



*Government of the Republic of Serbia*

# **Economic Reform Programme for the Period 2018-2020**

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## I FRAMEWORK AND MAIN GOALS AND GUIDELINES OF THE ECONOMIC POLICY

### *Preserving Fiscal Stability and Supporting Growth*

The Republic of Serbia is successfully completing the implementation of a three-year fiscal consolidation programme through the Precautionary Stand-By Arrangement with the International Monetary Fund (hereinafter: IMF). At the end of 2014, the government deficit was 6.6% of the gross domestic product (hereinafter: GDP), while the government debt amounted to 71.8% of GDP with a rising trend. We were faced with two paths, one leading to total destabilisation of public finances and public debt crisis, while the other involving the implementation of difficult but necessary measures for the recovery of government finances.

The results achieved in the implementation of the programme are impressive. The original goal for required structural adjustment of 4% of GDP is significantly exceeded. In the last three years, a lasting improvement of results of about 6% of GDP has been achieved. Public debt started on a downward path in 2016, a year earlier than envisaged by the Programme.

The priority in the following medium-term period is to preserve the accomplishments in the fiscal area achieved as a result of hard effort, while supporting the initiatives that should boost growth, such as an increase in public investment and decrease of the tax burden for low-income employees.

### *Macroeconomically Sustainable and Inclusive Growth of the Economy*

The measures of fiscal relaxation will have a two-pronged effect. Reducing the burden on the economy, through the increase of personal tax allowance, will encourage growth and job creation, while the growth of pensions and wages in a part of the public sector will strengthen the purchasing power of households and boost domestic demand. A stable inflow of foreign direct investments (hereinafter: FDI) coupled with support to innovation activities is another way to bolster sustainable growth, while the educational system reform, support to social entrepreneurship, gender budgeting, the minimum cost of labour increase are just some of the measures that should ensure inclusive and fairly distributed growth ultimately resulting in the reduction of poverty.

The macroeconomic policy-making is focused on building the institutional framework and removing the barriers to growth. Successfully implemented activities in the previous period are reflected in increased efficiency of the public administration, improvement of legislation, greater labour market flexibility, better external position of the country, rising FDI inflow, and specific support to the sector of small and medium sized enterprises.

The key prerequisites for the achievement of the planned medium-term scenario remain to be maintaining fiscal stability, continued restructuring of the economy (particularly the public sector part), further improving the business environment, expanding and modernising production capacities, primarily in the tradeables sector, as well as maintaining the continuity of convergence with the European Union (hereinafter: EU).

### *The EU Accession Process*

In addition to the establishment of an institutional framework and strengthening of the administrative capacity, which should ensure and assure democracy and the rule of law, the European integrations process also implies the creation of a stable macroeconomic environment, development of a market economy and strengthening its capacity to respond to the challenges of competition in the

EU. The Government's strategic commitment to becoming full member of the EU, and the progress towards accomplishing this goal were attested by the opening of new negotiating chapters in 2017. The beginning of the year saw the opening of Chapter 20 – Enterprise and industrial policy and Chapter 26 – Education and culture, which was temporarily closed. In mid-2017, Chapter 7 – Intellectual property law and Chapter 29 – Customs union were opened. In December, two additional chapters on Company law (Chapter 6) and External relations (Chapter 30) were opened. Regular political and economic dialogue on open issues from the Stabilisation and Association Agreement between the European Communities and their Member States, of the one part, and the Republic of Serbia, of the other part, adoption of the Economic Reform Programme for the period 2017–2019, Employment and Social Policy Reform Programme, revised National Programme for the Adoption of the EU Acquis, implementation of the Public Finance Management Reform Programme for the period 2016–2020, harmonisation of the domestic legislation, and the adoption of general and sectoral national development strategies, including this one, are all aimed at Serbia's fulfilment of economic requirements for membership laid down in *acquis communautaire* in the shortest time possible.

*The Government will continue improving the business environment with active measures in the next three years' period. The achieved fiscal stability ensures improved macroeconomic performance across the board. Long-term sustainability of growth should be additionally supported by complex and comprehensive reform processes, which the Government will continue to implement to remove the present barriers and risks. This works to encourage private initiative, awaken the spirit of entrepreneurship and innovation, and promote development based on knowledge and technological progress, which in turn will contribute to the creation of jobs and reduction of unemployment.*

## II MEDIUM TERM ECONOMIC FRAMEWORK

### 1. FORECASTS FOR THE INTERNATIONAL ECONOMIC ENVIRONMENT

The global economic recovery has gathered pace since the beginning of the year, and growth estimates for advanced and emerging market economies have been revised upwards, due to growth of investment, acceleration of the global economy and improved business and consumer confidence. Disparities remains one of the main characteristics of global growth, both between regions and within countries, between various population strata. On the other hand, instability is present in financial markets and inflation is still below the set boundaries. In this regard, there is a need for a clear economic policy that would ensure longer-term recovery. The announced gradual normalisation of the monetary policy by the US Federal Reserves (hereinafter: the FED) could result in a change of global currencies parity and public debt levels in emerging countries. Global recovery has been accompanied with the rise of primary commodity prices since the beginning of the year, primarily metals and oil, but they are expected to stabilise towards the end of 2018. The euro area growth has picked up while the Central and Eastern Europe region of is in the upswing phase of the cycle. The growth in the most important export markets provides momentum for growth in the region, but these economies are still vulnerable to the changes in the financial market due to high level of business and household debt. By improving its macroeconomic environment and removing external and internal imbalances, the Republic of Serbia increased its resilience to external shocks, while the euro area growth has a stimulative effect on economic and export activities.

