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COMMISSION STAFF WORKING DOCUMENT

ECONOMIC REFORM PROGRAMME

OF

**SERBIA
(2023-2025)**

COMMISSION ASSESSMENT

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1. EXECUTIVE SUMMARY

After a substantial slowdown in 2022, Serbia's economic reform programme (ERP) forecasts that economic growth will gradually accelerate in 2023-2025. Impacted by the economic fallout of the Russian war of aggression against Ukraine, in particular on inflation through energy and food prices, real GDP growth slowed to 2.3% in 2022, with private consumption and stockbuilding as the main growth drivers. The programme projects that economic growth will remain moderate at 2.5% in 2023 and gradually pick up to 3.5% in 2024 and 4.0% in 2025, thereby broadly returning to the pre-pandemic growth rates. Consumer price inflation continued to rise steadily throughout 2022 and beyond, reaching 16.2% in March 2023, but the ERP expects it to start declining in the first half of 2023 and to return to within the target range (3% \pm 1.5 percentage points (pps)) towards the end of 2024. High energy import costs and production outages at the domestic electricity utility caused the current account deficit to increase sharply in 2022 and the programme projects it to stay above 6% of GDP throughout 2023-2025. In a context of continued high uncertainty, the growth outlook is, as elsewhere, subject to a series of downside risks associated with Russia's war of aggression against Ukraine and related geopolitical tensions, such as further fluctuations in energy prices and global trade restrictions, but also supply chain disruptions, persistent high inflation and further tightening of financial conditions.

The fiscal strategy projects a gradual improvement in the budget balance and continued debt reduction over the medium term. In 2022, the general government budget deficit fell by one percentage point (pp) to 3.1% of GDP as high fiscal support to state-owned energy utilities and a series of ad hoc expenditure measures were largely offset by the balance-improving effects of high inflation. The 2023 budget targets a moderate further reduction of the deficit, helped by lower energy support measures. Further gradual expenditure-based fiscal consolidation is projected to bring the budget into compliance with the new deficit rule¹ that will be applicable from 2025. The debt-to-GDP ratio decreased by 1.5 pps to 55.6% in 2022 and is projected to moderately decline further in 2023-2025. There has been substantial progress in fiscal governance reforms in 2022, but some gaps remain unaddressed and have been further exposed by the energy crisis, especially as concerns the oversight and governance of state-owned enterprises (SOEs).

The main challenges Serbia faces are the following.

- **Fiscal sustainability needs to be better anchored by a consistent application of the new framework of fiscal rules and backed up by reforms.** Serbia has been able to very substantially mitigate the recent crises by using available fiscal buffers and is projected to go on achieving good macro-fiscal results. Given the high degree of uncertainty about the further repercussions of Russia's war of aggression against Ukraine, standing ready to provide further targeted and temporary energy crisis mitigation if needed seems appropriate. A gradual return to a more prudent fiscal

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

position in line with the new fiscal rules is key to rebuilding fiscal space in the medium term, which could also be enhanced by further improvements in medium-term budgeting.

- **There is further scope for managing and addressing 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 significant 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 and revenue collection.
- **Serbia's business environment is improving, with regulatory and administrative burdens easing, but significant structural challenges continue to hamper the competitiveness and growth potential of the private sector and of the economy as a whole.** The role of the state in the economy remains widespread, with privatisation efforts and measures 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 still be circumvented through special procedures. Further efforts are still needed to improve the transparency, assessment and prioritisation of public investment. Businesses also continue to be affected by a lack of transparency and predictability in the way business-related legislation is adopted and this is only slowly improving. The informal 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 a long-term strategy combining energy and climate targets is to be adopted in the course of 2023.** Serbia's competitiveness continues to be hampered by a polluting and inefficient energy sector that is not properly regulated. Inefficient energy use remains a big concern. Major investment is still needed to modernise the country's energy infrastructure and lower carbon emissions with a view to accelerating the green transition; avoiding being subject to the upcoming EU Carbon Border Adjustment Mechanism, diversifying supply and Serbia's overall energy mix and especially reducing its dependence on Russian energy supplies. The EU's energy support package and Serbia's associated action plan identify the reforms to be prioritised in the coming year as well as further reforms that must be accelerated. The IMF conditionality set out in the stand-by arrangement agreed in December 2022 is also relevant for the energy sector.
- **The share of young people not in employment, education or training (NEET) remains high.** School-to-work transitions remain as in other economies of the region more difficult than in the EU average. The introduction of the Youth Guarantee aims to address these challenges but the preparatory work for the introduction of the measure is not yet finalised, and the Youth Guarantee Implementation Plan is pending for adoption. Workers across the in all areas of employment are continuing to emigrate and the impact of the circular migration initiative cannot yet be quantified. The low labour market participation of women remains a priority issue. In addition, the number of people at risk of poverty remains high, and the social benefits for the needy part of the population do not cover the cost of living.

The policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2022 has been partially implemented. The authorities have provided very substantial but mostly untargeted fiscal support to cushion the impact of the energy crisis while the 2023 budget and medium-term fiscal strategy effectively plan for gradual fiscal consolidation. Following declines in 2021 and 2022 due to high nominal GDP growth, overall spending on wages as a percentage of GDP is projected to remain stable at around 9.6% in line with the new fiscal rule adopted in 2022 setting its maximum share of GDP at 10%. A new set of fiscal rules with debt-level-dependent deficit ceilings as a cornerstone was adopted in December 2022 and is set to become fully effective in 2025. The new model of electronic fiscalisation and the transition to electronic invoicing have been successfully completed. The Ministry of Finance appears to have brought in a more robust fiscal risk analysis, but 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 substantially 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 Law on special procedures for linear infrastructure projects and other exceptions to transparent public procurement remain in place. Serbia has committed to revoke the Law on special procedures for linear infrastructure projects in the course of the first half of 2023. The long-term energy and climate strategy is yet to be adopted in the course of 2023, and the renewable energy sources auction system continue to face delays. 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 partly aligned with the reform priorities identified by the European Commission. The macroeconomic and fiscal frameworks are sufficiently comprehensive and integrated with overall policy objectives, and provide a suitable basis for policy discussions and orientation. The ERP continues to lack ambitious reforms on the green transition including with regard to clean energy transition and energy efficiency, which has as in previous years 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. Regarding digital transformation, Serbia should now focus on well-targeted reforms and improving its 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 strong rebound in 2021, GDP growth was still solid in the first half of 2022 but decelerated strongly in the second half. Impacted by the economic fallout from Russia's war of aggression against Ukraine, in particular on inflation via soaring energy and food prices, overall real GDP growth slowed to 2.3% in 2022². Growth was mostly driven by higher private consumption and inventories that was partially offset by a negative contribution to growth from net exports. On the supply side, growth was mostly driven by services while agriculture and construction contracted and industrial activity broadly stagnated. Following a slight increase in 2021, the annual unemployment rate fell sharply in 2022 driven by robust employment growth in the first half of the year.

The ERP's baseline scenario forecasts that the pace of output expansion will still be moderate in 2023 but will gradually accelerate thereafter. Following a projected expansion by 2.5% in 2023 (2.5 pps below the projection in the previous ERP), annual GDP growth is projected to gradually pick up to 3.5% in 2024 and 4.0% in 2025, thus broadly returning to the pre-2020 rates. This acceleration is expected to be mostly driven by a gradual pick-up in private consumption and gross fixed capital formation. From 2023, these main growth drivers are projected to be accompanied by a positive contribution of net exports as a result of export growth substantially exceeding import growth, by around 1 pp in 2023 and 2 pps annually as of 2024. As a result, net exports are expected to contribute positively to GDP growth by 0.1 pp, 0.5 pps and 0.3 pps in 2023, 2024 and 2025 respectively. The output gap remained positive in 2022 following the strong rebound in 2021, but the ERP expects it to turn slightly negative in 2023 and to remain broadly unchanged thereafter as the economy is projected to expand in line with its potential growth rate. Supported by steady economic expansion, the annual unemployment rate is projected to continue its downward trend resumed in 2022, albeit at a somewhat slower pace of around -0.5 pps annually, to 8.3% in 2025.

The baseline scenario seems plausible overall but is surrounded by high uncertainty. The growth outlook continues to be subject to a high degree of uncertainty about the further economic impact of Russia's war of aggression against Ukraine. The macroeconomic scenario appears plausible overall. In spite of the strong deceleration of growth in the second half of 2022, the projected 2.5% growth in 2023 appears achievable in particular as the partial recovery of domestic electricity production and a closer to average agricultural season could contribute substantially to overall GDP growth in 2023. Albeit subject to high uncertainty due to the geopolitical context, the expected moderate gradual pick-up in consumption, investment, exports and imports in 2024-2025 also appears reasonable, also in view of the inflationary environment and the related monetary tightening. However, the expected positive contribution of net exports to growth assumes a further substantial expansion of new export capacities. The projections for potential growth appear to be reasonable overall as the moderate expected growth of total factor productivity is supported by foreign direct investment (FDI) inflows, domestic innovative activity, digitalisation and structural reforms.

⁽²⁾ Macroeconomic and fiscal estimates and forecasts covering the period 2022-25 have been taken from the ERPs themselves; if available, preliminary macroeconomic and fiscal outturn data for 2022 have been taken from the relevant national sources (national statistical office, ministry of finance, central bank).

Table 1

Serbia - Comparison of macroeconomic developments and forecasts

	2021		2022		2023		2024		2025	
	COM	ERP								
Real GDP (% change)	7.5	7.5	2.7	2.5	2.4	2.5	3.0	3.5	n.a.	4.0
<i>Contributions:</i>										
- Final domestic demand	9.3	9.6	2.8	2.8	2.5	2.0	2.8	3.4	n.a.	4.0
- Change in inventories	-1.2	-1.1	0.6	1.5	0.0	0.3	0.0	-0.3	n.a.	-0.2
- External balance of goods and services	-0.6	-1.0	-0.8	-1.7	0.0	0.1	0.2	0.5	n.a.	0.3
Employment (% change)	2.6	2.9	2.5	3.0	0.3	0.6	0.5	1.0	n.a.	1.2
Unemployment rate (%)	11.0	11.4	9.7	9.9	9.5	9.5	9.2	9.0	n.a.	8.3
GDP deflator (% change)	5.9	5.9	9.7	10.2	11.3	10.6	6.0	5.6	n.a.	4.3
CPI inflation (%)	4.1	4.0	11.9	12.0	10.6	12.5	5.6	5.3	n.a.	3.0
Current account balance (% of GDP)	-4.2	-4.3	-8.6	-9.0	-7.8	-8.5	-6.5	-6.7	n.a.	-6.0
General government balance (% of GDP)	-4.1	-4.1	-3.9	-3.8	-3.4	-3.3	-2.8	-2.2	n.a.	-1.4
Government gross debt (% of GDP)	57.1	57.1	55.2	56.9	52.4	56.1	51.3	55.1	n.a.	54.0

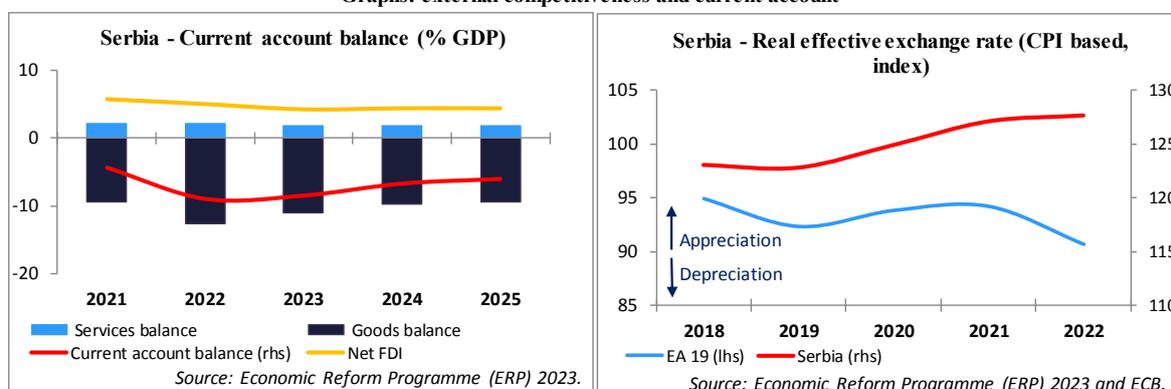
Sources: Economic Reform Programme (ERP) 2023, Commission Autumn 2022 forecast.

The ERP's economic risk analysis focuses on downside risks from external developments and includes a detailed alternative macroeconomic scenario. The programme identifies a series of risks to the baseline scenario related to uncertainty about the further economic impact of Russia's war of aggression against Ukraine and the ensuing changes in the geopolitical context. Fluctuations in energy prices, global trade restrictions and supply chain disruptions (particularly in the euro area gas market) could result in lower external demand and higher imported inflation than under the baseline scenario, thus dampening growth in disposable incomes and private consumption, and leading to tighter financial conditions and therefore lower investment growth. Unlike in previous years, no domestic risks have been included in the ERP's risk analysis section, which does not seem to provide a realistic assessment of the current domestic risk outlook. Under the alternative macroeconomic and fiscal scenario, which assumes that all external downside risks will materialise, economic growth in Serbia would be substantially lower (only 0.5% in 2023, 2.5% in 2024 and 3.0% in 2025) with a significant negative impact on the fiscal outlook. However, although the alternative scenario very pertinently points to the potential magnitude of risks related to a further deterioration of the geopolitical context, the ERP does not specify the scenario's underlying assumptions in sufficient detail to allow for a further assessment.

