aged less than 3 years in formal childcare	Worse than EU avg., deteriorating
Self-reported unmet need for medical care	Worse than EU avg., improving	

**Serbia has steadily improved employment and has reduced unemployment (best performer), and its labour market has shown relative resilience during the pandemic.** The employment rate exceeded pre-pandemic levels, as did the activity rate (76.4% in the third quarter of 2021 compared to 73% in the third quarter of 2019). Women in Serbia have a significantly lower employment rate than men. The gender employment gap is wider than the EU-27 average (14.6 pps. in Serbia, against 11 pps. in the EU in 2020). The gap is attributable to the lower statutory retirement age for women and the low level of part-time work combined with care responsibilities. Spending on active labour market policies has started to increase but remains insufficient at only around 0.1% of GDP (EU-27 average in 2019: 0.39%).

**Many young people in Serbia are not in employment, education or training (NEET) and the education system does not always meet the needs of the labour market.** The NEET rate was 20.0% in 2020, significantly above the EU-27 average (13.7%), but the lowest among all candidate countries. The activity rate in the third quarter of 2021 in the 15-24 age group was just 35.5%, compared to 41.0% in the EU. Vocational education and training is not sufficiently labour-market oriented, and opportunities for re-skilling and upskilling are lacking, both key obstacles to higher youth and adult employment and activity rates in Serbia.

**Serbia's performance on social inclusion, social protection, income equality and poverty alleviation could be significantly improved.** The at-risk-of-poverty rate stands

around 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 2020 (29.8%) and significantly above the EU-27 average (21.9%). 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 effective in reducing market inequality as other countries in Europe. 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 on public health and demographic trends. The quasi-governmental Social Inclusion and Poverty Reduction Unit processes and interprets data on poverty and inequality and develops indicators to monitor social policy. In academic and civil society circles the monitoring of social policy in Serbia is critically discussed, regarding methodology and results.

<sup>6</sup> The table includes 16 headline indicators of the Social Scoreboard, used to compare performance of EU Member States (<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. The assessment includes the country's performance in relation to the EU-27 average (performing worse/better/around the EU-27 average; generally 2020 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). For data see Annex B. NEET: neither in employment nor in education and training; GDHI: gross disposable household income.

## 5. OVERVIEW OF THE IMPLEMENTATION OF THE POLICY GUIDANCE ADOPTED AT THE ECONOMIC AND FINANCIAL DIALOGUE IN 2021

Every year since 2015, the Economic and Financial Dialogue between the EU and the Western Balkans and Turkey has adopted targeted policy guidance (PG) for all partners in the region. 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 PG is similar to that of the country-specific recommendations usually adopted under the European Semester for the EU Member States. The Commission evaluates the work carried out to implement the policy guidance in the following year's ERP assessments. The table below presents the Commission's assessment of implementation of the 2021 policy guidance jointly adopted by the EU and the Western Balkans and Turkey at their Economic and Financial Dialogue at Ministerial level on 12 July 2021.

Overall: Partial implementation (44.4%) <sup>7</sup>	
2020 policy guidance	Summary assessment
<p><b>PG 1:</b></p> <p>Provide well-targeted and temporary pandemic-related fiscal support to vulnerable households and businesses; provided the economic recovery is well entrenched, plan a gradual return to a deficit close to balance in the 2022 budget and medium-term fiscal framework.</p> <p>Contain overall spending on wages as a percentage of GDP by adopting an adequate wage indexation mechanism and taking steps towards an appropriately designed public sector wage system reform.</p> <p>Adopt a credible and binding system of fiscal rules for entry into force as of 2022.</p>	<p>There was <b>partial implementation</b> of PG 1</p> <p>1) <b>Substantial implementation:</b> The authorities have provided substantial temporary additional pandemic-related fiscal support. However, only around 10% was specifically targeted to vulnerable businesses or to incentivising vaccination while the remainder was offered to all businesses and all adult citizens. In view of the strong economic rebound, the 2022 budget and medium-term fiscal strategy effectively plan a gradual return to a deficit close to balance.</p> <p>2) <b>Limited implementation:</b> Following a 0.45ps decline in 2021 due to very high nominal GDP growth, overall spending on wages as a percentage of GDP is projected to remain stable at 10% in 2022-2024. However, the planned containment continues to rely entirely on ad hoc decisions on wage increases as no wage indexation mechanism has been adopted and the public sector wage system reform has been postponed to 2025. A new central electronic public wage and employment registry (Iskra) has been developed for personnel and wage management with a pilot already effective in the Ministry of Finance. The first phase of the new payroll information system should become operational for some sectors by April 2022 and then be rolled out to most of the public sector (excluding military, security and higher education institutions) by end-2023, which is deemed important for preparing the delayed wage system reform.</p> <p>3) <b>Limited implementation:</b> The adoption of a credible and binding system of fiscal rules has been</p>

<sup>7</sup> 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](https://ec.europa.eu/info/publications/economy-finance/2017-economic-reform-programmes-commissions-overview-and-country-assessments_en).