According to the IMF's October projections, a global growth is forecasted of 3.6% in 2017, and 3.7% in 2018 and 2019, respectively, which is an improvement of the previous expectations. Growth will result from the cyclical recovery of investment activity, increased output of the manufacturing sector, and acceleration of global trade, underpinned by price recovery in the primary commodities market, and is confirmed by the recorded increased business and consumer confidence. Advanced economies' growth for 2017 was revised upwards, due to higher growth in the euro area, Canada, and Japan, while in the medium-term growth in these economies is expected to slightly slow from 2.2% in 2017 to 1.8% in 2019. The outlook for emerging countries has timidly improved. Emerging economies are projected to accelerate from 4.6% in 2017 to 5.0% in 2019. Growth should be balanced and present in most world's economies, while individual recessions in some countries will be a consequence of exclusively internal problems of a non-economic nature. Over medium-term, inflation is expected to mildly accelerate, following the price movements of primary commodities and energy in the global market. Prices are forecast to rise moderately in advanced economies, by 1.7% in 2017 and 2018 respectively, and at a greater pace in emerging economies, from 4.2% in 2017 to 4.4% in 2018. OPEC's decisions to restrict production of oil in November 2016 and China's decision to reduce the production of coal have strongly affected the price rise of primary products, while accumulated stocks have an opposite effect leading to the stabilisation of oil prices at a higher level.

The ECB continues the quantitative easing programme by asset purchases amounting to EUR 60 billion until the end of 2017. It has been announced that this measure will extend into 2018, in order to bring the inflation closer to target<sup>1</sup>. At the same time, the key interest rate remains at a record low of 0.00%, and -0.40% on bank deposits. On the other hand, at the FED's Board of Governors, at its December meeting, decided to raise the target range for the key interest rate to between 1.25% and 1.50% due to improved US economy, in line with the FED's goals with respect to full employment and price stability. The key policy rates are expected to rise in the following period considering moderate growth of economic activity and employment since the beginning of the year.

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<sup>1</sup> In October, a decision was made to implement the quantitative easing programme at least until September 2018 while reducing the monthly amount of EUR 60 billion euro to EUR 30 billion.

According to the November forecast of the European Commission (hereinafter: EC) the recovery of economic activity in the euro area continues at the rates significantly higher than the potential. The expected growth is 2.2% in 2017, and 2.1% and 1.9% in 2018 and 2019 respectively. Although the increase of economic activity has strengthened and spread to all member states, there still exist some differences between the economic cycles of individual states, which threatens the ECB monetary policy synchronisation. The growth projection for 2017 is revised upwards by 0.5 p.p. relative to the May forecast, due to stronger contribution of domestic demand since the beginning of the year. The ECB's accommodative policy, rising employment and significant acceleration of investment activity triggered strong growth of domestic demand, which was the main driver of economic activity in 2016 as well. Increased output of the manufacturing sector, new orders, and positive sentiment in the business community has given a strong boost to the growth of the German economy, which is projected at 2.2%, up by 0.6 p.p. from the expectations in May. At the same time, the projected growth of the Italian economy is 1.5%, driven by the rise in domestic demand.

Table 1. International environment – macroeconomic indicators

	2016	2017	2018	2019
Real GDP growth <sup>2</sup> , %	3.4	3.8	4.0	4.0
Real GDP growth in the EU, %	1.9	2.3	2.1	1.9
Global trade growth <sup>3</sup> , %	1.9	4.0	3.8	3.8
Three-month EURIBOR	-0.3	-0.3	-0.3	-0.1
Ten-year government bond yields of the euro area members	0.1	0.3	0.6	0.8
USD/EUR exchange rate, end of period	1.11	1.13	1.18	1.18
Food prices, annual changes	-2.6	1.2	0.7	2.5
Metal prices, in US dollars, annual changes	-3.9	16.8	1.2	-1.0
Prices of primary commodities, annual changes	-0.5	10.6	-0.4	-0.3
Oil price, in US dollars	44.8	53.6	55.7	54.7

\*Source: EC, Autumn Forecast, November 2017

The recovery of the economic activity in the following period will take place in the low inflation environment although the output gap will be positive. After the euro area reaches the growth rate of 2.2% in 2017 which is the highest rate in the last ten years, the economic growth will continue in 2018 and 2019, albeit at a somewhat slower pace. The projected growth is based on the slowdown of private consumption and investments, moderate acceleration of government spending, and tepidly positive contribution of net exports. Owing to the appropriate fiscal and monetary policy, implemented labour market reforms and low inflation, private consumption was the main driver of growth in the previous period. In the next medium-term period, the normalisation of the ECB monetary policy is expected to take place through raising the key policy rate, which will encourage savings and, coupled with decelerated growth of wages and disposable income in 2018 and 2019, contribute to the slowdown of private consumption from 1.8% in 2017 to 1.5% in 2019. Declining debt-to-GDP ratios and interest rates in international capital markets have created conditions for a stronger impact of fiscal policy on economic growth. Government expenditure is expected to have a positive contribution of 0.3 p.p., respectively, each in the following period. The rise of profit margins, increased demand and reduced deleveraging pressures, along with the accelerated investment activity of the EC (the EC's Investment Plan for Europe), are the main factors that will affect the growth of investment spending in the following period. In the period 2017–2019 the average investment growth is expected to be 3.7%, driven by the acceleration of investment in equipment, due to the upswing phase of the economic cycle. Exports growth will be supported by rising global demand and gradual recovery of the global

<sup>2</sup> Global GDP excluding the EU.