Consumer price inflation continued to rise steadily throughout 2022, but the ERP expects it to start declining in the first half of 2023 and to return to within the target range in the second half of 2024. Following an initial rise in the second half of 2021 to 7.9% year on year in December, consumer price inflation continued on a steadily increasing path throughout 2022 reaching a plateau of 15.1% in November and December followed by a further increase to 16.2% in March 2023. Average annual inflation rose from 4.0% in 2021 to 11.9% in 2022. The strong increase in headline inflation continued to be driven by food and energy prices in particular while core inflation (excluding energy, food, alcohol and tobacco) also picked up steadily throughout the year and reached 10.1% in December 2022. The National Bank of Serbia (NBS) started to gradually raise its key policy rate in April 2022, bringing it up (in monthly steps of either 50 basis points (bps) or 25 bps) from 1% in March 2022 to 6.0% in April 2023. In line with its long-standing policy of exchange rate stabilisation, the central bank continued to intervene frequently in the foreign exchange market. Strong dinar depreciation pressures at the beginning of 2022

(due to a high level of energy imports and foreign currency cash demand by citizens following resulting from Russia's war of aggression against Ukraine) caused the NBS to sell EUR 2.3 billion on the foreign exchange market between January and April. Appreciation pressures in the remainder of the year led to cumulative purchases by the NBS of EUR 3.3 billion between May and December, resulting in net purchases of EUR 1.0 billion in 2022. The dinar remained stable against the euro in 2022 as a result. Gradual increases in electricity and gas tariffs for households (as included in the standby-arrangement (SBA) with the IMF) are still generating inflationary pressures in 2023 and the NBS expects inflation to peak in the first half of 2023 but gradually decline thereafter and to return below the upper limit of the target range ($3\% \pm 1.5$ pps) in the second half of 2024. Disinflation is expected to be supported by decreasing global cost pressures, the negative output gap and an expected closer to average agricultural season. Average annual inflation is projected to rise further to 12.5% in 2023 but to fall back sharply to 5.3% in 2024 and 3% in 2025. Overall, the inflation projections appear plausible because the energy tariff increases in 2023 contribute to a backloaded disinflation profile.

Graphs: external competitiveness and current account



The current account deficit increased sharply in 2022 and the ERP expects it to narrow only gradually and stay above 6% of GDP throughout the programme's duration. The ERP expected the current account deficit to increase from 4.4% of GDP in 2021 to 9.0% of GDP in 2022, but the actual outcome was much lower, at 6.9% of GDP. A substantially higher merchandise trade deficit (particularly due to energy imports) and a higher primary income deficit (mainly reflecting increases in reinvested earnings and dividends) were only partially offset by a higher surplus on the secondary income balance (reflecting in particular increased workers' remittances) and the services trade balance. According to the ERP's projections, the current account deficit is set to gradually narrow from 9% of GDP in 2022 to 6.0% of GDP in 2025. This is based mainly on forecasts of an improving goods trade balance (reflecting in particular lower energy imports and a foreign-direct-investment-driven increase in export capacities) and a lower primary income deficit. These balance-improving factors are expected to be partially offset by shrinking remittances as a percentage of GDP and a slightly deteriorating services trade balance.

Net inflows of FDI continue to make an important contribution to external sustainability and competitiveness. Net FDI inflows reached a record level of EUR 3.7 billion in 2021 (6.9% of GDP) and increased still further to EUR 4.3 billion (7.1% of GDP) in 2022. This was mainly driven by manufacturing and construction and continued to fully cover the current account deficit. The ERP projects that net FDI inflows will decrease to EUR 3.5 billion in 2023 before gradually rising to EUR 4.3 billion in 2025. They are thus expected to stabilise in GDP terms (at around 5.3%), but this would

not fully cover the current account deficit. Provided macroeconomic stability is maintained and the business environment is further improved, the sustained inflow of foreign direct investment, which is crucial for the further structural transformation of the economy towards tradable sectors, appears plausible. The stock of net FDI continues to account for a very high share (92% in Q3-2022) of Serbia's net international investment position, which, even after declining by 9 pps from the end of 2021, still stood at a relatively high level of -74% of GDP in Q3-2022. The high share of FDI in net foreign liabilities, coupled with the relatively high level of foreign exchange reserves, reduces Serbia's vulnerability to external shocks. Foreign exchange reserves helped cushion the impact of the crisis in early 2022 and rose to a record level of EUR 19.4 billion in December 2022, also boosted by the first instalment of the SBA with the IMF (EUR 1 billion) and a bilateral loan from the United Arab Emirates (USD 1 billion). The ERP expects that foreign exchange reserves will continue to cover around 5 months' worth of imports throughout the programme's duration.

The financial sector has maintained sound macroprudential indicators, but credit growth slowed down considerably in the second half of 2022. Impacted by tightening monetary policy and stricter credit standards applied by banks to both corporates and households, lending growth moderated in 2022. Until the third quarter the rate of nominal credit growth was still close to double digits but slowed considerably in the fourth quarter to 6.1% year on year for households and 4.2% year on year for companies in December 2022³. A large share of the growth in business lending was for liquidity and working capital. The non-performing loan (NPL) ratio continued to decline steadily from 3.6% at the end of 2021 to 3.0% in November 2022. After a fall in 2020 due to the COVID-19 pandemic and broad stabilisation in 2021, profitability indicators improved in 2022 and broadly returned to their 2019 levels by November 2022. The share of deposits denominated in dinar decreased temporarily in early 2022 due to heightened uncertainty resulting from Russia's war of aggression against Ukraine but resumed its upward trend in June 2022 and broadly returned to the previous year's level by December (40.1% -0.2 pps year on year). Dinarisation of banking sector claims had increased in 2020 and 2021 but decreased steadily throughout 2022 to 35.1% in December (-3.1 pps year on year). There appears to be scope to increase the financial sector's role in reaching climate and energy targets in line with European and international commitments by adopting policy measures in the area of sustainable finance (such as sustainability disclosures, sustainable finance taxonomies etc.).

⁽³⁾ Given rising inflation rates, credit growth rates turned negative in real terms in 2022.

Table 2

Serbia - Financial sector indicators

	2018	2019	2020	2021	2022
Total assets of the banking system (EUR million)	41 514	45 838	50 775	56 748	61 141
Foreign ownership of banking system (%)	75.4	75.7	86.0	87.0	83.4
Credit growth (aop)	4.3	9.7	12.3	9.1	10.9
Deposit growth (aop)	7.4	12.9	15.0	14.4	8.4
Loan-to-deposit ratio (eop)	1.00	0.96	0.91	0.88	0.88
Financial soundness indicators (% , eop)					
- non-performing loans to total loans	5.7	4.1	3.7	3.6	3.0
- regulatory capital to risk-weighted assets	22.3	23.4	22.4	20.8	20.2
- liquid assets to total assets	35.7	36.0	37.3	37.7	37.5
- return on equity	11.3	9.8	6.5	7.8	13.9
- forex loans to total loans*	68.5	67.1	64.7	63.2	65.5

* Includes both denominated and indexed positions.

Note: Data for December 2022 are preliminary.

Sources: ERP 2023, National Central Bank.

3. PUBLIC FINANCE

The general government deficit decreased in 2022 as a high level of fiscal support to state-owned energy utilities and a series of ad hoc expenditure measures were largely offset by the balance-improving effects of high inflation. Very good revenue performance due to high inflation, the delayed effect of the strong economic rebound in 2021 and overall containment of the main categories of current expenditure caused the general government deficit to decrease from 4.1% of GDP in 2021 to 3.1% of GDP in 2022. It thus came very close to the original 2022 budget deficit target of 3.0% and below the revised target of 3.8% of GDP despite some very substantial expenditure increases (mainly to support the state-owned energy utilities Elektroprivreda Srbije and Srbijagas to allow them to cover high energy import costs). Budget support for these two companies alone amounted to around 2.7% of GDP and drove the high outturn of budget loans to SOEs. At 2.9% of GDP, this exceeded the amount estimated in the November budget revision (2.2% of GDP). The November 2022 amending budget also included a series of ad hoc expenditure measures that the government had implemented throughout the year. This particularly concerned direct lump sum cash payments to young people aged between 16 and 30 (0.4% of GDP), increased family allowances and assistance for mothers to buy real estate (0.2% of GDP) and increased agricultural subsidies (0.2% of GDP). At the same time, the phasing-out in 2022 of the COVID-19-related 2021 fiscal support measures helped contain overall expenditure growth in 2022 at +11% year on year, which was lower than the 13.4% increase in revenue. Expressed as a share of GDP, total revenue increased by 0.1 pps, while total spending decreased by 0.9 pps due to very high nominal GDP growth. The most significant revenue increases were from VAT (+0.5 pps) and corporate income tax (+0.5 pps), while excise duties (-0.5 pps) and social contributions (-0.3 pps) recorded the most significant decreases. On the expenditure side, only net budget loans (+2.1 pps) and repayment of guarantees (+0.2 pps) increased faster than nominal GDP. The very high rise in nominal GDP caused the *ex post* share of public wages in GDP to fall from 10.0% in 2021 to 9.6% in 2022.

Table 3

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

	2021	2022	2023	2024	2025	Change: 2022-25
Revenues	43.3	43.0	40.9	40.4	39.6	-3.4
- Taxes and social security contributions	38.6	37.7	35.6	35.5	35.0	-2.8
- Other (residual)	4.7	5.3	5.3	4.9	4.7	-0.6
Expenditure	47.4	46.8	44.2	42.5	41.0	-5.9
- Primary expenditure	45.7	45.2	42.4	40.5	39.1	-6.1
<i>of which:</i>						
Gross fixed capital formation	7.4	7.3	6.8	6.4	6.1	-1.2
Consumption	17.9	17.5	16.7	16.5	16.2	-1.3
Transfers & subsidies	16.8	15.6	15.7	15.3	15.2	-0.5
Other (residual)	3.5	4.8	3.2	2.3	1.5	-3.2
- Interest payments	1.7	1.6	1.8	2.1	1.9	0.3
Budget balance	-4.1	-3.8	-3.3	-2.2	-1.4	2.5
- Cyclically adjusted	-4.6	-4.1	-3.2	-2.0	-1.3	2.9
Primary balance	-2.4	-2.2	-1.5	-0.1	0.6	2.8
- Cyclically adjusted	-2.9	-2.5	-1.4	0.1	0.7	3.2
Gross debt level	57.1	56.9	56.1	55.1	54.0	-3.0

Sources: Economic Reform Programme (ERP) 2023, Commission calculations.

The planned gradual return to a prudent fiscal position in line with the new deficit rule is a welcome objective of the ERP's fiscal strategy over the medium term. The very high level of support to the energy sector in 2022 that is projected to be only gradually phased out over 2023-2025 means that the fiscal consolidation planned in the previous ERP was again largely postponed by one year at slightly higher annual deficit levels. The deficit is projected to be reduced to 3.3% of GDP in 2023, 2.2% in 2024 and 1.4% in 2025 – so below the 1.5% limit set by the new fiscal rule if debt is lower than 55% of GDP. This is consistent with a gradual fall in the debt-to-GDP ratio to below 55% in 2025. The overall planned fiscal stance appears appropriate to ensure medium-term fiscal sustainability. The tightening of the cyclically-adjusted primary balance is expected to be frontloaded in 2023-2024.

The ERP expects the improving fiscal balance to be driven by a strong decrease in the expenditure-to-GDP ratio over 2023-2025⁴. The decreasing spending ratio (-5.9 pps between 2022 and 2025) results from the planned gradual reduction of support to the state-owned energy utilities; the non-renewal of one-off support measures adopted in 2022; the decreasing share of capital expenditure from a high base; and modest growth below nominal GDP for most spending categories in 2023-2025. Social transfers as a share of GDP are projected to remain broadly stable at around 13% throughout 2022-2025, reflecting an increase in the share of pensions by 0.9 pps to 9.9% of GDP and a 0.8 pps decrease in the share of other social assistance to 3.2% of GDP. The latter is mostly frontloaded in 2023, reflecting the non-recurrence of the one-off payments to pensioners implemented in 2022. On the revenue side, the ERP expects a 3.4 pps fall in

⁽⁴⁾ In this paragraph, all changes in the 2023-2025 revenue and spending ratios in comparison to 2022 refer to expected changes as compared to the 2022 ERP estimates.

the revenue ratio in 2023-2025. This decrease is set to be mostly frontloaded in 2023 (-2.1 pps compared with the ERP 2022 estimate) as a result of revenue-decreasing discretionary measures (such as the reduction of employers' social contributions by 1 pp) and the expiry of one-off factors that boosted revenue in 2022, including the deferred payment of 2020 social contributions. The share of excise duties as a proportion of GDP is also expected to decline by 0.7 pps in 2023 which reflects, among other factors, the extension of the temporary reduction of excise duties on certain petroleum products that was initially introduced in March 2022. Good collection performance in 2022 means that VAT projections for 2023 (a 0.2 pps decline in VAT receipts) are very conservative. As in previous years, the programme also estimates non-tax revenue prudently, based on the conservative exclusion of extraordinary non-tax revenues⁵ for future budget planning (this entails a -0.3 pps drop in 2023). The only revenue item that is projected to increase as a percentage of GDP in 2023 is donations, which are expected to increase by 0.4 pps (mostly due to the budget support received from the EU to address the energy crisis). VAT, corporate and personal income tax are projected to increase broadly in line with nominal GDP in 2024, but overall revenue as a share of GDP is still expected to decrease by 0.5 pps, mostly reflecting the non-recurrence of the EU's energy-crisis-related budget support. The further drop of revenue as a share in GDP by 0.8 pps in 2025 mostly reflects conservative assumptions regarding non-tax revenue and excises and prudently low revenue elasticities for VAT, corporate and personal income tax.