	<p>postponed by another year due to the COVID-19 crisis. Establishing the new fiscal rules framework was included as a commitment in the new policy coordination instrument with the IMF, to be completed by June 2022 deadline allowing for entry into force in 2023.</p>
<p><b>PG 2:</b></p> <p>To reduce the grey economy, increase VAT collection and improve the tax control process, implement the new model of electronic fiscalisation and the transition to electronic invoicing according to the ERP 2021 timeline.</p> <p>To increase the transparency of the fiscal impact of state-owned enterprises, reinforce fiscal risk analysis capacity and publish quarterly reports on SOEs' financial performance.</p> <p>Implement the first steps of the time-bound action plan for deployment of the new SOE ownership and management strategy to improve the governance of SOEs and reduce related fiscal risks.</p>	<p>There was <b>partial implementation</b> of PG 2.</p> <p>1) <b>Full implementation:</b> The new electronic fiscalisation model and the transition to electronic invoicing have been implemented broadly within the set deadlines. The centralised platform for electronic fiscalisation was launched on 1 November 2021. The deadline for taxpayers to switch to the new system is 30 April 2022. As regards electronic invoicing, the launch of e-invoices for public users has been postponed by four months and is now due to start on 1 May 2022 while the remaining phased deadlines have been maintained for 1 July 2022 for storage of e-invoices issued by others and 1 January 2023 for general use in the private sector. Training for users of the new fiscalisation model and electronic invoicing began in July 2021.</p> <p>2) <b>Partial implementation:</b> While the Ministry of Finance appears to have improved fiscal risk analysis by adopting a unified monitoring methodology, filling posts and providing training in the Fiscal Risks Monitoring Department, the results of the department's work on state-owned enterprises do not appear to have been published in quarterly reports.</p> <p>3) <b>Partial implementation:</b> in line with the action plan adopted in June 2021, for the establishment of a centralised database of economic entities in which the Republic of Serbia has ownership, as well as to create criteria for their classification, a questionnaire had to be submitted by economic entities by December 2021. Following receipt of the data their processing is ongoing. No information has been provided on the achievement of the other Q4-2021 target of establishing mechanisms and criteria for reviewing and approving key decisions of SOEs by the Ministry of Economy, to be used as basis for future amendments to the legislative framework.</p>
<p><b>PG 3:</b></p> <p>Maintain a strong financial sector regulatory framework in line with international and EU best practices, maintain sound credit risk management, as well as a transparent display of asset quality and adequate provisioning.</p> <p>Further reduce remaining obstacles to swift and effective NPL resolution.</p>	<p>There was partial <b>implementation</b> of PG3:</p> <p>1) <b>Substantial implementation:</b> the NBS continued to closely monitor the impact of the economic fallout from the pandemic on the financial sector. Forceful measures and policies contributed to supporting the banking system through the pandemic, while most forbearance measures have been withdrawn in the meantime in line with the economic recovery. Provisioning seems broadly adequate, despite a slight decrease in the coverage ratio.</p> <p>2) <b>Limited implementation:</b> there was no progress on reducing remaining obstacles to NPL</p>

<p>Continue efforts to promote the use of the national currency, including by further encouraging forex hedging and raising awareness of risks related to forex lending.</p>	<p>resolution, such as enabling the sale of retail NPLs or improving judiciary processes. This requires work by all key stakeholders and improving the legal and judicial framework. At the same time, the NPL ratio remained low and the impact of the COVID-19 crisis on asset quality has remained very contained so far.</p> <p>3) <b>Substantial implementation:</b> policy has supported the development and use of local government bond and corporate bond markets and has encouraged dinar-denominated deposit and loan growth in the banking sector, which reached an all-time record. A new measure to incentivise dinar lending to corporates will be effective starting from July 2022. However, currency substitution remains high and sustained efforts are needed, e.g. to enhance longer-term funding in dinars for the banking system and to further expand the use of hedging instruments.</p>
<p><b>PG 4:</b></p> <p>Further improve transparency in the adoption and implementation of legislation, particularly by ensuring a timely consultation of businesses and social partners on new legislation affecting their operations.</p> <p>Ensure a harmonised approach for prioritising and monitoring all investments and base investment decisions on feasibility studies, cost-benefit analysis and environmental impact assessments.</p> <p>Apply the principles of competition, equal treatment, non-discrimination and transparency in public procurement and state aid procedures in line with the EU acquis for all public investment projects regardless of the financing source and ensure an operational independence of the Commission for State Aid Control.</p>	<p>There was <b>limited implementation</b> of PG 4.</p> <p>1) <b>Partial implementation.</b> The legal framework for conducting transparent, inclusive public consultations is in place. However, further improvements are needed to achieve full and consistent implementation, as businesses continue to experience shortcomings in the procedures. These shortcomings make it harder for businesses to obtain information about legislative changes, and to prepare for and provide comprehensive input.</p> <p>2) <b>Limited implementation.</b> Although a decree on capital project management was adopted in 2019, it is not being applied to all investments. Furthermore, several gaps remain in the decree which are yet to be addressed.</p> <p>3) <b>Limited implementation.</b> The special law on linear infrastructure projects remains in force and continues to be applied to certain investments, allowing for the circumvention of the domestic law on public procurement. Although a number of by-laws related to the law on State aid have been adopted, others have still to be adopted. In addition, issues persist regarding competition and State aid provided through fiscal State-aid schemes and intergovernmental agreements. The Commission for state aid control still needs to build up a track record of demonstrable operational independence.</p>
<p><b>PG 5:</b></p> <p>Develop a long-term energy and climate strategy in line with the Green Agenda for the Western Balkans and international commitments, and step up investments in modernising energy infrastructure and lowering carbon emissions.</p> <p>Implement regulatory, financial and institutional measures for higher take-up of renewables and</p>	<p>There was <b>limited implementation</b> of PG 5.</p> <p>1) <b>Limited implementation.</b> Work on developing a long-term energy and climate strategy started in 2021, but is at very early stage; a first draft is still to be finalised. Investment in modernising energy infrastructure and in lowering carbon emissions is limited, there is still no prioritisation mechanism for investments, and ongoing investments are facing delays in implementation.</p> <p>2) <b>Limited implementation.</b> There is still no secondary legislation on RESs and energy</p>