<sup>3</sup> Global trade growth, excluding the EU.

economy. After deteriorating in 2017, the terms of trade are expected to increase by 0.5% in 2018, while remaining unchanged in 2019. Such trends, coupled with the stability of import prices will result in the decrease of current account surplus from 3.0% of GDP in 2017 to 2.9% of GDP in 2019.

As a result of the economic recovery, employment is expected to expand strongly in the following period, with continuing reduction of the unemployment rate to 9.1% by the end of 2017. The receding unemployment trend will continue but at a slower pace, so at the end of the forecast period the expected unemployment rate is about 8.0%, which is the lowest rate since 2008, however still higher than the pre-crisis level.

In the following medium-term period, the inflation trend will follow the prices of primary products and energy, but will still remain under the impact of low core inflation. Inflation is forecast at 1.5% in 2017 and 1.4% and 1.6% in 2018 and 2019, respectively. Despite the positive output gap, low inflation expectations and prices of primary commodities, as well as a subdued wage growth, limit higher inflation.

Fiscal policy will make a neutral contribution to growth in the following period, although it will be slightly expansionary in some member states. In 2017, fiscal deficit will amount to 1.1% of GDP, which is 0.3 p.p. less than previously expected, due to a stronger growth of GDP. In 2018 and 2019, the deficit is projected at 0.9% and 0.8% of GDP, respectively, accompanied with the stabilisation of the structural deficit. The expected robust economic recovery, low interest rates, and consequent deleveraging, are the main factors affecting the projected reduction of the fiscal deficit in almost all euro area member states. Stronger nominal growth and low interest rates will keep the public debt on the downward path, from 89.3% of GDP in 2017 to 85.2% of GDP in 2019.

The macroeconomic outlook is associated with risks, which are less pronounced than in the previous forecasts. The risks that may jeopardise economic growth are external in nature and relate to geopolitical tensions and faster than expected monetary tightening by the FED. The consequent increase of financial risks and investors' risk aversion may threaten growth in the countries in the EU external environment and, indirectly, also the growth of the EU28. In the medium term, there is also a risk of Chinese economy adjustment, or the rising corporate debt in China, indicating possible increase of the country's financial risk, while pursuing protectionist trade policy in the USA may have a negative impact on the global recovery. The uncertainty regarding the Brexit negotiations with the United Kingdom (hereinafter: the UK) and stronger than anticipated euro appreciation can have negative consequences for the economic activity and forecast recovery.

## 2. CURRENT ECONOMIC TRENDS AND OUTLOOK FOR 2017

In 2016, the acceleration of economic activity was achieved together with strong fiscal adjustment, resulting in 2.8% growth of the Serbian economy, which significantly exceeded the original projections which have been revised upwards three times.

On the production side, all sectors had a positive impact, with the dominant role of services, the positive contribution of which was 1.4 p.p., underpinned primarily by the growth of trade and transport, but also by an increasingly important role of information and communication technology services. Due to favourable agrometeorological conditions and larger areas sown, agriculture increased by 8.1%, while the growth of total industry stemmed from the increase of electricity generation, as well as the growth of manufacturing. Removing administrative barriers provided for the acceleration of private investments in the first half of the year, which, supported by more intensive public works in the second half of the years, resulted in y-o-y growth of construction by 3.2%.

Disaggregated GDP on the expenditure side shows that all components had a positive contribution to the growth of GDP in 2016. Improvement of the business environment, better financial standing of companies, diversified FDI inflow into industries that produce tradeables, improved

competitive position of the country, and new market niches enabled an increase in export and investment of 12% and 5.1%, respectively. Thus, these two components accounted for half the economic growth in 2016, which is a model that macroeconomic policymakers have for many years insisted on and aimed for. The short-term negative effects of fiscal consolidation on private consumption were mitigated by the increase in private sector employment and wages, lower costs of financing, and a larger volume of granted new loans, particularly cash loans, as well as more favourable price trends.

Positive economic trend recorded in 2016 has continued in 2017. However, the activation of a one-off negative factor resulted in deceleration of activity in certain sectors with a major share in GDP, and consequently had a significant negative contribution to the overall economic growth. Adverse weather conditions at the beginning of the year slowed the construction activity but also interfered with production processes in mining and quarrying and electricity production, and were followed by unfavourable agrometeorological conditions decimating yields of major crops. That resulted in more modest growth rates in the first two quarters.