The 2023 budget targets a relatively minor reduction of the deficit. As a result of decreases in both the revenue and expenditure ratios by 2.1 pps and 2.6 pps respectively, the 2023 budget plans a moderate headline fiscal consolidation of 0.5 pps to 3.3% of GDP (which would even correspond to a slight 0.2 pps increase compared with the actual 2022 deficit of 3.1% of GDP). On the revenue side, the 2023 budget introduces some changes to tax legislation that mostly build on gradual adjustments initiated in previous years. These adjustments concern the planned further small increase in the tax-exempt part of gross salaries which will slightly reduce the tax wedge on labour (though only in nominal terms given the increase in inflation) and a 1 pp decrease in the rate of employers' pension contributions. The budget also extends the temporary reduction of excise rates on certain petroleum products (introduced in March 2022) and does not apply the usual indexation of excise duties to the previous year's inflation. On the expenditure side, the 2023 budget reduces the expected net budget loans to the state-owned energy sector by around 0.5% of GDP. The budget increases pensions by 12% as from January 2023, in line with the modified indexation rule. This comes on top of the 9% ad hoc increase granted in November 2022 and therefore brings the full year-on-year pension increase in 2023 to around 20.5%. The minimum wage has been increased by 14.3%. Public sector wages have been increased on an ad hoc basis by 25% for professional military personnel and by 12.5% for all other public sector employees, thus resulting in an overall average increase of around 13%. This is projected to bring overall general government wage expenditure to 9.6% of GDP (i.e. within the 10% limit stipulated in the new fiscal rule which entered into application in 2023). Capital expenditure is projected to decrease to 6.8% of GDP in 2023 (following an ERP estimate of 7.3% GDP in 2022 and an outturn of 7.2% of GDP).

⁽⁵⁾ Ordinary non-tax revenues include various fees, charges, revenues of bodies, etc. that are generated at a broadly steady rate over the year but with some seasonal variations. Extraordinary non-tax revenues include profits of public companies and agencies, budget dividends, etc.

The budget for 2023

The Serbian parliament adopted the 2023 budget on 9 December 2022.

The general government deficit target for 2023 was set at 3.3% of GDP. This indicates some policy tightening when compared with the ERP estimate of 3.8% of GDP for 2022 but a slight fiscal easing when compared with the actual 2022 result of 3.1% of GDP. On the revenue side, the main discretionary fiscal policy measures are the reduction in employers' contributions to pension insurance by 1 pp and an increase in the personal income tax allowance. The main new expenditure measures are the decrease of budget loans to energy utilities and a decrease in capital expenditure.

Main discretionary fiscal measures in the 2023 budget*

Revenue measures	Expenditure measures
<ul style="list-style-type: none">• reduction by 1 pp of the pension insurance contribution paid by employers (-0.4 % of GDP)• increase in personal income tax allowance from RSD 19 300 to RSD 21 712 (-0.1% of GDP)• Instrument for Pre-Accession assistance (IPA) budget support grant (+0.2% of GDP)	<ul style="list-style-type: none">• decrease in budget support to energy utilities (-0.5% of GDP)• decrease in capital expenditure (-0.5% of GDP)• energy subsidies financed by IPA grant (+0.2% of GDP)
Total revenue effect (-0.3% of GDP)	Total expenditure effect (-0.8% of GDP)

* Estimated impact on general government revenue and expenditure compared with the 2022 ERP estimate.

** This table does not include the main expenditure impact corresponding to the carry-over effect from the November 2022 additional pension increase because this had already been adopted in the November 2022 amending budget.

The ERP expects the public debt ratio to continue gradually declining due to high nominal GDP growth and an improving primary balance. The general government debt-to-GDP ratio continued to decrease to 55.6% in 2022 (1.3 pps lower than the ERP estimate of 56.9% due to the lower-than-projected deficit outturn and lower deficit-increasing stock-flow adjustments). The ERP projects the debt ratio to fall by 1.0 pp annually on average in 2023-2025 thanks to high nominal growth and a further gradual improvement in the primary balance. These debt-reducing effects are expected to be only partly offset by positive stock-flow adjustments, which are not further specified. Less favourable conditions on international and domestic financial markets meant that Serbia did not issue any Eurobonds in 2022 to cover the increased financing needs related to costly energy imports, but it did agree a two-year standby arrangement (SBA) with the IMF (worth approximately EUR 2.4 billion and replacing the non-disbursing Policy Coordination Instrument) with an immediate disbursement of EUR 1 billion in December 2022. Serbia also secured a bilateral loan from the United Arab Emirates of USD 1 billion, which was also disbursed in December 2022. On 19 January 2023, in view of some stabilisation of financing conditions on international markets, Serbia issued a USD 1 billion ten-year eurobond and a USD 750 million five-year eurobond at coupon

rates of 6.25% and 6.5%, respectively⁶. The large proportion of foreign currency-denominated debt (74.6% in Q3-2022) continues to expose government debt to exchange rate risks (as demonstrated by the ERP's debt sensitivity analysis). This risk is nevertheless mitigated by the authorities' exchange rate stabilisation policy, which is underpinned by ample official foreign exchange reserves. The recently adopted reinforced rules-based framework designed to better anchor fiscal policy may also play an important role in reinforcing medium-term debt sustainability.

<i>Debt dynamics</i>					
Serbia					
Composition of changes in the debt ratio (% of GDP)					
	2021	2022	2023	2024	2025
Gross debt ratio [1]	57.1	56.9	56.1	55.1	54.0
Change in the ratio	-0.7	-0.2	-0.8	-1.0	-1.1
<i>Contributions [2]:</i>					
1. Primary balance	2.4	2.2	1.5	0.1	-0.6
2. "Snowball" effect	-5.1	-4.8	-4.7	-2.6	-2.3
<i>Of which:</i>					
Interest expenditure	1.7	1.6	1.8	2.1	1.9
Growth effect	-3.8	-1.3	-1.2	-1.8	-2.0
Inflation effect	-3.0	-5.1	-5.3	-2.9	-2.2
3. Stock-flow adjustment	2.0	2.4	2.4	1.5	1.7

[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) 2023, Commission calculations.*

The government debt-to-GDP ratio decreased by 1.5 pps in 2022 (more than the ERP projection of 0.2 pps). This decrease resulted from the effects of high inflation and moderate real growth, which more than offset the debt-increasing impact of the primary deficit, interest expenditure and positive stock-flow adjustments. The ERP expects that the primary balance will still have a substantial debt-increasing impact in 2023 and that this impact is set to turn broadly neutral in 2024. In 2025, stock-flow adjustments and interest expenditure are projected to remain the only debt-increasing factors. High inflation, reaccelerating real growth and the return to a primary surplus are expected to ensure a moderate downward trend for the debt ratio over 2023-2025. It is projected that the improvement in the debt-to-GDP ratio will continue to be slowed down by substantial debt-increasing stock-flow adjustments that reflect reserves for potential higher use of project loans, possibly higher local government debt and potential adverse shocks due to current global circumstances. Restitution-related debt could also contribute to an increase in the debt-to-GDP ratio by around 3 pps.

There are some short-term upside fiscal risks related to conservative revenue estimates and easing energy price pressures, while structural downside fiscal risks persist in the medium term. In the short term, despite a high degree of uncertainty surrounding the economic outlook, there are some upside risks relating to the achievement of the 2023 fiscal targets because budget revenues have been forecast using conservative assumptions. Also on the revenue side of the budget, the new electronic fiscalisation model and transition to electronic invoicing have been successfully completed and constitute an upside risk because they may have a significant impact by shrinking the grey economy, increasing VAT collection and improving the tax control

⁶ The corresponding USD exposure has been hedged into EUR, which reduces exchange rate risk under the current policy of a de facto stabilised RSD exchange rate against the EUR.

process. Moreover, the gradual retail price increases for gas and electricity agreed in the SBA might (in combination with lower than expected international energy prices and the earlier reestablishment of domestic electricity production capacity) reduce the need for the budget transfers to the state-owned electricity company Elektroprivreda Srbije and to Srbijagas as compared to budget plans. On the other hand, new unforeseen economic repercussions from the Russian war of aggression against Ukraine may call for further fiscal mitigation measures. In addition and as in previous years, new non-budgeted ad hoc expenditure measures could be announced. Looking ahead, revenue projections remain relatively conservative in terms of elasticities but keeping expenditure growth below the nominal growth of GDP might be challenging for some expenditure categories in view of their track record (particularly for spending on employees, subsidies and transfers to state-owned enterprises). Given the scale of fiscal risks stemming from inefficient state-owned enterprises (as highlighted by the ERP's sensitivity analysis), more transparency and effective implementation of structural reforms in this area (particularly as regards EPS and Srbijagas⁷) seem crucial in order to ensure the sustainability of the targeted 2.1 pps of GDP reduction in net budget loans (and even a reduction of 2.8 pps when compared with the 2022 outturn). The further implementation of the SOE ownership and management strategy could play an important role in this regard. As in previous years, the programme does not mention the restitution-related obligations of EUR 2 billion (around 3% of 2022 GDP) concerning properties confiscated by the communist government after the Second World War. The government confirmed the arrangements for monetary compensation in 2021 and the first government bonds specifically relating to this were issued in January 2022 and January 2023 (to a value of EUR 69 million (0.1% of GDP) and EUR 40 million (0.05% of GDP) respectively). The guarantee schemes set up during the COVID-19 crisis in 2020 and 2021 also constitute a contingent liability that may be triggered to some extent. 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. The original 2020 scheme was topped up in 2021 with an additional EUR 500 million (1% of GDP) and complemented by a new guarantee scheme to the same amount to support the most affected sectors and enterprises. However, updated estimates for the two guarantee schemes point to relatively low default risks in the coming years⁸. Another non-negligible fiscal risk concerns decisions by domestic and foreign courts that result 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 by employees of former socially-owned enterprises).

Recent improvements in the quality of public finances are set to be consolidated. The projected breakdown of public expenditure confirms that progress has been made towards a stronger pro-growth orientation of the budget, especially as regards the share of capital expenditure. After a record level of public capital expenditure of 7.5% of GDP in 2021 and an ERP estimate of 7.3% of GDP in 2022 (the actual result was 7.2% of GDP), the ERP forecasts annual decreases of around 0.4 pps over 2023-2025, which will gradually

⁽⁷⁾ As regards EPS and Srbijagas in particular, it appears essential to effectively address governance challenges and implement structural reforms despite the expected short-term improvements in financial outcomes resulting from the scheduled increases in electricity and gas prices,

⁽⁸⁾ The revised 2023-2025 fiscal strategy expects gross fiscal outflows related to the guarantee schemes to be limited to 0.12% of GDP in 2022, 0.07% in 2023 and 0.01% in 2024.

bring the ratio down to 6.1% of GDP, which is still high. There is nevertheless room to strengthen the cost-effective implementation of infrastructure spending by applying the same rigorous selection and management framework to all projects, regardless of the source of financing. Health expenditure⁹ peaked at 7.1% of GDP in both 2020 and 2021 due to the COVID-19 pandemic and is estimated to have remained high at 6.6% of GDP in 2022. After a further fall to 6.1% of GDP in 2023, it is expected to stabilise at that level in 2024 and 2025 (i.e. still 0.8 pps of GDP above the pre-COVID-19 crisis level). Education spending as a proportion of GDP is projected to remain unchanged at the 2022 estimated level of 3.1% of GDP throughout the programme period. Interest expenditure is projected to gradually increase from an estimated 1.6% of GDP in 2022 to 1.8% in 2023 and 2.1% of GDP in 2024 (in line with less favourable financing conditions and the relatively slow projected decrease in the debt-to-GDP-ratio) before slightly decreasing to 1.9% of GDP in 2025 (in line with the decreasing debt level). On the revenue side, increasing the tax-free allowance for personal income tax and lowering employers' pension contributions by 1 pp should help to gradually reduce the tax wedge for low-income earners. To make informal labour less attractive, there may be grounds for raising the threshold further and above the inflation rate.