<p>energy efficiency, including introducing renewable energy sources (RES) auction system and establishing a sustainable financing mechanism for energy efficiency.</p> <p>With a view to further liberalising the energy market, address outstanding reforms, in particular of the energy utility EPS, including price and tariff reform, accelerate the unbundling of Srbijagas in a manner compliant with the EU acquis, and provide third-party access to gas infrastructure.</p>	<p>efficiency related to the set of laws adopted in April 2021. This is holding up the launch of the RES action system. Work is ongoing regarding the establishment of the Energy Efficiency Administration, but is not yet completed.</p> <p>3) <b>Partial implementation.</b> The electricity sector has been unbundled, and the generation of electricity has been split off from transmission, but the government is still supervising both companies, and third-party access to the Horgos interconnector point is still not granted. The price and tariff reform has not been implemented. Although amendments to the founding acts of Srbijagas and Transportgas Srbija were adopted the gas sector has not yet been fully unbundled. Work is ongoing on the certification of Transportgas Srbija as a transmissions system operator, but has not yet been finalised.</p>
<p><b>PG 6:</b></p> <p>Reduce poverty by increasing the adequacy of benefits of the Financial Social Assistance (FSA) scheme for individuals and families with children and by increasing substantially the untaxable wage base close or equal to the level of the minimum salary for workers.</p> <p>Facilitate school-to-work transitions by stepping up further VET, including dual VET, through revised curricula and the provision of infrastructure which enables the acquisition of practical skills.</p> <p>Develop in co-operation with all relevant ministries, their agencies and stakeholders a Youth Guarantee Implementation Plan.</p>	<p>There was <b>limited implementation</b> of PG 6.</p> <p>1) <b>No implementation:</b> The FSA benefits are very low. As an example: FSA support for a family of three amounts to less than half the cost of the average consumer basket and less than half the poverty threshold. There has been no announcement about the adoption of the new social protection law or amendments to the FSA scheme. The tax-free allowance increased by RSD 1 000 a month in 2022 and is adjusted annually with the consumer price index but remains well below the minimum salary.</p> <p>2) <b>Partial implementation:</b> The vocational education and training (VET) curriculum in general remains outdated, although more work seems to have been done on dual profiles. Serbia adopted an education strategy that is expected to be fully implemented by 2023. Reform of the VET schools has started. Attention was focused on setting up the regional vocational training centres, but an evidence-based action plan for locating and rolling out these centres is still lacking. A dual education monitoring framework was piloted and is to be integrated into quality assurance mechanisms. The Qualification Agency adopted a new methodology for developing qualification standards and some 40 new qualification standards were put forward to the Sector Skill Councils. To make a meaningful impact on students' skills development, this needs to be followed with more up-to-date curricula, teacher training and delivery in classrooms.</p> <p>3) <b>Partial implementation:</b> Serbia recently set up an expert group and a coordination body for drafting and monitoring implementation of the Youth Guarantee implementation plan. NEET mapping is ongoing with support from EU-ILO technical Assistance Facility. The Ministry of Labour confirmed its target of delivering a draft Youth Guarantee implementation plan by the end of April 2022.</p>

## **ANNEX A: ASSESSMENT OF OTHER AREAS AND STRUCTURAL REFORM MEASURES INCLUDED IN THE ERP 2022-2024**

### ***A.1 Public finance management***

Despite generally strong diagnostics, more emphasis on the remaining obstacles could help identify well-targeted reform measures and clarify the link to the proposed reform measures that focus exclusively on tax and VAT collection. Although the new 2021-2030 public administration reform strategy and the new 2021-2025 public financial management reform programme have both been adopted, weaknesses in managerial accountability persist. The capacity to monitor the functioning of the internal control systems, including risk management and internal audit, needs to be further expanded and monitoring needs to be better accepted in the administrative culture of the public sector. The Ministry of Finance's centralised budget inspection function, and parliamentary oversight of public finances, both require further strengthening. The State Audit Institution's institutional capacity needs to expand and its continued independence ensured.

#### **Measure 9: 'Transformation of tax administration'**

This reform measure has been carried over from previous ERPs, where it was dealt with in the section on improving the business environment. Although the transformation has been ongoing since 2015, and some targets have been met, the overall improvement remains limited. Improvements in terms of predictability and fairness in the implementation of tax rules are yet to fully materialise. The lack of sufficient human resources remains unaddressed by the measure. The description of the measure recognises its link to the business environment and the grey economy in particular.

#### **Measure 10: 'Introducing a new fiscalisation model and switching to electronic invoicing'**

This reform measure has been carried over from last year's ERP, and moved from the section on improving the business environment. The measure aims to improve tax control and thus increase VAT collection and reduce the grey economy, and also to modernise invoicing by replacing paper invoices with digital ones. Although ambitious, the activities under the reform measure remain largely unclear, which may hinder its effectiveness. The description of the measure recognises its link to the business environment and the informal economy in particular. Although the measure also recognises its potential impact on the environment through digital procedures, there is no explicit reference to the green and digital transition.