According to the Statistical Office of the Republic of Serbia (hereafter: SORS) flash estimate, economic growth in the third quarter gained pace and was 2.1% y-o-y. It was driven by the growth in industrial and services sectors, and supported by the acceleration of construction activity. Manufacturing is on a stable growth path, the impact of one-off factors on the energy sector is waning, while agricultural production still has a negative contribution. Observed by expenditure components, the dominant source of growth is private consumption, resulting from the increase of disposable income of households and rise in employment. Positive contribution of investments is strengthening, the y-o-y growth of which, according to the Ministry of Finance estimate, exceeds 6.0%, while the contribution of net exports is mildly negative.

High frequency indicators show stable growth of the most part of the economy in the first nine months of 2017. Downside risks were activated in mining and quarrying, electricity generation and construction activities, which had a decelerating effect on the activities in the first half of the year. Monthly data for early second half of the year indicate recovery in these sectors, primarily in construction and mining and quarrying. The intensification of structural reforms in public enterprises, that are major operators in these industries, is expected to increase the resilience of production processes to external shocks and contribute to greater efficiencies, thus ensuring continuing growth of the generated gross value added (hereinafter: GVA). The manufacturing industry, being the most important segment of total industry with a GDP share of around 15%, has observed an increase of the physical volume of production by 6.8% y-o-y in the first nine months of 2017. Its growth is diversified and derives primarily from export-oriented industries, and is basically the result of FDI effects. The most important are chemical, rubber, and machine industries, as well as the manufacturing of metal products, and manufacturing of electrical equipment. Stable growth is also seen in tobacco industry and production of base metals, the importance of which is increasing. The manufacturing of motor vehicles had a negative impact in this period, while food processing industry has also been slowing in the last few months, which is a consequence of a bad year in agriculture but also of market uncertainties. When disaggregated by type of product, the dominant source of growth is seen in intermediaries, the output of which was 10.1% higher than last year, driven by chemical and rubber industries. Significant growth of 11.1% was also achieved in the capital goods group, where the largest contribution comes from the machine industry, while the production of durable and non-durable goods also had a positive contribution. The overall industry growth was negatively affected by energy production, recording a fall of 3.9% y-o-y. The service sector is recording stable growth amidst fiscal stabilisation, which attests to the fact that the undertaken measures were well calibrated. In the period January-September 2017, retail sales increased by 4.0% in real terms. The largest increase of 7.1% was achieved in the sales of non-food products. The sales of food, beverages, and tobacco were up by

3.4%, while trading in engine fuel remained approximately at the same level as last year. The Government's strategic commitment to the development of tourism services resulted in higher tourist numbers of approximately 2.4 million, which is up by 12.4% relative to the same period last year, with more than 6.5 million overnight stays (10.1% increase). In real terms, foreign currency inflow from tourism and turnover in catering were higher by 14.0% and almost 8.0% respectively. Significant rise in the physical volume of land and air transport, and telecommunication services has continued.

The situation on the labour market has continued to improve in 2017, mostly as a result of increased economic activity and related increased demand for labour force, but also of a more favourable operating environment brought about by the changes in labour legislation, coupled with successful retraining programmes, self-employment incentives, and active employment policies. According to the Labour Force Survey, the number of employed persons in the first half of 2017 rose by 3.8% y-o-y, while the unemployment rate dropped by 3.9 p.p. to 13.2%. The increase in the number of employed persons was largely due to favourable trends in the industry and services sector. Formal employment, as the better quality part of overall employment, went up by 5.0%, while informal employment went down by 0.6%, above all as a result of more effective activities of inspections services on curbing the informal economy. Considerable decrease of the long-term unemployment rate from 11.2% to 8.1% is yet another indicator of labour market improvement. Positive labour market developments are also confirmed by the data available in the Central Registry of Mandatory Social Insurance, which show that the total number of formally employed persons in the period January-September 2017 went up by 2.9%, y-o-y. The employment growth in this period is completely the result of the rise in the number of employees in the private sector (5.0%), while employment in the public sector fell by 1.5%. Employment growth was reported in the manufacturing industry, mining, trade, etc., which is in line with the favourable economic trends in these sectors. Additionally, according to the National Employment Service data, the number of actively unemployed persons in the period January-September 2017 dropped by 8.1%, y-o-y.

The rise of wages in the private sector and their timid decline in the public sector were reflected in continued narrowing of the gap between them during 2017. Thus, in the period January-September 2017, the average net wage in the private sector was 3.6% lower than the public sector wage, which is a reduction of difference by 1.7 p.p. from 2016. The overall real average net wage in the period January-September 2017 increased by 0.9% y-o-y, completely driven by wage growth in the private sector (1.5%). In terms of individual industries, manufacturing and trade were the largest contributors to this wage increase. At the same time, the real average net wage in the public sector was slightly lowered by 0.1% as a result of wage decline in administration and local public enterprises, which could not be offset by the wage increase in national public enterprises, health care and education.

Based on the very positive labour market results recorded in the period January-September 2017, and the economic activity growth in the first half of the year, but also on the expected acceleration of GDP growth in the second part of the year, it is estimated that overall employment will grow in 2017, driven primarily by the growth of employment in the private sector.