Structural fiscal reforms progressed well in 2022, particularly as regards the adoption of revised fiscal rules. Following a delay of several years (due in part to the COVID-19 crisis), a new system of fiscal rules was adopted through a corresponding revision of the budget system law in December 2022. The central rule consists of a general government deficit ceiling set by reference to the level of debt (3% of GDP if debt is below 45% of GDP; 1.5% of GDP if debt is below 55% of GDP; 0.5% if debt is below 60% of GDP and 0% if debt is above 60% of GDP). This deficit rule has already been adopted but will only enter into force in 2025 because specific deficit targets for 2023 and 2024 had already been agreed in the SBA with the IMF. The new rules also include a cap on the general government wage bill at 10% of GDP and a modified rule for pension indexation for which the calculation methodology will vary according to the ratio of pension expenditure to GDP¹⁰. The enforcement mechanism might need to be strengthened, but the new rules can be considered to be reasonably credible and binding due to their relative flexibility at lower debt levels / lower shares of pensions/salaries relative to GDP. It would seem appropriate to reinforce the medium-term perspective of the fiscal rules' implementation by strengthening medium-term budgeting. The public sector wage system reform has been postponed to 2025, but the new central electronic public wage and employment registry (Iskra) became operational for some sectors in 2022 and will be rolled out to most of the public sector (except military, security and higher education institutions) by the end of 2023 as an important preparation for the reform. The November 2022 amending budget was adopted using the urgent procedure, but the 2023 budget was adopted broadly in line with the normal legislative procedure (albeit with some delay). Neither the 2022 amending budget nor the 2023 budget provide an adequate level of transparency regarding the breakdown of capital transfers and guarantees to SOEs, in particular to EPS and Srbijagas. There was a meaningful

⁽⁹⁾ As defined using the functions of government (COFOG) classification.

⁽¹⁰⁾ Pensions are indexed in line with average earnings if they represent less than 10% of GDP. If they represent between 10% and 10.5% of GDP, then the indexation rate is the total of half the growth rate for average earnings and half the inflation rate (the 'Swiss formula'). If they represent more than 10.5% of GDP, then they are indexed in line with inflation.

parliamentary debate on the 2023 budget and the government also submitted the final annual budget execution report for 2021 to the parliament. The well-established Fiscal Council has continued to function properly and produce independent fiscal assessments and recommendations. Budgetary statistics have been delivered on time, but budget execution reports still lack information on large one-off measures.

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 opening or restructuring. Its underperformance continues to undermine Serbia's competitiveness and economic growth potential - this has been accentuated during the current energy crisis, as long-standing structural issues remain unaddressed. Moreover, Serbia will only be able to achieve higher growth rates in the longer term if it makes better use of the opportunities offered by the single market and the service sector, and ensures a level playing field for all companies. Further economic growth and improvements in living standards towards EU levels will therefore depend on the continuous implementation of structural reforms across many sectors.

The Commission has conducted an independent analysis of Serbia's economy and identified three key structural challenges to competitiveness and inclusive growth, drawing on Serbia's own ERP and other sources:

- (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 and diversifying Serbia's energy sector, reducing dependence on Russian energy supply and fully opening the energy market.

While the Serbian economy continues to experience several obstacles to inclusive growth and competitiveness the three key structural challenges through properly targeted reforms offers the biggest potential for economic resilience, and inclusive growth and competitiveness. The Commission welcomes that Serbia has broadly 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 3 on greening and diversifying Serbia's energy sector, reducing dependence on Russian energy supply and fully opening the energy market. The ERP still does not sufficiently focus on the greening aspects of this challenge, which the Commission considers to be key to reforming the sector. This year's ERP recognises that the energy market should be fully opened as well as the need to diversify the energy sector away from Russia, but the reform measures currently planned by Serbia are not sufficient to achieve these objectives.

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 monitoring the issues of strengthening the rule of law and fighting corruption in its annual Serbia report.

Furthermore, the country should proactively implement the Energy Community's Decarbonisation Roadmap to achieve the agreed climate and energy targets, and strive towards establishing a carbon pricing instrument compatible with the EU ETS.

Key challenge #1: Increasing employment, particularly of young people, women and vulnerable groups, and social protection to combat poverty

The labour market has rebounded since the peak of the COVID-19 pandemic. The employment rate (aged 20-64) rose from 64.3% in 2020 to 66.7% in 2021, whereas the activity rate (aged 15-64) rose from 66.4% to 70.3% in the same period. This is the highest level for both indicators in the last 10 years. Serbia is making steady progress towards the EU's average employment and activity levels, but there is still some way to go (the average employment rate of the EU-27 was 73.1% and the average activity rate was 73.6% in 2021). The unemployment rate for all age groups taken as a whole rose from 9.1% in 2020 to 11.1% in 2021 but declined again in 2022 (it was 8.9% in Q3-2022). The rate for the EU-27 in 2021 was 7%. Here too, Serbia is close to some EU Member States.

Despite an overall good performance in all area of employment, Serbia continues to face structural challenges that are hampering further improvement. Many of its young people are emigrating to the EU and other economies where they can enjoy better career prospects in all fields of employment. This outflow is compromising Serbia's economic growth potential. The average and median salaries were EUR 882 and EUR 490 respectively in Q3-2022. The 2022 housing and population census revealed that Serbia's population had fallen by 402 193 compared with the previous census in 2011 (Serbian Statistical Office 2022). The share of the working population aged 15-64 decreased from 68.3% in 2011 to 64.4% in 2021. Around 14% of people who were born in Serbia now live abroad (ETF, 2021). This labour outflow is particularly (but by no means exclusively) weakening the health and service sectors in the Serbian countryside and the Serbian economy's overall growth perspective. It also poses a challenge to the ongoing green and digital transition, which requires new skills to be available on the labour market. The Serbian ERP acknowledges the need to provide incentives to encourage the Serbian diaspora to return home and the need to attract foreign experts. The Serbian government has adopted the strategy on economic migration of the Republic of Serbia for the period 2021-2027 (Official Gazette of the RS, No. 21/20) and an action plan to implement this strategy. The strategy covers a range of topics related to the economic migration, its management, the correlation between migration and development, and the diaspora's potential role as a driver of (local) development. Serbia is proposing Reform Measure 4 ('improvement of the environment for encouraging, supporting and monitoring circular and economic migration') in this context. This measure has been rolled over from the two previous ERPs. It remains a valuable initiative, but it would also be worthwhile to examine how effective the reform measure is in practice and Serbia should therefore quantify how many highly qualified (and other) people have returned home to Serbia. Data are collected periodically and the next data set is due to be collected in April 2023.

School-to-work transitions have improved but remain structurally difficult. The low quality of available jobs is limiting young Serbians' chances of properly establishing themselves in the labour market, and they remain more likely to be in temporary and/or informal employment than other age groups. 52.4% of young people (aged 15-24) have only temporary jobs and the rate of young persons in informal employment is 4.8 pps

higher than for the overall working-age population. The high NEET (not in employment, education or training) rate only began to decrease in the 15-29 age group in 2021 (from 20% in 2020 to 18.8% in 2021). However, insufficient investment in human capital, limited capacities of the public employment service and the unfinished reform of VET resulted in this age group having lower employment prospects than older age groups. Serbia is addressing this by upgrading VET.

Reform Measure 3 ('qualifications oriented to the needs of the labour market') will introduce a dual VET system. The measure has been rolled over from several years, but the share of dual VET has stagnated at 5% despite plans to reach 12% by 2025. It seems reasonable to increase the share of dual VET and to improve quality standards in the remaining school-based VET education in order to improve the overall situation. Serbia also needs to launch the Youth Guarantee, which is a flagship initiative for the Western Balkan economies under the economic and investment plan (EIP) and an EU-tested tool to get young people in to employment. To this end Serbia has launched the Reform Measure 1 ('establishment of a framework for the introduction of the Youth Guarantee in the Republic of Serbia'). The goal of this structural reform is to provide young people with an offer of high-quality employment, continuing education, an internship or training within a period of four months of becoming unemployed or leaving education. Serbia needs to implement this measure consistently and to adopt its Youth Guarantee implementation plan in line with the Western Balkans Declaration on ensuring sustainable labour market integration of young people (Brdo Declaration of 9 July 2021). The staffing and resources of the Serbian public employment service need to be significantly upgraded to make it effective and fit for purpose.

The female employment rate is still significantly lower than the male employment rate (the employment rate of women aged 15-74 in the third quarter of 2022 was 43.9%, while the employment rate of men was 58.3% – a gender employment gap of 14 pps). Female labour force participation is a key factor for the future development of the labour market and the economic growth. The picture is better for the gender pay gap, remaining stable at 8.8% and lower than the EU average (14.1%). The percentage of children aged under 3 years in formal childcare was 17.2% in 2019. Bringing this closer to the EU-27 average of 35.3% by upgrading childcare facilities would help to bring more women into paid work and would thus help narrow the gender employment gap. Serbia scores 58.0 points in the Gender Equality Index, which is below the EU-27 average of 67.4 but nonetheless higher than some individual EU Member States. This score has improved by 2.2 points on 2016, but the European Institute for Gender Equality (EIGE) estimates that it will take another 59 years to reach full equality at the current rate of change. Serbia is addressing gender equality with a 2021-2030 gender equality strategy and an associated action plan, but the ERP does not outline the concrete measures of this action plan – even though this should be a matter of priority.

Active labour market policies remain underfunded at 0.1% of GDP in 2021. The 2021 national employment strategy includes an employment rate target of 66.1% for those aged 15-64 in 2026. This would be an increase of 5.9% compared with the base year of 2019. More offers for reskilling and upskilling with a view to the green and digital transformation of the society could help achieve the employment target. The 'my first salary programme' was a good example of an active labour market policy.

Serbia is fostering social enterprises and adopted a Law on social entrepreneurship in February 2022. Social enterprises have great potential to provide inclusive employment to the more vulnerable sections of the national workforce. Helping such enterprises is therefore a worthwhile initiative and in line with policy developments in the EU.

Serbia has not tapped the full potential of social dialogue, which can advance economic development. Collective bargaining in the private sector remains limited and there are only a few sectoral agreements. Sectoral agreements in the private sector could promote a level playing field in various areas and provide benefits such as complementary pensions. The expertise of social partners in view of VET reskilling and upskilling of the workforce is not being put to use. In addition, social partners and government have not been able to agree on an adequate minimum wage in recent years, with the result that the government has had to set the level of the minimum wage by decree. The minimum wage has been approximately RSD 40 000 (around EUR 340) since January 2023. This is roughly the price of the minimum consumer basket for a three-person household. This is just above the EUR 337 minimum consumer basket for a three-person household in 2021, but the fact that minimum wage recipients still need to pay taxes and social security contributions means that it hardly constitutes a living wage. Reducing the tax wedge for low incomes would help to curb poverty and labour migration. The social dialogue institution (the Economic and Social Council) has to issue opinions on government initiatives but is not always consulted in good time and is therefore unable to function properly.

Lower secondary school education results for 15-year-olds lag behind the EU average, although Serbia's PISA rating is the best in the Western Balkans and its average scores are close to those of some EU Member States (Bulgaria, Greece and Romania). The average score is 439.5 in reading (EU: 481.7; Western Balkans: 402), 448.3 in mathematics (EU: 488.6; Western Balkans: 414) and 439.9 in science (EU: 484; Western Balkans: 408). Entry into upper secondary programmes is not equitable because boys are twice as likely as girls to attend VET which is not conducive to increasing female labour market participation. The high proportion of early school leavers (young people aged 18-24 who at best completed primary education and did not pursue further education) continues to be a problem and amounted to 5.1% in the third quarter of 2022. Upskilling efforts to improve their employability remain necessary given current and future anticipated skills shortages. Serbia has introduced structural reform measure 2 ('the young talent fund reform'), which is intended to promote academic excellence in public administration and in the economy. This is a commendable measure but is limited in scope with 225 funded talents in the Serbian administration and economy targeted by 2025.

Serbia's ERP also recognises the challenges in the field of social protection but has not yet addressed them with suitable measures. The AROPE (at-risk-of-poverty or social exclusion) rate was 28.4% in 2021 (6.7 pps more than the EU average of 21.7%). The impact of social transfers (excluding pensions) on poverty reduction was 18.02% in 2019 (32.38% for the EU-27). As noted above, the average minimum consumer basket for a three-member household in Serbia was EUR 337 in 2021, while the poverty risk threshold for a three-member household (two adults and one child under the age of 14) was EUR 368. At the same time, the amount of social assistance received by a three-member family amounted to EUR 147, which was less than half of the average minimum consumer basket and less than half of the poverty risk threshold. There is therefore an

urgent need to properly fund and resource social policy. Serbia has committed itself to the European Pillar of Social Rights which includes adequate social protection. The policy guidance of past ERPs has unfortunately not been taken into consideration because Serbia has increased the financial social assistance (FSA) benefit only slightly nominally and below the inflation rate, which has led in turn to a de facto fall in the level of benefits. The Commission therefore reiterates its policy recommendations from the 2021 and 2022 ERP cycles and calls on Serbia to substantially increase its FSA social benefits to an adequate level close to or at the cost of living. The Law on the Social Card, which was presented in previous ERPs, came into force in 2022. It established the Social Card Register to better coordinate and follow up social benefits, but it does not affect the adequacy of benefits. Serbia is also working on amendments to the Law on Social Protection, whose exact scope and impact is not yet known. It is intended to improve the procedure for activating working-age beneficiaries of financial social assistance. This seems to be a rationalisation and activation effort, rather than an increase in the level of benefits for the vulnerable part of the population. Finally, Serbia has been working for several years on its new social protection strategy. Its ambition and impact will need to be checked once it has been issued.