### ***A.2 Green transition***

With the green agenda endorsed by Serbia in November 2020, the adoption of a climate law in March 2021 and a package of important energy laws in April 2021, Serbia started advancing its green transition, as recognised by the opening of Cluster 4 in the accession negotiations in December 2021. Although the ERP identifies and tackles a number of relevant issues Serbia needs to address, it fails to integrate the green transition throughout the ERP, across the entire economy, beyond transport, energy, waste management and air quality.

### **Measure 11: ‘Introduction of the circular economy concept’**

The measure to promote the circular economy has been carried over from last year’s ERP. No planned activities took place last year. The measure remains very relevant as it recognises the benefits of the circular economy for the environment, innovation, economic growth and job creation. This is particularly important in view of Serbia’s overall need for green transition. Although this year’s ERP introduces some additional activities, the measure still lacks ambition. It does not include any immediate practical steps towards a circular economy, which would need to be underpinned by a sufficient budget and robust performance indicators. The description of activities remains vague. The ERP provides no data on the level of allocations from Serbia’s budget for any of the three years

### ***A.3 Digital transformation***

Serbia has made notable progress on digital transformation across the economy. Digitalisation remains a key priority for the government as clearly demonstrated in the ERP. However, the diagnostics do not sufficiently focus on remaining obstacles to help identify well-targeted reforms. Serbia’s communications infrastructure still requires systematic improvement in both regulation and investment. The broadband roll-out is too slow, preventing the uptake of e-government and business services and slowing down the digital transformation of the economy. The 2025 Serbia programme, adopted in December 2019, announced much needed investments in infrastructure in the tune of EUR 14 billion by 2025. However, staff capacity in the ICT sector remains an issue. The challenge remains to ensure links between the ICT sector and traditional industries so as to speed up modernisation in traditional sectors. Unfortunately, the ERP does not include a link to the green transition.

### **Measure 12: ‘Improvement of the national information and communication infrastructure’**

The measure is rolled over from previous ERPs. It remains relevant in the context of providing fast broadband connectivity to under-served regions in Serbia - a main obstacle to the digital transition. 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, especially relevant in the context of the COVID-19 pandemic. However, the measure only addresses the infrastructure aspect. It should also contribute to laying the ground for implementing the digital aspects of the common regional market.

### **Measure 13: ‘Setting the infrastructure and environment for the creation and application of innovative and artificial intelligence based solutions’**

The measure is new in this year’s ERP and is relevant as it provides for further infrastructure to expand the digital transformation. However, the objective of the measure is not sufficiently clear in the ERP and there is a lack of detailed activities. Furthermore, the measure only addresses the infrastructure aspect but neglects other aspects such as digital skills, and support to private sector for digital transformation, etc.

#### ***A.4 Business environment and reduction of the informal economy***

The business environment and the relevant reform measures 4, 5 and 6 are analysed above in Section 4 under key challenge 2.

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, as reforms are being implemented at a slow pace. Undeclared labour remains a persistent issue, despite some improvements in the labour market. Agriculture, construction and household services have a particularly high share of undeclared work. The driving forces are corruption, high taxes and contributions on salaries, lack of financial resources and favourable loans, parafiscal charges, hidden tax fees and red tape. The government should develop a mechanism for incentivising companies and workers to move to the formal sector.

The ERP once again does not contain any reform measures specifically addressing the issue of the shadow economy. However, reform measures 9 ('tax administration transformation') and 10 ('introduction of a new fiscalisation model and transition to electronic invoicing') carried over from last year's ERP may, if properly implemented, lead to improvements in tax inspections, with a positive impact on the informal economy. The reform measures are ambitious in scope but remain unclear in terms of concrete actions and targets.

#### ***A.5 Research, development and innovation***

As recognised in the ERP, although Serbia has a relatively good scientific base, investment in research and development remains low at around 0.9% of GDP, with less than 40% coming from the private sector. The diagnostics also recognise the lack of human resources for research and development and the continued weak cooperation between businesses and academia. However, the underlying reasons for these major structural issues have not been sufficiently identified. Infrastructure for science and technology parks is being expanded, but the need for further support services for these institutions remains. Similarly, the Innovation Fund, which provides grants for industrial research, needs to play a more prominent role in the national funding system. The smart specialisation strategy, the industrial policy strategy, and the strategy for the development of artificial intelligence adopted by Serbia in 2020 are slowly moving towards their implementation phases. The ERP does not include the link to the green and digital transition in this area.

#### **Measure 14: 'Development of the start-up ecosystem'**

The measure is new in this year's ERP. It aims to stimulate public and private investment and develop an ecosystem for start-up firms. The reform is relevant as it is aimed at addressing one of the main structural issues in the area and could, if successfully implemented, also help stimulate Serbia's economic growth and competitiveness. However, the measure focuses on smart specialisation and artificial intelligence which significantly narrows its scope. Furthermore, the planned activities are not sufficiently concrete.