In the period January-October 2017, the current account deficit was about EUR 1.5 billion and fully covered by net FDI inflow (EUR 2.0 billion). Current account deficit is estimated to be EUR 1.7 billion, or 4.6% of GDP at the annual level, which is 1.5 p.p. higher than in 2016. The increase of the current account deficit from the same period the previous year is for the most part a result of a trade deficit increase, due to adverse weather conditions in early 2017 that led to higher imports of energy. That the current account deficit increase at the beginning of the year was to a great extent caused by the cold weather indicated by its drop during q2 and q3 to 3.8% and 4.1% of GDP. In 2017 the terms of trade deteriorated by 1.8% y-o-y (in the period January-October), as a consequence of a faster rise in import prices (4.5% y-o-y), primarily energy, owing to the higher price of oil on the global market, relative to export prices (2.6% y-o-y). The foreign trade in services surplus increased by 4.2% y-o-y,

mostly in the field of ICT (24.5% y-o-y) and other business services (27.6% y-o-y). On the other hand, the rise in net outflows of primary income is for the most part covered by the rise in net inflows from secondary income.

The implementation of projects based on the FDIs from the previous periods, higher demand of our main foreign trading partners (euro area and CEFTA signatories), better business environment and increased competitiveness of domestic industry have had a favourable effect on the growth of exports (by 11.6% y-o-y), characterised by greater product and geographic diversification. The value of manufacturing industry exports achieved a year-on-year growth of 14.1% in the first ten months of 2017. The greatest positive contribution came from the exports of base metals (mostly iron, steel and copper products), and rubber and plastic products (car tyres), followed by chemicals, machinery and equipment, metal products, electrical equipment and food products. Of the 23 areas of manufacturing industry, only tobacco product exports decreased year-on-year from the peak it reached the previous year.

The value of imports increased by 13.5% y-o-y mostly owing to higher prices of crude oil and gas. In addition, the imports of other raw materials – primarily base metals, but also machinery and equipment also rose, as did the imports of consumer goods, but to a lesser extent.

The primary income account deficit was 22.6% higher y-o-y, above all as a consequence of anticipated higher expenditures based on direct investments (mostly reinvested profits). Secondary income account surplus is up by 10.1% y-o-y, mostly owing to increased inflow of remittances.

The capital and financial transaction account in the period January-October 2017 recorded a net inflow of EUR 2 billion, largely from FDIs that rose by 26.4% y-o-y in the first ten months of 2017, which was more than enough to cover the current account deficit (132.8%). FDI inflows remained diversified in terms of projects and mostly focussed on manufacturing industry, financial sector, construction, and trade. Broken down by country, the largest part of direct investments came from the EU Member States, but the investments from China (including Hong Kong and Taiwan), Russia, and United Arab Emirates also increased. The net FDI inflow in 2017 is expected to be about EUR 2.1 billion (5.7% of GDP), which will ensure full coverage of the current account deficit. Portfolio investments in the period January-October 2017 recorded a net outflow of EUR 16.0 million, which is EUR 731.3 million less than in the same period last year. As regards financial loans, foreign net borrowings by residents amounted to EUR 22.7 million, while cash and deposits abroad decreased by EUR 461.1 million. Foreign exchange reserves of the National Bank of Serbia (hereinafter: NBS; excluding inter-currency and price changes), which increased by EUR 916.9 million, are at the adequate level ensuring protection from external shocks – considering they cover almost six months of imports of goods and services and 248.3% of debt<sup>4</sup> that becomes due and payable in the following year.

During the entire year 2017, inflation moved within the boundaries of a new, lower target of  $3\pm 1.5\%$ . Movements of the year-on-year inflation at the beginning of the year stemmed from the recovery of global oil prices from the second half of 2016, as well as the effects of exceptionally cold weather at the beginning of the year on the increase of the prices of fruit, vegetables and heating fuel. Having peaked at 4.0% in April as a result of a one-off rise in the prices of a few products, inflation started on a downward path in May and then stabilised in the second half of the year around the 3.0% target. That the inflation pressures have remained low is confirmed by the core inflation, which has stayed around the lower boundary of the target band, and stood at 1.4% in November.

***Credit activity and monetary trends.*** The past monetary policy easing by the National Bank of Serbia, increased competition among banks, acceleration of the economic activity and recovery of the labour market, drop in risk premiums and low interest rates in the euro money market, all contribute to further growth of credit activity. The growth in domestic loans (after excluding the effects of exchange