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

Serbia's business environment is improving, but significant structural challenges still have to be addressed if Serbia is to achieve its economic growth and competitiveness potential. Serbia has made notable progress in reducing the regulatory and administrative burden on businesses and in particular through digitalisation efforts, which were accelerated by the pandemic, such as expanding e-commerce. However, the impact on SMEs was limited. Key structural challenges nonetheless remain largely unaddressed, relating primarily to the continued strong footprint of state-owned enterprises (SOEs) in the economy and their market dominance in key sectors that remain unreformed, threatening the level-playing field. Unaddressed issues also include insufficient transparency, reliability and predictability of the regulatory framework.

Serbia has recorded strong inflows of foreign direct investment in recent years but private domestic investment is still lagging behind. Addressing the remaining issues would encourage both private and public, domestic and foreign investment, including in industries that play a key role in sectors crucial to making progress in digitalising and greening the economy in line with the Green and the Digital Agendas for the Western Balkans, and the need to move with some urgency towards renewable and more diversified energy sources away from Russian sources and in line with the REPowerEU strategy, as well as to avoid Serbian goods becoming subject to the upcoming EU Carbon Border Adjustment Mechanism. Addressing the remaining issues 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 continues to recognise 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 also in this year's ERP.

The role of the state in the economy is shrinking but remains large and hampers competition, while the continuing poor management and financial performance of many state-owned enterprises (SOEs) constitutes a fiscal problem. Outside the financial sector, privatisation and restructuring efforts have largely stalled and SOEs continue to dominate many sectors, including energy, transport, utilities, telecommunications, infrastructure, mining, and extraction of natural resources. This outsized presence deters private investment and innovation, and impedes overall competitiveness. Furthermore, many of Serbia's state-owned enterprises do not apply corporate governance rules and operate with low efficiency and high costs. Most public companies continue to rely on state support, in the form of direct or indirect subsidies. The poor management and subsequent financial performance of these companies poses substantial fiscal risks, as recently confirmed by Elektroprivreda Srbije's (EPS) losses of nearly EUR 630 million in 2022. This is of particular concern in the current context of rising inflation and other disturbances accentuated by Russia's war of aggression on Ukraine, and potential new external shocks to the economy.

Governance of SOEs also continues to pose problems 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 new Law on SOEs, which is currently in the drafting stage is expected to make it possible to address these issues.

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, and the independence of the commission for state aid control has yet to be demonstrated through a consistent and transparent track record. In the area of State aid, well defined rules are not always implemented due to strong political pressure for financial assistance, channelled to SOEs and large foreign investors. These resources are often substantial and may have a significant impact on competition. State support is not sufficiently transparent, including in the 2023 budget.

A robust process for transparent appraisal and selection of public investment projects is a priority, given Serbia's significant infrastructure needs and long pipeline of future projects, including projects for the green and digital transition, and for the diversification of the energy sector. The legislative framework for public investment management remains unsatisfactory as regards transparency, assessment and prioritisation of investment. 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, which is expected to be revoked in the course of the first half of 2023, still allows certain linear infrastructure projects to be exempted from public procurement rules, without providing clear guidelines for strategic prioritisation. This increases opportunities to extract benefits by inflating prices in the absence of competition and various subcontracting contracts and creates opportunities for corruption. Serbia has committed to revoke the Law on special procedures for linear infrastructure projects in the course of the first half of 2023. 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 granted mostly by non-EU countries. Investment decisions are still often taken without the appropriate feasibility studies, cost-benefit analysis and environmental impact assessments necessary to ensure the sound use of public funds.

Serbia has in recent years reduced the regulatory and administrative burden on businesses, but more effort is needed. Some burdensome business procedures have been significantly simplified and their cost reduced, but many burdensome administrative procedures still remain, 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 many parafiscal charges remain high and non-transparent, lacking rationalisation, thus undermining the predictability and stability of Serbia's tax system and hampering economic development. The business community generally considers the Law on foreign exchange transactions 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. This includes numerous trade restrictions introduced by Serbia with little or no notice, thus negatively impacting the stability of supply-chains, and further hampering the predictability for businesses and investors.

Further efforts are needed to improve the quality, independence and efficiency of the justice system. An efficient and independent judicial system is a prerequisite for a predictable investment- and business-friendly environment, and is necessary in order to encourage innovation, attract additional 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, but, 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 (2.5 in 2021). The supervisory institutions (the Public Procurement Office, the Commission for the Protection of Rights in Public Procurement Procedures, the State Audit Institution, the Anti-corruption Agency, the state prosecutor, etc.) lack staff and do not always coordinate their anti-corruption work effectively and systematically.

The widespread informal 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 informal economy include high taxes and contributions on the lowest salaries, a lack of financial resources and favourable loans, parafiscal charges, hidden tax fees and red tape. The consequences are tax evasion, market distortion, unfair competition and inefficient resource allocation. Notable investment has been made to reduce the size of the informal sector, but the pace of reform is slow.

The ERP reform measures in the area of the business environment target as last year the high administrative and regulatory burden, the management of state-owned enterprises and the functioning of the capital markets, but they still do not sufficiently address the main underlying structural weaknesses. *Reform measure 5, 'Improvement of the quality of public services through optimisation and digitalisation of administrative procedures – e-paper'*) has been rolled over from past ERPs. It has the potential to significantly reduce administrative costs for businesses, reduce opportunities for corruption and increase Serbia's general attractiveness as an investment destination. However, the measure has only yielded rather limited results so far: out of nearly 3 000 procedures, 380 have been fully optimised, 64 digitalised, and 21 abolished. Significant efforts are needed to speed up and eventually conclude the reform. *Reform measure 6 ('Sustainable and efficient management of business entities owned by the Republic of Serbia')* has been rolled over from last year's ERP and remains very relevant given that it aims to improve the management of SOEs. The ERP rightly recognises the need to speed up the implementation of the related 2021-2027 strategy. Finally, *Reform measure 7 ('Development of the domestic capital market providing a greater level of investor protection')* has also been carried over from last year's ERP. 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 and the planned activities lack ambition and detail.

The ERP once again does not contain any reform measures specifically addressing the issue of the informal economy. However, *Reform measure 11 ('tax administration transformation')* has been carried over from last year's ERP and may, if properly implemented, lead to improvements in tax inspections and management, with a positive impact on reducing the informal economy. This reform measure is further analysed in Section 6 under public financial management.

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

There was good progress in 2021, particularly on renewables and energy efficiency. However, the energy sector remains inefficient and polluting, and is not fully compliant with the Energy Community Treaty or 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 many individual heating systems use wood and coal as fuel. The energy sector is the main source of air pollution in Serbia and imposes health costs on the economy. Licensing rules are rarely applied. In addition, the underperformance of the energy sector and the slow progress on the green energy transition constrain 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 both in the immediate future and after its accession to the EU. Furthermore, Serbia's dependence on Russia in the energy sector is the highest in the Western Balkans. Russia's war of aggression on Ukraine, its impact on the global energy market and Russia's control of critical infrastructure makes Serbia particularly and further underlines the need to diversify and thus secure supply.

Addressing the 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. The need to reduce dependence on specifically Russian energy sources is only partially recognised.

Serbia's energy sector as a high energy and carbon intensity. This is due to losses in distribution, outdated infrastructure, intensive use of coal and low energy efficiency at the end-user level. Most energy companies are state-owned and have down the years relied to a varying degree on support from the budget. Serbia paid direct subsidies worth about EUR 35 million to support coal-fired power generation in 2020, thus 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 97% of participation in the electricity market in 2021. Direct or indirect regulation of energy prices is keeping entry barriers to the sector high.

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. In 2021, about 60% of domestic electricity production came from coal (lignite), 33% from hydropower, 2% from gas, but only 3% from wind and solar combined, and around 1% from other renewable energy sources (SORS, 2023). Serbia continues to invest in new coal power plants and is currently building a new lignite power plant (Kostolac B3) with a capacity of 350 MW, although it did suspend the new Kolubara B 350 MW power plant project in early 2021. The new climate law adopted in March 2021 is a step in the right direction. The long-standing national energy and climate plan is due to be adopted by the end of June 2023 and must be sufficiently ambitious to take forward Serbia's green transition.

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 caused a total of nearly 14 400 premature 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. Sulphur dioxide emissions were six times higher than the national ceiling in 2020. Serbia adopted a national emission reduction plan in February 2020, but it has still not been implemented in practice for sulfur dioxide and dust.

Inefficient energy use in Serbia is a major concern. Lack of efficiency in the energy sector is critically undermining the country's overall economic competitiveness. Serbia did nevertheless make major progress in aligning its legislation with the EU *acquis* on energy efficiency in 2021. It has created a new Directorate for Energy Efficiency and launched a housing renovation programme. An additional step was taken in February 2022 through the adoption of a long-term building renovation strategy until 2050. Priorities include continuing to improve financial, institutional and human resource capacities and better coordinating energy efficiency actions with all relevant stakeholders, including at the local level. Boosting investment in energy efficiency requires large-scale consumption-based metering and billing in district heating and the setting up of a sustainable financing mechanism. Serbia has not yet fully aligned its legislation with the EU's Energy

Performance of Buildings Directive. Serbia should also allocate all income from the new energy efficiency fee, in full, to financing energy efficiency measures, and should develop energy efficiency programmes to support vulnerable households.

Major investment is needed to modernise Serbia’s energy infrastructure and lower carbon emissions. Serbia’s energy infrastructure is generally old and outdated, resulting in high energy losses (particularly in distribution). Serbia’s reliance on coal-based energy supply means that major investment is needed to implement the necessary transition from fossil fuels, especially coal, to renewable sources of energy, while planning for the re-training of affected workers’ and upgrading of their skills. Investment in renewable energy is increasing but only slowly. In 2020, Serbia achieved a 26.3% share of renewables in gross final energy consumption, which was 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 capacity significantly in the next 5-10 years, and therefore require investment in new capacity.

Greening Serbia’s energy sector is of paramount importance if Serbia is to meet its obligations under the Energy Community Treaty and its EU membership ambitions, and ensure the sector’s sustainability and profitability. 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. Decreasing global prices for renewable energy and increasing efforts to address carbon leakage in Europe mean that 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. However, implementing legislation that will enable the launch of renewable energy sources auctions and simplify procedures for prosumers remains outstanding.

Electricity prices in Serbia are slowly increasing but have been too low for too long and do not incentivise investment in energy efficiency and energy savings – while the management and financial performance of the electricity provider EPS constitutes a fiscal risk. Current electricity tariffs do not cover the real cost of the investment needed to guarantee security of supply, an issue which has been accentuated with the increasing energy costs due to the situation on the global market and lower domestic production, accompanied by higher electricity imports. Moreover, they are unable to cover the investment needs for Serbia’s energy and climate reforms. The planned continued increase in electricity prices should be accompanied by appropriate social programmes to mitigate potential adverse effects, bearing in mind that a considerable and increasing proportion of the population suffers from absolute poverty and energy poverty. The Commission’s 2022 energy support package and the IMF’s stand-by arrangement should create fiscal space for action. In December 2022, Serbia adopted the new Decree on Protection of Vulnerable Customers that should allow for increased number of beneficiaries (around 190,000) to receive support for paying energy bills. The energy bills of all Serbian citizens include the EU logo and a description of the EU’s support in helping to reduce energy costs, as well as information on how citizens can take individual action in order to lower their energy consumption.

Increased efforts are necessary to diversify Serbia’s energy supply and overall energy mix and reduce its dependence on Russian energy sources. Ensuring security of supply

for the domestic natural gas market remains a challenge, despite the diversification of gas supply routes. Serbia depends on imported natural gas for 88% of its total needs, which it receives from a single supplier, thus creating a supply security risks. Work started on the Serbian side of the Serbia-Bulgaria gas interconnector in February 2022 and on the Bulgarian side at the end of 2022. Locally produced electricity comes primarily from lignite. This supply mix is characterised by high direct and indirect costs, is converted inefficiently and is transported to sectors and industry at a price that does not allow full cost recovery. Serbia should in this regard make the best use of the economic and investment plan for the Western Balkans (European Commission, 2020) as well as the Commission's 2022 energy support package in order to begin phasing out coal and start building a climate-neutral economy by replacing fossil fuels with renewable energy, and gas as a transitional fuel, avoiding stranded assets, and reduce its dependence on Russian energy sources in line with the REPowerEU strategy.

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 the 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 have been unbundled. Serbia adopted an action plan on gas unbundling in May 2021 but key elements have been significantly delayed, including the certification of Transportgas Srbija. The implementation of Serbia's action plan on gas unbundling also depends on further amendments to the Energy Law.