### **Measure 15: ‘Creation of conditions for the development of bio science and bioeconomy through the construction of Bio4 campus’**

The measure is new in this year’s ERP. It aims, by developing relevant infrastructure, to attract and experts and businesses in the Bio4 fields (biotechnology, biomedicine, bioinformatics and biodiversity) and to bring them together in Serbia. It further aims to modernise the healthcare system through technological development. Although the measure could contribute to creating an attractive new sector in Serbia, the measure is very narrow considering its pure focus on Bio4. Furthermore, the planned activities are not detailed enough to get a clear picture of the potential of the measure. The measure does not seem to address any of the obstacles set out in the diagnostics.

#### ***A.6 Economic integration reforms***

The ERP rightly analyses ongoing reforms in the area, but does not sufficiently identify underlying issues that remain to be addressed. The structure of the economy has improved further and economic integration with the EU, Serbia’s biggest trade and investment partner, remains high, accounting for 61.4% of its total trade and two-thirds of net foreign direct investment inflows in 2020. Serbia is still to complete accession to the World Trade Organization, which is not moving forward. Trade with the region remains significant and Serbia actively participates in regional cooperation such as the common regional market and the Central European Free Trade Agreement (CEFTA). Further efforts are needed to continue implementing the CEFTA Additional Protocols, as correctly identified in the ERP and reform measure 18. Progress in this context could boost Serbia’s economic growth and competitiveness, and would speed up the recovery from the pandemic and maximise the benefits of the economic and investment plan. In February 2020, Serbia adopted a customs administration development plan for customs e-systems, aiming to ensure integration with the EU system.

### **Measure 16: ‘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. The activities planned under CEFTA are appropriate and credible. Serbia should continue to play a constructive role within CEFTA. As progress on finalising WTO accession has been minimal in the past years, Serbia needs to take appropriate steps rapidly and resolutely, which has so far not been the case.

#### ***A.7 Energy market reforms***

This sector and reform measures 7 and 8 are analysed above in Section 4 under key challenge 3.

#### ***A.8 Transport market reforms***

The ERP identifies remaining challenges across the transport sector and sets out steps taken, particularly on rail transport, where progress is continuing. An updated transport strategy leading to an EU *acquis*-compliant transport sector still needs to be put in place. Critical improvements are needed on traffic management, maintenance, road safety and the transparency of transport investment. Priorities need to be aligned with the goals of economic development and EU integration, and with the EU’s sustainable and smart

mobility strategy. Improvements regarding inland waterways are underway; the potential of river ports as important trade channels needs to be further examined and measures are needed to ensure their full interoperability with roads and railways. The ERP does not sufficiently reflect on the link to the green transition, considering its particular relevance in this area.

### **Structural Reform 17: ‘Improvement of efficiency and safety in railway traffic’**

The reform has largely been carried over from previous ERPs to advance Serbia’s railway reform process. Although the diagnostics set out issues across the transport sector, the reform measure targets only the railway sector. The focus on rail transport safety and access charges is appropriate, but remains too narrow considering other important aspects of the rail reform, such as strengthening institutional capacities, facilitating border crossing procedures, the granting of train driving licences and safety certificates to foreign operators and mutual recognition of rolling stock. Serbia needs to put more focus on railway infrastructure maintenance, in particular given the ongoing cycle of investment in Serbian railway lines. Using rail to export and import goods should be more systematically encouraged to reduce pressure on the environment and on roads and to speed up the green transition.

## ***A.9 Agriculture, industry and services***

### ***Agriculture***

The ERP rightly recognises the importance of agriculture for the economy which remains significant when coupled with the more dynamic food processing sector. Agriculture employs around one sixth of the labour force. Agriculture and exports of food products accounted for 18.5% of all exports in 2020 and the trade surplus remains significant and stable. The sector nonetheless remains hampered by inefficiency, most notably concerning land (fragmentation, low productivity due to outdated technologies, small economic size and low utilisation of agricultural land per farm), and a lack of investment in new technologies. The strong influence of weather conditions on the sector’s performance remains an unaddressed issue. Moreover, the sector faces the challenge of meeting EU obligations on food safety, veterinary and phytosanitary regulation, strengthening responsible authorities in those areas, and better risk analysis and risk-based performance in relation to border inspections. EU support allocated to Serbia for IPARD is increasing every year and is substantial. Clear bottlenecks in the implementation of IPARD hinder that support to the agriculture and rural development sector is maximised. Successful implementation of IPARD would help increase competitiveness of the sector, increase the attractiveness of rural livelihoods and reduce outmigration from rural areas. It would also contribute to increasing the environmental and climate performance of agricultural producers and primary processors. The scope remain for further strengthening the capacity of the IPARD Agency as well as to further facilitate access to finance.

### **Measure 18: ‘Improvements in the competitiveness of agriculture’**

The measure is a continuation of activities under reform measure 6 from last year’s ERP, but with more detailed activities planned. The measure remains relevant, but does not aim to address the most significant issues set out in the ERP. The measure also continues to face the risk of further postponements to legislative initiatives, in particular the law on quality schemes for agricultural and food products, and the law on organic production (originally planned for three years ago and repeatedly postponed). The delays in the

adoption of legislation is creating a bottleneck both in terms of further legislative alignment and in projects moving forward and developing structures as required by the EU *acquis*.