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<sup>4</sup> June 2017

rate variations) picked up from 2.9% y-o-y at end of 2016 to 6.4% y-o-y in October 2017. The recovery of the credit activity is supported to a greater extent by the growth in loans to households (11.8% y-o-y in October), and increasingly in corporate loans, which has exhibit a more favourable trend since the summer (year-on-year growth of 2.0% in October). At that, the growth of credit activity is continuing despite intensive activities of banks and the NBS on resolving the non-performing loans (hereinafter: NPL), whose share in total loans (11.9% in October) is at its lowest since December 2008. Excluding the effect of NPL write-offs in the last year, the year-on-year growth of total loans in October was 11.3%, of which 8.7% were loans to businesses, and 14.2% were loans to households. Further recovery of credit activity is also reflected in the new loans granted in the first ten months, which were up by 22.0% (to households) and 8.0% (to businesses). Although dinar cash loans still have the largest share in loans to households, housing loans have recovered noticeably, on the back of the real estate market recovery and increased employment and wages in the private sector. In the businesses segment, loans for working capital account for just over a half of newly granted loans (53%), and investment loans have retained a relatively high share (about 22%). Considering the acceleration of economic activity and favourable labour market trends, earlier relaxation of the NBS monetary policy, and the ECB monetary policy that will remain expansionary in 2018, we expect the growth of credit activity to continue in the coming period. Similar expectations – rising demand for loans and relaxing of the lending standards based on lower costs of sources of funds for loans – have for some time been shared by the banks in the surveys on lending activity, conducted both by the NBS for the banks operating on the territory of Serbia, and the European Investment Bank for the banks whose subsidiaries operate in Serbia.

Improved government fiscal position has limited the money supply during 2017, while greater lending to the private sector has had the opposite effect. In nominal terms, dinar aggregates were almost unchanged in October compared to the end of 2016, while being lower in real terms – M1 by 2.5%, and M2 by 2.9%. Dinar savings deposits of households in October amounted to RSD 48.5 billion. Foreign exchange savings deposits of households reached almost EUR 9.0 billion, which, coupled with increased foreign exchange deposits of enterprises, owing to good export results, translated into the growth of total savings deposits since the beginning of the year by EUR 538.4 million. Year on year, the growth of monetary aggregates has slowed in 2017; in October, M1 was up by 7.6% M2 by 8.4%, and M3 by 2.8%, in real terms.

During 2017, the dinar nominally strengthened against the euro by 4.2%. At the beginning of the year, there were short-term pressures towards the weakening of the dinar as a result of high demand for foreign exchange of domestic companies, mostly energy importers, as well as uncertainty in the international financial market in the situation of diverging monetary policies of leading central banks, for which reason foreign investors reduced their government securities portfolios. In February and March depreciation pressures weakened, and from April onwards, appreciation pressures have prevailed. This is the effect of good export results and high inflow of FDIs. Appreciation pressures were also generated by the return of foreign investors to the government securities market in the circumstances of more favourable growth outlook for the CEE region and the strengthening of macroeconomic fundamentals, seasonal rise in remittance inflows, and the growth of foreign-currency denominated bank assets related also to foreign-currency denominated lending to businesses. Relative stability in the foreign exchange market has for some longer time been aided by the improvement of macroeconomic fundamentals, which resulted in the fall in country risk premium to the lowest level since the beginning of monitoring for Serbia. In December, depreciation pressures prevailed, caused by the growing demand for foreign exchange of energy importers and due to the expectation that the FED will increase the key interest rate at its December meeting, which happened as expected.

To mitigate excessive short-term oscillations of the dinar exchange rate, in 2017 the NBS intervened on the inter-bank foreign exchange market in both directions – by purchasing EUR 1,355 million and by selling EUR 630 million.

### 3. MEDIUM-TERM MACROECONOMIC SCENARIO

The projections of main macroeconomic aggregates and indicators for the Republic of Serbia in the period 2018-2020 were based on the current economic indicators and outlook for the Republic of Serbia and the international environment, taking into account the achieved fiscal stability and planned economic policies, the Precautionary Stand-by Arrangement concluded with the IMF, and evident improvement of the economic environment and external position of the country.

The projected cumulative GDP growth rate for the period from 2018 to 2020 is 11.4%, determined by the growth of domestic demand through the recovery of private consumption and intensified investment activity. Reform laws in combination with the achieved macroeconomic stability and strengthened public administration have improved the position of the country on international competitiveness lists, while intensified structural reforms are expected to further increase efficiency and productivity of the economy. The FDI inflow, projected at over two billion euro per year, will provide for the transfer of technology and know-how, and contribute to the increase of competitiveness of the overall economy, and enable the penetration of new markets. On the other hand, the Government provides support to domestic initiatives and the development of the private sector through specific programmes within the “Decade of Entrepreneurship”, but also with a range of measures targeted at agriculture, ICT sector, and tourism. Investments into environmental protection and renewable sources of energy are also expected to intensify. All activities take into consideration the need for the regional balance and social fairness of economic growth.

Table 2. Projection of main macroeconomic indicators for the Republic of Serbia

	Estimate	Projection		
	2017	2018	2019	2020
<b>GDP, RSD billion (current prices)</b>	<b>4,469</b>	<b>4,755</b>	<b>5,057</b>	<b>5,417</b>
Real GDP growth, %	2.0	3.5	3.5	4.0
GDP deflator, %	2.8	2.8	2.8	3.0
<i>Real growth of individual components of GDP, %</i>				
Private consumption	1.8	2.7	3.4	3.8
Government consumption	1.4	2.2	1.9	2.7
Gross investment in fixed assets	4.3	5.1	4.1	5.3
Exports of goods and services	9.8	8.8	8.4	7.9
Imports of goods and services	10.6	7.0	7.2	7.0
Balance of goods and services, in EUR, % of GDP	-7.7	-6.7	-6.2	-6.0
Current account balance, in % of GDP	-4.6	-4.2	-4.1	-3.9
Inflation, period average, in %	3.1	2.7	2.8	3.0