Serbia's ERP for 2023-2025 is not sufficiently ambitious regarding the clean energy transition and energy efficiency. The reform measures proposed in the ERP once again 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 8 ('Improvement of conditions for enhancing energy efficiency through creating conditions for application of energy labelling and eco-design, as well as through the incentives for enhancing energy efficiency')* has been partly carried over from last year's ERP. Novelties regard the introduction of eco-labelling as a contributor to higher energy efficiency in the housing sector. It correctly identifies the need to improve the legal framework in line with the EU *acquis*. However, the measure still falls short of effectively incentivising energy efficiency investments, including in both the manufacturing and housing sectors. Steps to implement consumption-based metering and billing in district heating or a large-scale renovation wave in Serbia are still missing.

Reform measure 9 ('Integration of renewable sources of electricity through the "Beograd 2025" project') is a new reform, aimed at enabling integration of electricity stemming from renewable sources into the transmission system primarily in parts of Belgrade and Zemun. Construction is planned to start mid-2024. The reform is relevant as it will prepare the electricity transmission system for electricity produced through renewable sources. However, its geographical coverage is rather limited. The planned activities are not sufficiently detailed, and do not, for example, cover what will be done to reduce the Corona effect which can cause significant losses of electricity in certain weather conditions. Such measures would reduce inefficiencies in the electricity system and help reduce energy inefficiency.

Reform Measure 10 ('Energy market development coupled with energy infrastructure construction') has been 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 focuses on the last two sections of this project, which are facing delays. As in the past, the reform does not go far enough in the gas sector, where no progress has been made in unbundling and providing third-party access to existing gas infrastructure.

Monitoring performance in light of the European Pillar of Social Rights¹¹

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., worsening
	Individuals' level of digital skills	Worse than EU avg., improving
	Youth NEET (% of total population aged 15-29)	Worse than EU avg., improving
	Gender employment gap	Worse than EU avg., worsening
	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., worsening
	Housing cost overburden	Worse than EU avg., improving
	Children aged less than 3 years in formal childcare	Worse than EU avg., improving
	Self-reported unmet need for medical care	Worse than EU avg., improving

Serbia has steadily improved employment and has reduced unemployment and its labour market has grown. The employment rate exceeds pre-COVID-19 levels, as does the activity rate (70.3% in 2021, compared with 66.4% in 2020). The employment rate for women in Serbia is significantly lower than the employment rate for men. The gender employment gap is wider than the EU-27 average (14 pps in Serbia in 2021; 10.8 pps in the EU) due to the lower statutory retirement age for women and the low level of part-time work available combined with care responsibilities. Spending on active labour market policies remains insufficient at only around 0.08% of GDP in 2019 (the EU-27 average in 2019 was 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 18.8% in 2021 significantly above the EU-27 average of 13.1%) but the lowest among all candidate countries.

Vocational education and training is not sufficiently oriented to labour market needs and, together with the lack of opportunities for reskilling and upskilling, is a key obstacle to higher youth and adult employment and activity rates in Serbia.

Serbia's performance on social inclusion, social protection, income equality and poverty alleviation is improving but could still be significantly improved even further. The AROPE rate is 23.2% and is among the highest in Europe. Children and those aged under 18 face an at-risk-of-poverty rate of 27.5%. The at-risk-of-poverty-or-social-exclusion rate was very high in 2020 (28.4%) and significantly above the EU-27 average (21.7%). The disposable income of individuals in the top income quintile is on average almost six times higher than the disposable income of those in the lowest quintile. Serbia's tax-benefit system is not as effective in reducing market inequality as other European countries' systems. Furthermore, high government expenditure does not greatly reduce income inequality.

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. The monitoring of social policy in Serbia (including methodology and results) is critically discussed in academic and civil society circles.

⁽¹¹⁾ 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

5. OVERVIEW OF THE IMPLEMENTATION OF THE POLICY GUIDANCE ADOPTED AT THE ECONOMIC AND FINANCIAL DIALOGUE IN 2022

Every year since 2015, the Economic and Financial Dialogue between the EU and the Western Balkans and Türkiye has adopted targeted policy guidance for all partners in the region. The guidance represents the participants' common view on the policy measures that should be implemented to address macrofiscal vulnerabilities and structural obstacles to growth. The underlying rationale for the policy guidance 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 the implementation of the 2022 policy guidance jointly adopted by the EU and the Western Balkans and Türkiye at their Economic and Financial Dialogue at Ministerial level on 24 May 2022.

Overall: Partial implementation (51.4%) ¹²	
2022 policy guidance (PG)	Summary assessment
<p>PG 1:</p> <p>If needed, use the available fiscal space in the 2022 budget to cushion the potential impact of adverse shocks through targeted support to vulnerable households and firms; provided the economic recovery is well entrenched, plan a further gradual return to a deficit close to balance in the 2023 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 preparatory steps towards an appropriately designed public sector wage system reform.</p>	<p>There was substantial implementation of PG 1</p> <p>1) Partial implementation: The authorities have provided very substantial fiscal support to cushion the impact of the energy crisis on households and firms via budget support to state-owned energy utilities, lower excise duties on fuel and specific support to farmers. However, energy support was not specifically targeted to vulnerable households and businesses and lump sum payments to all young people between 16-30 were not targeted to specific needs. Lower energy support needs helped to allow the 2023 budget and medium-term fiscal strategy to effectively include a plan for gradual fiscal consolidation, and the deficit is expected to meet the applicable fiscal rule in 2025.</p> <p>2) Substantial implementation: Following a further 0.3 pps decline in 2022 due to very high nominal GDP growth, overall spending on wages as a percentage of GDP is projected to remain stable at 9.6% in 2023-2025. The planned containment continues to rely on ad hoc decisions, but the revised fiscal rules (adopted by amendment of the budget system law in December 2022) stipulate that the yearly budget law must stipulate the percentage of public sector wage increases and that the resulting share of wages as a proportion of GDP must not exceed 10% from 2023 onward. The public sector wage system reform has been postponed to 2025, but the new central electronic public wage and employment registry (Iskra)</p>

change). For data see Annex B. NEET: neither in employment nor in education and training; GDHI: gross disposable household income.

⁽¹²⁾ For a detailed description of the methodology used to assess policy guidance implementation, see Section 1.3 of the Commission's Overview and Country Assessments of the 2017 Economic Reform Programmes. This is available at https://ec.europa.eu/info/publications/economy-finance/2017-economic-reform-programmes-commissions-overview-and-country-assessments_en.

<p>Adopt a credible and binding system of fiscal rules for entry into force in 2023 as envisaged in the ERP.</p>	<p>became operational for some sectors in 2022 and will be rolled out to most of the public sector (except military, security and higher education institutions) by the end of 2023 as an important step in preparing the delayed wage system reform.</p> <p>3) Full implementation: A new system of fiscal rules has been adopted via a corresponding revision of the budget system law in December 2022. It sets a general government deficit ceiling based on the general government debt level (3% of GDP for debt below 45% of GDP; 1.5% of GDP for debt below 55% of GDP; 0.5% for debt below 60% of GDP; and 0% for debt above 60% of GDP). The deficit rule will not apply before 2025 because budget targets for 2023 and 2024 had already been agreed in the SBA with the IMF. The new rules also include ceilings (already applicable in 2023) on two large expenditure items: a 10% maximum share of GDP for the general government wage bill and a modified rule for pension indexation based on the ratio of pension expenditure to GDP. The enforcement mechanism may need to be strengthened, but the new rules appear reasonably credible and binding due to their relative flexibility at lower debt levels / lower shares of pensions/salaries as a proportion of GDP.</p>
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<p>PG 2:</p> <p>To reduce the grey economy, strengthen VAT collection and improve the tax control process, finalise the introduction of the new model of electronic fiscalisation and the transition to electronic invoicing and implement the tax administration reform according to the ERP 2022 timeline.</p> <p>Reinforce fiscal risk analysis capacity, in particular on SOEs, and make resulting reporting publicly available in the fiscal strategy updates in spring and autumn.</p> <p>Implement the time-bound action plan for the deployment of the new SOE ownership and management strategy according to the ERP 2022 timeline to improve the governance of SOEs and reduce related fiscal risks.</p>	<p>There was partial implementation of PG 2.</p> <p>1) Substantial implementation: The new electronic fiscalisation model and the transition to electronic invoicing have been implemented broadly within the set deadlines. Turnover has been exclusively recorded according to the new system of e-fiscalisation since 1 May 2022. As regards electronic invoicing, all three introduction phases (business-to-government as from 1 May 2022, government-to-business as from 1 July 2022 and business-to-business as from 1 January 2023) have been completed as planned. Training programmes for users of the new fiscalisation model and electronic invoicing were held as planned up to the end of 2022. The implementation of tax administration reform measures has been progressing broadly in line with the ERP 2022 timeline.</p> <p>2) Limited implementation: Work appears to be ongoing to establish and adjust models of fiscal risk analysis in line with the unified monitoring methodology adopted in 2021, and to improve capacities in the Fiscal Risks Monitoring Department via reinforced training. However, the expansion of the reporting on the results of the department's work in the fiscal strategy has been postponed until the upcoming fiscal strategy update in autumn 2023.</p> <p>3) Substantial implementation: A centralised database of economic entities which the Republic of Serbia fully or partly owns has been established and made publicly available on the website of the Business Registry Agency. An internal act of the baseline for setting mechanisms and criteria for reviewing and approving SOEs' key decisions has been adopted in the Ministry of the Economy. A draft law on ownership management for state-owned enterprises was prepared in 2022 and adoption was planned for early 2023 but may be delayed due to ongoing discussions and revisions.</p>
<p>PG 3:</p> <p>Carefully assess and analyse price developments and stand ready to tighten monetary policy further, if needed, to preserve price stability in the medium term.</p> <p>Maintain a transparent and accurate reporting of asset quality and adequate provisioning, further upgrade NPL resolution, including by facilitating out-of-court settlement, and continue to reduce data gaps in particular as regards the real estate sector.</p>	<p>There was substantial implementation of PG3:</p> <p>1) Full implementation: During 2022, the central bank reacted swiftly to mounting price pressures and progressively tightened its monetary policy stance. Until April the central bank increased its average repo rate by tightening liquidity conditions. It then engaged in a series of consecutive hikes of the policy rate, which are helping to contain inflation and keep inflation expectations anchored.</p> <p>2) Substantial implementation: The COVID-19-related measures have been fully unwound, and provisioning remained high. There was no progress on reducing the remaining obstacles to NPL resolution, such as enabling the sale of retail NPLs and improving judiciary processes, but asset quality continued to improve. The Republic Geodetic Authority recently started to regularly publish real</p>

<p>Continue efforts to promote the use of the national currency, including by enhancing long-term financing in national currency, further encouraging forex hedging and raising awareness of risks related to forex lending.</p>	<p>estate sector data, which helps to fill data gaps in this area.</p> <p>3) Substantial implementation: The authorities have kept supporting the development and use of local government and corporate bond markets and encouraged dinar-denominated deposit and loan growth in the banking sector. However, the positive trend in dinarisation of recent years came to a halt in the first part of 2022, mainly because Russia’s war on Ukraine triggered a confidence shock that led to domestic and foreign residents increasing their demand for foreign currency in terms of both deposits and loans.</p>
<p>PG 4:</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>Continue with the process to ensure a harmonised approach for prioritising and monitoring all investments and basing 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 a consistent and transparent track record demonstrating the operational independence of the Commission for State Aid Control.</p>	<p>There was limited implementation of PG 4.</p> <p>1) Limited implementation. The legal framework for conducting transparent and inclusive public consultations is in place. Although the establishment of the e-consultation portal in 2021 should help ensuring its implementation, further improvements are needed, as the share of legislation undergoing consultative procedures remain low, and 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) Limited implementation. 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) Limited implementation. The special law on linear infrastructure projects remains in force, allowing for the circumvention of the domestic law on public procurement. Serbia has committed to revoke the law in the course of the first half of 2023. Although a number of bylaws 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, special laws and intergovernmental agreements. The Commission for State aid Control still needs to continue building up a track record of demonstrable operational independence.</p>