### ***Industry***

Although the competitiveness of industry is key to growing the economy, the ERP does not identify any remaining structural issues in this area, which makes it difficult to assess the relevance of the proposed reform measure. The ERP rightly recognises that the performance of industry is stable despite the continuing pandemic (industry grew by 0.4% year on year and manufacturing industry by 0.1% in 2020). The ERP also recognises that access to finance for SMEs has improved. However, SMEs still face a number of structural challenges and their borrowing costs are still above those of large companies despite several programmes to support SME development, and despite their potential to create new, quality jobs. Support for incoming foreign direct investment is principally geared towards attracting manufacturers. While support for investment is well developed, other services are less so. Clusters, technology parks, internationalisation, and industrial research do exist, and new standards or digitalisation in traditional industries have been introduced but have not yet had a systemic impact. Measures of this kind should be stepped up should be fully compliant with State aid rules. The ERP is regrettably lacking a substantive measure for industrial green growth and does not refer to the green or digital transition in this area.

### **Measure 19: ‘Safe and quality product – industry Measure 19: “Safe and quality product - industry development factor”**

This measure is a carry-over of reform measure 19 from last year’s ERP where it was covered in the area of economic integration. It consists of two components:

- i) financial support for businesses, primarily SMEs, to increase the use of standards in production and business organisation, product certification, management systems; and
- ii) 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 has the potential to boost the competitiveness of the economy by facilitating the free movement of goods between the EU and Serbia. The measure is thus relevant, but the link to areas beyond industry is not explained in the ERP.

### ***Services***

The ERP recognises the importance of the sector in Serbia’s economy, which accounts for over half of the economy and about 30% of total exports, despite the negative impact of the COVID-19 pandemic and related measures taken to limit the spread of the virus. Tourism was particularly affected. About half the value added by services comes from retail, real estate and healthcare. Services have the potential to expand to take an even bigger share of total exports. 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 across the services sector. The CEFTA agreement and the common regional market highlight further sectors in which

services could expand regionally, if enough progress were made towards achieving mutual recognition of qualifications and certificates. Although the ERP recognises the need to improve capacities in tourism to become sustainable and meet environmental objectives in line with the green agenda for the Western Balkans, the ERP does not make any clear reference to the green or digital transition and does not include any reform measure directly targeting the services sector.

#### ***A.10 Education and skills***

This sector and the relevant reform measures 1 and 2 are analysed above in Section 4, under key challenge #1.

#### ***A.11 Employment and the labour market***

This sector and the relevant reform measure 3 are analysed above in Section 4, under key challenge #1.

#### ***Social dialogue***

**Social dialogue remains weak and 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 have limited capacity to address labour and employment challenges. Foreign investors represent a significant share of employers but do not participate in social dialogue. The tripartite Economic and Social Council of Serbia is not consulted in a timely manner on policy initiatives and draft laws prior to their adoption. The Economic and Social Council lacks appropriate resources for its work.

#### ***A.12 Social protection and inclusion***

This sector is analysed above in Section 4, under key challenge #1.

#### ***A.13 Healthcare***

Serbia's healthcare system covers 99% (2021) of the population. The compulsory health insurance scheme is managed by the Health Insurance Fund. The system is partially financed by the contributions of employed and self-employed persons, persons with non-standard work-contracts and pensioners. Unemployed people who are not insured otherwise are insured free of charge. The contribution rate is 10.3%, equally shared between employer and employee. Public expenditure on healthcare accounted for 7.1% of GDP in 2021, up 1 pp. compared to the previous year (EU-27 average in 2021 was 8.0% of GDP). Only 0.13% of the population have private insurance. In 2020, 3.8% of the Serbian population reported unmet needs due to costs, travel distances or waiting lists. This is 2 pps. lower than in 2018 but still above the EU-27 average of 1.8% (2020). According to the World Health Organization, 37.04% of the payments to healthcare providers are out-of-pocket payments made by individuals (2019), significantly higher than the EU-27 average (15.57% in 2018). There are no official records on over-the-counter payments for pharmaceuticals.

## **Measure 21: ‘Improvement of the Efficiency of the Healthcare System through the Process of Digitalization’**

This reform has been rolled over from last year. The single electronic health card will create a digital health file with patient information accessible to 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 sustainable development goal 3: good health and well-being. The reform will make for greater transparency and efficiency in healthcare. However, the measure does not alleviate the shortage of medical staff and their tendency to emigrate.

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

Area/Sector	2016	2017	2018	2019	2020	EU-27 Average (2020 or most recent year)
<b>Energy</b>						
Energy imports dependency (%)	29.7%	33.8%	34.6%	35.6%	29.8%	57.5%
Energy intensity: Kilograms of oil equivalent (KGOE) per thousand Euro	418.39	418.01	394.50	375.78	391.18	110.18
Share of renewable energy sources (RES) in final energy consumption (%)	21.15%	20.29%	20.32%	21.44%	25.98%	22.09%
<b>Transport</b>						
Railway Network Density (meters of line per km <sup>2</sup> of land area)	42.55 <sup>w</sup>	42.53 <sup>w</sup>	42.53 <sup>w</sup>	42.52 <sup>w</sup>	43.2 <sup>w</sup>	49.0 <sup>(2018)</sup>
Motorization rate (Passenger cars per 1000 inhabitants)	266.3	278.2	284.1	297.6	312.5	519 <sup>(2018)</sup>
<b>Agriculture</b>						
Share of gross value added (Agriculture, Forestry and Fishing)	8.2%	7.2%	7.7%	7.2%	7.6%	1.8%
Share of employment (Agriculture, Forestry and Fishing)	18.6%	17.2%	15.9%	15.6%	14.6%	4.3%
Utilised agricultural area (% of total land area)	39.1% <sup>w</sup>	38.8% <sup>w</sup>	39.4% <sup>w</sup>	39.3% <sup>w</sup>	N/A	40.6
<b>Industry</b>						
Share of gross value added (except construction)	26.4%	26.5%	25.4%	24.0%	23.4%	19.5%
Contribution to employment (% of total employment)	20.2%	21.2%	22.5%	22.6%	22.6%	18.2%
<b>Services</b>						
Share of gross value added	60.7%	61.3%	61.5%	61.9%	62.5%	73.1%
Contribution to employment (% of total employment)	57.0%	57.5%	57.2%	57.0%	57.5%	71.0%