Source: MoF

**Real sector.** Stabilisation of public finances, coupled with reform laws and structural reforms, significantly mitigates internal and external imbalances, making the economy more resilient to endogenous and exogenous shocks. One-off, short-term slowdowns of GDP growth cannot jeopardise its upward trend in the coming three-year period. The Government will pursue a responsible and predictable fiscal policy aimed at preserving the fiscal achievements. The measures of moderate fiscal relaxation will have a two-pronged effect. Reducing the burden on businesses through the increase of the personal tax allowance boosts growth and job creation, while the increase of pensions and wages in part of the public sector strengthens the purchasing power of households and stimulates internal

demand. Stable FDI with support to innovation activities is another form of assisting sustainable growth, while the reform of the education system, support to social entrepreneurship, gender budgeting, and increasing the minimum price of labour, are just some of the measures that should ensure inclusive and fairly distributed development with poverty reduction as its ultimate effect.

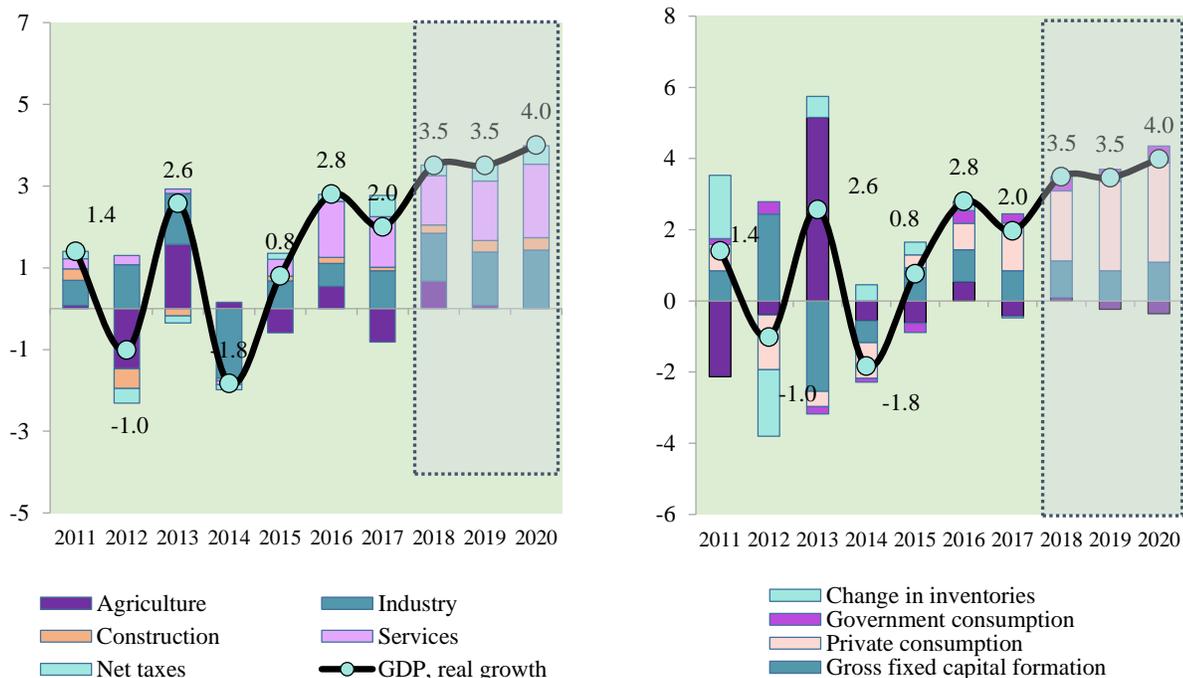
The real growth of economic activity for 2018 is projected at 3.5%. Taking into account caution exercised when projecting agricultural output and construction activity, and moderate expectations relating to investment and exports, this projection can be deemed conservative.

The drivers of growth in the following year will be the industrial and service sectors, and it is expected that these two sectors will generate two thirds of total growth. A stable increase of manufacturing industry output, coupled with the recovery of the electric power generation sector, will provide for the overall industry growth of about 5.5%. The projected growth of the service sector is 2.2%. In the first nine months of 2017, the service sector generated 2.0% more GVA than in the same period last year, and it is realistic to expect its acceleration triggered by the increase of pensions and public sector wages. Agricultural output returning to its average multi-year level will ensure a growth rate of agriculture of about 9.0%, while the projects initiated in the construction sector will accelerate activities by 4.9%. Observed from the expenditure side, private consumption will be the most important source of growth, which is only expected since it is a dominant component of the GDP expenditure side, and will be stimulated by fiscal relaxation measures. The projected growth of private consumption of 2.7%, contributing to the overall growth with 2.0 p.p., is based on sound sources, and lower than the real GDP growth, and will not generate the increase of internal and external imbalance. In the long term, the role of investments is more important as they are a dominant source of growth. In 2018, investment activity is expected to pick up and to grow by 5.1% in real terms, which will contribute to the overall growth with 1.0 p.p. Export is growing steadily, it is diversified and there are no risks of deceleration over the medium term. It is expected that export will grow by 8.8% and import by 7.0%, meaning that net export will have a mild positive contribution to economic growth. Such developments combined with better terms of trade will result in a better current account balance, whose share in GDP will drop to 4.2%. Economic growth, on the one hand, and good fiscal result with lasting deficit reduction, on the other, coupled with more favourable borrowing terms on the international financial market, will provide for continued fall of public debt as share of GDP in 2018.