<p>PG 5:</p> <p>Continue to develop and adopt a long-term energy and climate strategy in line with the Green Agenda for the Western Balkans and international commitments, and further increase investments in modernising energy infrastructure and lowering carbon emissions with a view to accelerating the green transition.</p> <p>Implement outstanding financial and institutional measures for higher take-up of renewables and energy efficiency, including launching first auctions for renewable energy sources (RES) and further develop the administrative entity for energy efficiency which has been fully operational since early 2022, and further improve the sustainability of the financing mechanism.</p> <p>With a view to further liberalising the energy market, address outstanding reforms including price and tariff reform for both gas and electricity, accelerate the unbundling of all energy utilities in line with the EU acquis, and as regards the gas sector in line with Serbia's Action plan which is also an obligation vis-à-vis the Energy Community, as regards Gastrans, Serbia should ensure that its regulatory regime is in full compliance with EU legislation all in line with the Action plan developed following the recently opened Cluster 4 for energy, Climate and Transport in the EU accession process. .</p>	<p>There was limited implementation of PG 5.</p> <p>1) Partial implementation. Work on developing a long-term energy and climate strategy started in 2021 and although draft was finalised in 2022, it remains to be adopted and must ensure an ambitious approach in line with EU goals. 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) Limited implementation. The completion of secondary legislation on RESs and energy efficiency related to the set of laws adopted in April 2021 is still pending. This is holding up the launch of the first RES actions. The Energy Efficiency Administration has been fully operational since early 2022.</p> <p>3) Limited implementation. 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. In the gas sector, third-party access to the gas infrastructure including Horgos interconnection point is still not granted. The price and tariff reform has been started in line with the stand-by arrangement agreed with the IMF; further reform is expected. The founding acts of Srbijagas and Transportgas Srbija have been amended, but the gas sector has not yet been fully unbundled. Work on the certification of Transportgas Srbija as a transmissions system operator has been delayed.</p>
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<p>PG 6:</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>Continue facilitating 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>Finalise, in co-operation with all relevant ministries, their agencies and stakeholders, a Youth Guarantee Implementation Plan, adopt it and initiate its implementation.</p>	<p>There was limited implementation of PG 6.</p> <p>1) No implementation: T 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 that this would be addressed by the draft social protection law in the pipeline or other initiatives. The tax-free allowance increased by RSD 1 000 a month in 2022 and is adjusted annually with the consumer price index but remains far below the minimum salary.</p> <p>2) Partial implementation: The Office for Dual Education and NQF was recently established as a new institution in the VET system, however it is still to be clarified what the added value of establishing a new institution is and how its competencies will contribute to improving the VET system, and not overlap with other institutions. No major developments have taken place since the previous ERP. There is a slow increase in the number of developed qualification standards in secondary VET, while higher education is yet to see the development of qualification standards and how this will link with quality assurance procedures in higher education. However, in order to make a meaningful impact on students' skills development, this is yet to be followed by the development of modernized curricula, teacher training and delivery in classrooms. VET curriculum in general remains outdated, however there has been some increased focus on the set up of regional VET training centres. A dual education monitoring framework was piloted and should be integrated in quality assurance mechanisms. The outreach of the dual VET is too limited with 5% share of all VET.</p> <p>3) Partial implementation: Serbia set up an expert group and a coordination body for drafting and monitoring implementation of the Youth Guarantee implementation plan. Work is ongoing with support from EU-ILO Technical Assistance Facility. Due to the change of government delays in the implementation occurred. The Ministry of Labour, Employment, Veteran and Social Affairs confirmed its target of delivering a draft Youth Guarantee implementation plan by March 2023 with a view to its adoption at the latest by Q2 2023.</p>
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ANNEX A: ASSESSMENT OF OTHER AREAS AND STRUCTURAL REFORM MEASURES INCLUDED IN THE ERP 2023-2025

Public financial 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 measure that focuses exclusively on tax collection. The proposed reform measure does not address any of the Commission's recommendations in its 2022 report on Serbia in this area and the related part of the 2022 policy guidance. 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, parliamentary oversight of public finances, and budget transparency require further strengthening. Action is still needed to put in place and implement a unified, comprehensive and transparent system for capital investment planning and management. Analytical units in all ministries and line bodies are still to be established to foster the effective consolidation of strategic, operational and financial management functions, in line with national strategic documents. Furthermore, the monitoring of fiscal risks has still to be improved in practice and the development of medium-term plans has not yet been completed in line with the Law on the Planning System. Finally, the quality of the State Audit Institution's audit work continues to improve, but its institutional capacity also needs to be improved and its continuing independence ensured.

Measure 11: '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 and some activities are facing delays. Increases in tax revenues have been registered over the past year but the direct link to the reform is not statistically confirmed. The predictability and fairness in the implementation of tax rules are yet to fully materialise. A first step aimed at improving the management of human resources has now been incorporated among the planned activities. The measure does not include concrete activities to address the issue of insufficient human resources, but a gap analysis to feed into a new human resources strategy is ongoing. The description of the measure recognises its link to the business environment and the grey economy in particular.

Green transition

Following Serbia's endorsement of the Green agenda in November 2020, the adoption of a climate law in March 2021 and a package of important energy laws in April 2021, Serbia started making progress with its green transition, as recognised by the opening of Cluster 4 in the accession negotiations in December 2021. However, further progress with the adoption of important legislation and strategic documents, as well as significant implementation and enforcement efforts, is crucial to effectively address persisting

environmental concerns. Although the ERP identifies and tackles a number of relevant issues that Serbia needs to address, it once again fails to integrate the green transition into all parts of the ERP, across the economy as a whole rather than just transport, energy, waste management and air quality. Furthermore, despite the recognition that environmental changes are a challenge for the Serbian economy, the ERP contains only one reform measure in this cross-policy area.

Measure 12: ‘Implementation of the circular economy in creating favourable environment for the green transition’

The measure to promote the circular economy has been carried over from previous ERPs and remains relevant as it aims at supporting businesses and local self-governments in the green transition. This year’s ERP introduces support for the application of green public procurement within this reform measure. Although the details of this activity are unclear, especially as this concept does not currently exist in Serbia and is pending the adoption of amendments to the Law on public procurement and therefore might be premature, it has potential. However, the measure still lacks ambition and still 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 and it is unclear what type of support is planned.

Digital transformation

Serbia has made notable progress on digital transformation across the economy. Digitalisation remains a key priority for the government, but the diagnostics do not sufficiently focus on remaining obstacles to identifying well-targeted reforms. Serbia’s communications infrastructure still requires systematic improvement of both regulation and investment. Broadband roll-out is too slow and this prevents the uptake of e-government and business services, and slows down the digital transformation of the economy. The 2025 Serbia programme, which was adopted in December 2019, announced much-needed investment in infrastructure to the amount of EUR 14 billion by 2025. The Law on broadband coverage is aligned with the 2025 European Gigabit Society Goals (100 MB/s networks) and is planned for adoption in 2023, but 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 still does not link this area to the green transition.

Measure 13: ‘Improvement of the national information and communication infrastructure’

This measure has been rolled over from previous ERPs. It remains relevant as the lack of fast broadband connectivity in under-served regions in Serbia is a major obstacle to the digital transition, and as work to rectify this has been delayed. Most of the identified risks to the reform measure remain high, thus indicating that its implementation will probably be delayed still further. The measure is expected to have a favourable impact on competition, development and better connection of innovation/industry/services (a benefit to businesses and online work) as well as provide further education possibilities (access to schools) and better household access to the internet in general. However, the measure only addresses the infrastructure aspect and should also help to lay the ground for implementing the digital aspects of the common regional market.

Measure 14: ‘Setting the infrastructure and environment for the creation and application of innovative IT solutions’

This measure has been rolled over from last year’s ERP but with certain aspects extracted to form a separate individual measure (measure 15). However, the potential link between reform measures 14 and 15 is unclear. Measure 14 remains relevant as it provides for further infrastructure to expand the digital transformation, but its objective is still not sufficiently clear and detailed measures are still lacking. Furthermore, the measure only addresses the infrastructure aspect and neglects other aspects such as digital skills and support to the private sector for digital transformation, etc.

Measure 15: “Support for the development of talents and creative industries by establishing a multi-functional innovative and creative center Ložionica“

This measure appears as a stand-alone reform measure for the first time but was part of Reform Measure 14 last year and can therefore be considered as carried over from last year’s ERP. It focuses on establishing a hub to support the development of creative industries in Serbia. It does not seem to address any of the issues identified in the diagnostics. It is also not clear if the measure is intended or has the potential to address other structural challenges to Serbia’s inclusive economic growth and job creation. Furthermore, the target value seems low and the potential link to reform measure 14 is unclear.

Business environment and reduction of the informal economy

The business environment and the relevant reform measures 5, 6 and 7 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 only slowly being implemented. 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 the lowest salaries, lack of financial resources and favourable loans, parafiscal charges, hidden tax fees and red tape. The government should develop a mechanism to incentivise 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 informal economy. However, reform measure 11 (‘tax administration transformation’), which has been carried over from last year’s ERP, may, if properly implemented, lead to improvements in tax inspections and have a positive impact on the informal economy. The reform measure is ambitious in scope but concrete results have been limited so far.

Research, development and innovation

As the ERP recognises, Serbia has a relatively good scientific base, but investment in research and development in 2021 has remained low at around 0.9% of GDP and with less than one third of this 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 still not been sufficiently identified. Infrastructure for science and technology parks is being expanded, but further support services for these institutions are still needed. The Innovation Fund, which provides grants for industrial research, similarly needs to play a more prominent role in facilitating academia-business cooperation. The smart specialisation strategy, the industrial policy strategy, and the strategy for the development of artificial intelligence adopted by Serbia in 2020 are being implemented. The ERP still does not include the link to the green and digital transition in this area.

Measure 16: ‘Development of the start-up ecosystem’

This measure has been carried over from last year’s ERP. It remains relevant because it is aimed at stimulating public and private investment and developing an ecosystem for start-up firms – one of the main structural issues in the area. It could, if successfully implemented, also help stimulate Serbia’s economic growth and competitiveness. Work to establish a register on the National Innovation System is under way but facing delays. The measure focuses on smart specialisation in artificial intelligence and, although it has been extended to also cover biotechnology, its scope still remains relatively narrow. The planned activities are still not sufficiently concrete.

Measure 17: ‘Creation of conditions for the development of bio science and bioeconomy through the construction of Bio4 campus’

This measure has been carried over from last years’ ERP. It could help to create an attractive new sector in Serbia but is very narrow given its pure focus on Bio4 (biotechnology, biomedicine, bioinformatics and biodiversity). The planned activities are still not detailed enough to give a clear picture of the measure’s potential. The measure still does not seem to address any of the obstacles set out in the diagnostics.

Economic integration reforms

The ERP does still not sufficiently identify unaddressed issues, including underlying issues related to the long awaited adoption of the Law on genetically modified organisms (GMOs). This is an obstacle to finalising Serbia’s accession to the World Trade Organization (WTO). Economic integration with the EU, which is Serbia’s biggest trade and investment partner, remains high despite increasing integration with non-EU countries. The EU accounted for around 60.% of Serbia’s total trade in goods (ESTAT 2023) and around one third of net foreign direct investment inflows in 2022. Serbia is still to complete accession to the WTO, 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). The implementation of the CEFTA Additional Protocols 5 and 6 continues, as stipulated also by reform measure 18. Further integration within the region could boost Serbia’s economic growth and competitiveness, and maximise the benefits of the economic and investment plan. The customs administration development plan for customs e-systems, which aims to ensure integration with the EU system adopted in February 2020, is being implemented. Despite the role that digitalisation plays in improving administrative trade and customs procedures and in further integrating systems, as well as the recognition in the diagnostics of the upcoming EU Carbon Border Adjustment Mechanism, no link has been made to the green or digital transition.

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

This measure has been rolled over from several 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. However, planned activities to accede to the WTO continues to lack concrete progress, delaying the ultimate accession and the benefits it could bring to Serbia as an export-oriented country. Appropriate steps are needed rapidly and resolutely, including the adoption of the new GMO-law through cooperation across relevant ministries. The activities planned under CEFTA are appropriate and credible, but it is not clear what results have been achieved so far and what remains to be implemented because the description of the planned activities lacks details. Serbia’s constructive role within CEFTA remains crucial and Serbia’s coming role as chair of CEFTA in 2024 could provide an opportunity to move the regional agenda forward. The planned activities do not address more recently appeared barriers to trade in the form of export restrictions introduced by Serbia.

Energy market reforms

This sector and reform measures 8, 9 and 10 are analysed above in Section 4 under key challenge 3.

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 has been pending for years. Critical improvements are still 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 recognises the role of the railway sector and the construction of a metro in contributing to the green transition, but it does not reflect on this relevant link in other areas of the transport sector.

Structural Reform 19: ‘Improvement of efficiency and safety in railway traffic’

This 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 one reform measure targets only the railway sector. The focus on rail transport safety and access charges is appropriate and in line with recommendations in the Commission’s Serbia 2022 Report. However, it remains too narrow considering other important aspects of the rail reform, such as strengthening institutional capacities, facilitating border crossing procedures, improving the management of railway network capacity, improving the management of railway assets, improving the process of issuing train driving licences and safety certificates to railway undertakings 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.

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. The ERP also recognises the structural challenges that remain. The number of people employed in the sector still accounts for around 15% of the total labour force but is diminishing in favour of the industrial and services sectors. However, its contribution to Serbia's GDP is stable. Exports of agricultural products accounted for nearly 5 % total exports at % in 2021. 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 and climate changes on the sector's performance remains unaddressed. 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 substantial and increasing. Bottlenecks in the implementation of IPARD hinder that support to the sector is maximised. Successful implementation IPARD prevent support to the sector from being maximised. Successful implementation of IPARD would help increase the sector's competitiveness, increase the attractiveness of rural livelihoods, reduce outmigration from rural areas, and contribute to increasing the environmental and climate performance of agricultural producers and primary processors. There is a need to further strengthen the capacity of the IPARD Agency to facilitate access to finance. The ERP insufficiently notes the link to the green transition. There is no mention of the connection to the digital transition - an important element in helping to increase the efficiency in this sector too – even though it is part of reform measure 20.