<b>Business Environment</b>						
Rank in Global Competitiveness Index (Source: World Economic Forum)	94	78	65	72	N/A	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	N/A
<b>Research, Development and Innovation</b>						
R&D intensity of GDP (R&D expenditure as % of GDP)	0.84%	0.87%	0.92%	0.89%	0.9%	2.32%
R&D expenditure – EUR per inhabitant	43.6€	48.6€	56.3€	N/A	61.2€	EUR 694.60€
<b>Digital Economy</b>						
Percentage of households who have internet access at home	64.7% <sup>w</sup>	68%	73%	80%	81%	91%
Share of total population using internet in the three months prior to the survey [NB: population 16-74]	67.1%	70%	73%	77.4%	79%	88%
<b>Trade</b>						
Export of goods and services (as % of GDP)	48.6%	50.5%	50.4%	51.0%	48.2%	46.7%
Import of goods and services (as % of GDP)	53.3%	57.1%	59.1%	61.0%	56.5%	42.9%
Trade balance (as % of GDP)	-6.8%	-8.1%	-10.3%	-11.7%	-10.6%	N/A
<b>Education and Skills</b>						
Early leavers from education and training (% of population aged 18-24)	7.0%	6.2%	6.8%	6.6%	5.6%	9.9%
Young people neither in employment nor in education and training (NEET) (% of population aged 15-29)	22.3%	21.7%	20.1%	19.0%	20.0%	13.7%
Children aged less than 3 years in formal child care (% of under 3-years-olds)	18.1%	14.5%	13.3%	17.2%	18.1%	32.3%
Individuals who have basic or above basic overall digital skills (% of population 16-74)	N/A	39%	N/A	46%	N/A	56% <sup>(2019)</sup>

<b>Employment</b>						
Employment Rate (% of population aged 20-64)	57.6%	60.0%	61.6%	63.6%	64.3%	71.7%
Unemployment rate (% of labour force aged 15-74)	16.5%	14.6%	13.8%	11.3%	9.8%	6.8%
Long term unemployment rate (% of labour force aged 15-74)	9.5%	7.4%	6.7%	5.5%	4.5%	2.5%
Gender employment gap (Percentage points difference between the employment rates of men and women aged 20-64)	15.1 pps.	14.7 pps.	15.4 pps.	14.6 pps.	14.6 pps.	11.0 pps.
Disability employment gap (Percentage points difference in employment rates between people with and without a disability)	27.3 pps.	25.4 pps.	27.2 pps.	36.0 pps.	34.8 pps.	24.5 pps.
Real gross disposable income of households (Per capita increase, Index = 2008)	N/A	N/A	N/A	N/A	N/A	107.23
<b>Social Protection System</b>						
At-risk-of-poverty or social exclusion rate (AROPE) (% of population)	30.0%	39.5%	34.0%	31.1%	29.8%	21.9%
At-risk-of-poverty or social exclusion rate of children (% of population 0-17)	34.5%	41.7%	36.0%	34.5%	30.6%	24.2%
Impact of social transfers (Other than pensions) on poverty reduction	21.28%	18.67%	17.91%	18.02%	18.73%	32.68%
Income inequality - quintile share ratio (S80/S20) (Comparison ratio of total income received by the 20% of the population with the highest income to that received by the 20% with the lowest income)	11.00	9.40	8.60	6.50	6.06	5.24
Housing cost overburden (% of population)	31.0%	33.6%	31.3%	21.6%	17.8%	32.68%

<b>Healthcare</b>						
Self-reported unmet need for medical care (of people over 16)	4.5%	4.8%	5.8%	4.8%	3.8%	1.8%
Out-of-pocket expenditure on healthcare (% of total health expenditure)	40.45% <sup>z</sup>	40.64% <sup>z</sup>	38.31% <sup>z</sup>	37.04% <sup>z</sup>	N/A	15.57% <sup>(2018)</sup>