Measure 20: 'Improvements in the competitiveness of agriculture'

This measure has been carried over from previous ERPs and remains relevant, but it does not aim to address the most significant issues set out in the ERP. It also continues to being exposed to further postponements of legislative initiatives, in particular the Law on quality schemes for agricultural and food products, and the Law on organic production (originally planned for 4 years ago and repeatedly postponed). The delays in the adoption of legislation are delaying both further legislative alignment and moving forward projects and developing structures as required by the EU *acquis*.

Industry

The competitiveness of industry is key to growing the economy, but the ERP still does not identify any remaining structural issues in this area. The ERP rightly recognises that the performance of industry has been stable despite the impact of COVID-19 (industry grew by 6.3% year on year and manufacturing industry by 5.5% in 2021). 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 higher than those for large

companies despite several programmes to support SME development, and despite their potential to create new, high-quality jobs. A strategy for the development of micro companies, SMEs and entrepreneurship is pending adoption. Support for incoming foreign direct investment continues to be principally geared towards attracting manufacturers. Support for investment is well developed, but this is less the case for other services. 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 fully comply with State aid rules. The ERP still lacks a measure for industrial green growth and does not refer to the green or digital transitions in this area.

Services

The ERP recognises the importance of the services sector, which has recovered well from the COVID-19 pandemic with the support of incentives for the tourism sector and a continued inflow of investments. About half the value added by services comes from retail, real estate and healthcare. Services have the potential to expand and represent an even greater share of total exports. Service exports are dominated by tourism, transport and ICT services. Investment in infrastructure and skills needs to be tailored for these fast growing and competitive services so that they can expand further. Targeted efforts are also needed to slow down the ongoing brain drain in most skilled labour areas across the services sector. The CEFTA agreement and the three agreements on mobility reached within the common regional market at the Berlin process summit in Tirana on 3 November 2021 highlight further sectors in which services could expand regionally. The ERP recognises the need to improve capacities in tourism to make it sustainable and meet environmental objectives in line with the Green agenda for the Western Balkans, but the ERP still does not make any clear reference to the green or digital transitions and does not include any reform measure directly targeting the services sector.

Education and skills

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

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 directly participate in social dialogue. The tripartite Economic and Social Council of Serbia is not always 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.

Social protection and inclusion

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

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 nonstandard work-contracts and pensioners. Unemployed persons 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 aims at contributing 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 aims at 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	2017	2018	2019	2020	2021	EU-27 Average (2021 or most recent year)
Energy						
Energy imports dependency (%)	33.8%	34.6%	35.6%	29.8%	n/a	55.6%
Energy intensity: Kilograms of oil equivalent (KGOE) per thousand Euro	418.01	394.50	375.78	391.18	n/a	110.35
Share of renewable energy sources (RES) in final energy consumption (%)	20.29%	20.32%	21.44%	26.29%	25.28%	21.7%
Transport						
Railway Network Density (meters of line per km ² of land area)	42.53 ^w	42.53 ^w	42.52 ^w	43.2 ^w	43.4 ^w	N/A
Motorization rate (Passenger cars per 1000 inhabitants)	278.2	284.1	297.6	315	325.4	N/A
Agriculture						
Share of gross value added (Agriculture, Forestry and Fishing)	7.2%	7.7%	7.2%	7.6%	7.6%	1.8%
Share of employment (Agriculture, Forestry and Fishing)	17.2%	15.9%	15.6%	14.6%	15.0%	4.3% ⁽²⁰²⁰⁾
Utilised agricultural area (% of total land area)	38.8% ^w	39.4% ^w	39.3% ^w	n/a	n/a	40.6% ⁽²⁰²⁰⁾ n/a
Industry						
Share of gross value added (except construction)	26.5%	25.4%	24.0%	23.4%	23.0%	19.9%
Contribution to employment (% of		22.5%	22.6%	22.6%		n/16.1% ^a

total employment)	21.2%				n/a	
Services						
Share of gross value added	61.3%	61.5%	61.9%	62.5%	na	79.2%/n/a
Contribution to employment (% of total employment)	57.5%	57.2%	57.0%	57.5%	n/a	70.9%/a

Research, Development and Innovation						
R&D intensity of GDP (R&D expenditure as % of GDP)	0.87%	0.92%	0.89%	0.91%	0.99%	2.26%
R&D expenditure – EUR per inhabitant	48.6€	56.3€	Nna	61.2€	77.2€	734.5
Digital Economy						
Percentage of households who have internet access at home	68%	73%	80%	81%	82	92.5% ⁽²⁰²²⁾
Share of total population using internet in the three months prior to the survey [NB: population 16-74]	70%	73%	77.4%	79%	84	90% ⁽²⁰²²⁾
Trade						
Export of goods and services (as % of GDP)	50.5%	50.4%	51.0%	48.2%	54.5%	50.4%
Import of goods and services (as % of GDP)	57.1%	59.1%	61.0%	56.5%	62.3%	46.7%
Trade balance (as % of GDP)	-8.1%	-10.3%	-11.7%	10.6%	-11.6%	n/a
Education and Skills						
Early leavers from education and training (% of population aged 18-24)	6.2%	6.8%	6.6%	5.6%	6.3%	9.7%
Young people neither in employment nor in education and training (NEET) (% of population aged 15-29)	21.7%	20.1%	19.0%	20.0%	16.4%	10.8%

Children aged less than 3 years in formal child care (% of under 3-yearsolds)	14.5%	13.3%	17.2%	18.1%	18.0%	36.2%
Individuals who have basic or above basic overall digital skills (% of population 1674)	39%	n/a	46%	n/a	41%	54%

Employment						
Employment Rate (% of population aged 20-64)	60.0%	61.6%	63.6%	64.3%	66.7%	73.1%
Unemployment rate (% of labour force aged 15-74)	14.6%	13.8%	11.3%	9.8%	11.1%	7.0% ⁹
Long term unemployment rate (% of labour force aged 15-74)	7.4%	6.7%	5.5%	4.5%	n/a	n/a
Gender employment gap (Percentage points difference between the employment rates of men and women aged 20-64)	14.7 pps.	15.4 pps.	14.6 pps.	14.6 pps.	14 pps.	11.5 pps.
Disability employment gap (Percentage points difference in employment rates between people with and without a disability)	25.4 pps.	27.2 pps.	36.0 pps.	34.8 pps.	n/a	n/a
Real gross disposable income of households (Per capita increase, Index = 2008)	n/a	n/a	n/a	n/a	n/a	n/a
Social Protection System						

At-risk-of-poverty or social exclusion rate (AROPE) (% of population)	39.5%	34.0%	31.1%	29.8%	28.4%	21.7%
At-risk-of-poverty or social exclusion rate of children (% of population 0-17)	41.7%	36.0%	34.5%	30.6%	n/a	n/a
Impact of social transfers (Other than pensions) on poverty reduction	18.67%	17.91%	18.02%	18.73%	28.14%	37.08%
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)	9.40	8.60	6.50	6.06	5.95	5.97
Housing cost overburden (% of population)	33.6%	31.3%	21.6%	17.8%	n/a	n/a
Healthcare						
Self-reported unmet need for medical care (of people over 16)	4.8%	5.8%	4.8%	3.8%	5.3%	2.0%
Out-of-pocket expenditure on healthcare (% of total health expenditure)	40.64% ^z	38.31% ^z	37.04% ^z	n/a	n/a	n/a

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'

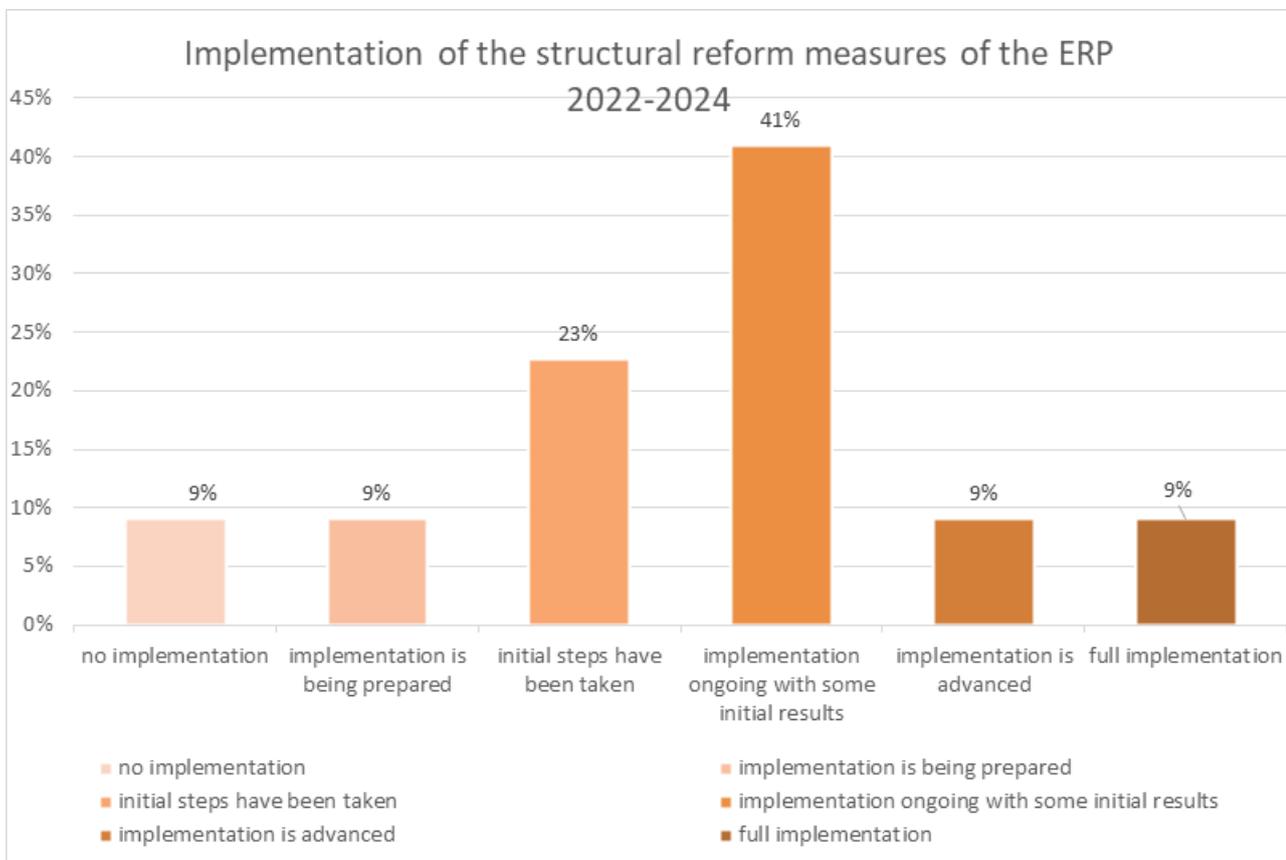
z: Data from World Health Organisation

Source of data in Annex B: EUROSTAT unless otherwise indicated

ANNEX C: PROGRESS WITH STRUCTURAL REFORM MEASURES FROM ERP 2022-2024

There was continued progress in implementing the measures in 2022, with an average score of 3.1 out of 5 (down from 3.3 in 2022). Overall, reporting on the implemented activities is fair but would benefit from being more concrete.

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, but also the energy sector. The reform measure on the introduction of a new fiscalisation model and electronic invoicing, and the reform measure on developing infrastructure related to the energy market both reached full implementation. By contrast, the pace of implementation is particularly slow for reforms regarding land consolidation, digitalisation of the agricultural sector and railway reform. The start of implementation of the reform measure on the digitalisation of the education system was not initiated.



ANNEX D: COMPLIANCE WITH PROGRAMME REQUIREMENTS

The government adopted and formally submitted the Economic Reform Programme on 31 January 2023. The programme is in line with the medium-term fiscal strategy and the 2023 budget and covers 2023-2025.

Inter-ministerial coordination

Preparation of the 2023-2025 ERP was coordinated by the Ministry of Finance (the 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 macrofiscal part) and some line ministries (for the structural reform measures part). This ERP, which is the ninth, has benefited from the accumulated know-how and lessons learned from previous rounds, which further improved the overall process. Several training courses for those involved in preparing the document were organised by the Centre of Excellence in Finance, the German [Academy for International Cooperation](#) (GIZ) and other bodies.

Stakeholder consultation

The national authorities involved stakeholders in the preparation of the document and held a consultation on the draft ERP. Stakeholders were invited to provide comments through the new online e-consultation portal for the second consecutive year. The final step in the consultation procedure was a meeting with the National Convention, which brought 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 then submitted comments and suggestions. Some participants voiced their strong interest in having more time to comment on the ERP and to be involved earlier in the process. 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 macrofiscal scenario that results in lower economic growth and higher budget deficit and debt levels. The alternative scenario appears very relevant in view of the identified risks in a context of inflationary pressures and high uncertainty, but the underlying assumptions do not appear to be sufficiently detailed and quantified to allow further assessment.

Fiscal framework

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

Structural reforms

Reporting on implementation of the 2022-2024 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. . Some measures are narrow in scope, well-targeted and planned in detail, but others are overambitious and too wide-ranging. The annexed tables have been filled in correctly.

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