*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'*

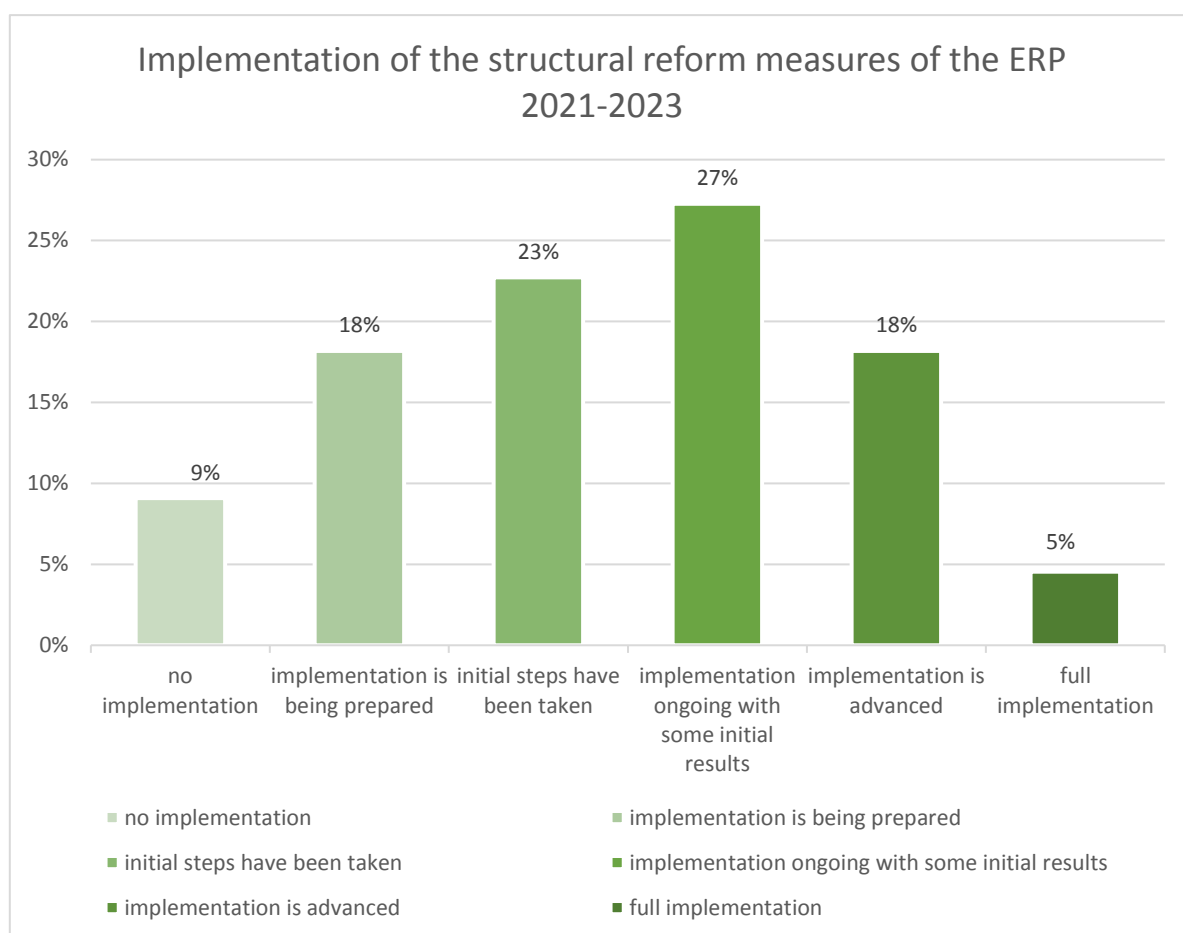
*z: Data from World Health Organisation*

Source of data in Annex B: EUROSTAT unless otherwise indicated

### ANNEX C: PROGRESS WITH STRUCTURAL REFORM MEASURES FROM ERP 2021-2023

There was continued progress in implementing the measures in 2021, with an average score of 3.3 out of 5 (up from 2.8 in 2020). Overall, reporting on the implemented activities is fair.

The highest level of implementation involves measures that have been carried over for several years, in particular measures relating to the reduction in administrative and regulatory burden for businesses. By contrast, the pace of implementation is particularly slow for reforms regarding land consolidation, digitalisation of the agricultural sector and railway reform.



## **ANNEX D: COMPLIANCE WITH PROGRAMME REQUIREMENTS**

The government adopted and formally submitted the Economic Reform Programme on 31 January 2022. The programme is in line with the medium-term fiscal strategy and the 2022 budget and covers 2022-2024.

### *Inter-ministerial coordination*

Preparation of the 2022-2024 ERP was coordinated by the Ministry of Finance (Minister of Finance was appointed as a national coordinator) and the Secretariat for Public Policies. A number of other institutions also contributed through a working group set up specifically for this task, including the National Bank of Serbia (for the macro-fiscal part) and a number of line ministries (for the structural reform measures part). This ERP, the eighth, benefited from the accumulated 'know-how' and 'lessons learnt' from previous rounds, which further improved the overall process. Several training courses were organised by the Centre of Excellence in Finance, the German [Academy for International Cooperation](#) (GIZ) and others, for those involved in preparing the document.

### *Stakeholder consultation*

The national authorities involved stakeholders in the preparation of the document, and held a consultation on the draft ERP. For the first time, stakeholders were invited to provide comments through the new online e-consultation portal. It is unclear whether all stakeholders were invited to comment, following some complaints from social partners. As a final step in the consultation procedure, a meeting took place with the National Convention, which brings together some 700 social partners, non-governmental organisations, business associations and other stakeholders in Serbia. The National Convention set up an inter-sectoral working group, which examined the proposed reform measures and submitted comments and suggestions. The participants were given sufficient time to comment in writing and the draft was made available online. Comments received from stakeholders were included in the annex to 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 inflationary pressures and 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 21 reforms, one more than the maximum suggested by the guidance. The quality of measures varies. In some cases, measures are narrow in scope, well-targeted and planned in detail, while in others they are overly ambitious and wide in scope. The annexed tables are filled in correctly.

## REFERENCES

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