In the medium term, the potential GDP growth is expected to gain pace. In 2017, potential GDP is expected to grow at the rate of about 2.5%. The greatest impetus to its growth will come from the strong recovery on the labour market, and to a lesser degree the capital factor, as a result of the anticipated intensification of investment activity in the second half of the year. The estimated potential medium-term growth is based on the accelerated economic recovery, where the output gap is expected to close in early 2019. It is predicted that rising investment and continued favourable labour market developments will contribute positively to potential GDP growth in the coming years. Better financing conditions and stronger investment activity in the transport, energy, and agriculture sectors will increase the economy's potential.

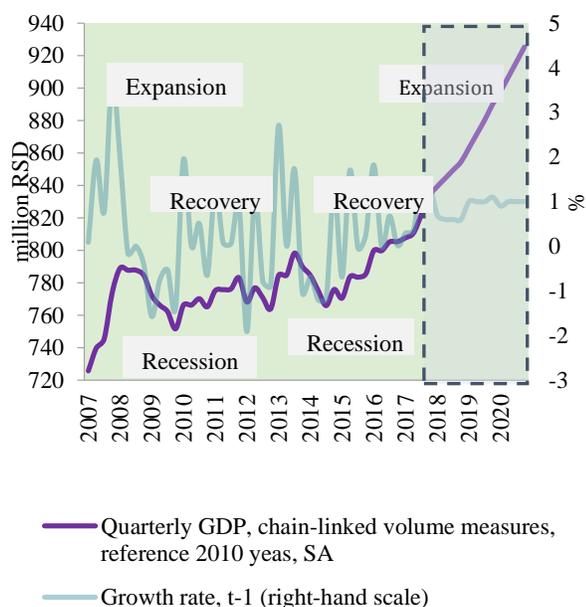
Further implementation of reforms towards the creation of an environment conducive to investment and employment will also enable a more efficient utilisation of the available but underutilised production capacity.

Graph 1. Contributions to real GDP growth, production and expenditure approach, p.p.

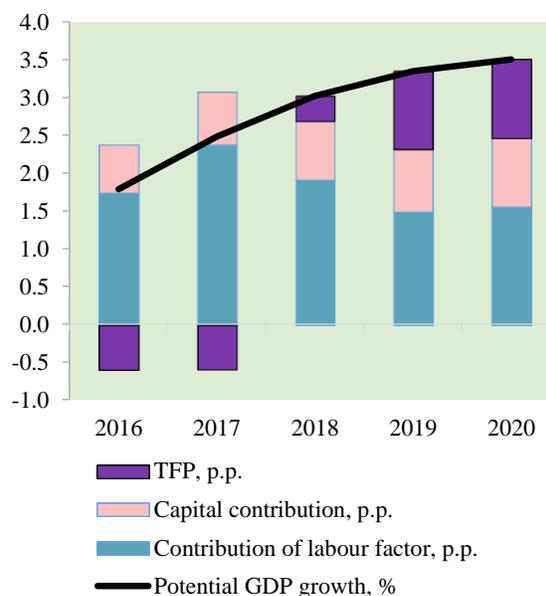


In the medium-term macroeconomic projections the average real GDP growth is forecast at 3.7%. Account must be taken of the fact that growth will be achieved in parallel with the process of fiscal stability consolidation, reduction of public debt, and structural reforms. Stable growth is expected for investments with gradual increase their share of GDP. Export will grow at an average rate of 8.4%, while the projected average annual growth of import is 7.0%. A further drop in unemployment combined with wage rise, supported by better lending terms and fiscal relaxation measures, will give a boost to domestic demand, so the average annual growth of personal consumption is expected to be 3.3%, followed by the rise in government consumption of 2.3% annually on average. On the supply side, the main source of growth will be the service sector, and a significant contribution will also come from the industrial production expected to grow by 6% on average. Construction activity will accelerate after growing by about 5% in 2018, to reach the rates above 6.0% in 2019 and 2020. On the output side, in the period 2017–2019, the largest contribution to GDP growth is expected from the service sector and industrial production. Increased investment activity of the private sector, and intensified implementation of infrastructural projects will result in a positive contribution of the construction sector, while the contribution of agriculture should be mildly positive.

Graph 2. Cyclical movements of economic activity



Graph 3. Contributions of production factors to the potential growth rate



The three-year development scenario was created in line with the strategic Government orientation towards sound and sustainable trajectory of economic growth aided by structural adjustments and systemic improvements, grounded in export and investment activities. The goals are ambitious but realistic, take into account internal specificities as well as dynamic changes in the international environment and make a sound basis for the fastest possible convergence with advanced economies through improvement of the key components of GDP. At end-2020, gross investment in fixed assets as share of GDP will be about 2.0 p.p. higher than in 2014, the share of government consumption in the same period will drop by about 16.0%, which is significantly below the European average (about 20.0%). The share of export of goods and services in GDP in 2017 will be 52.5% and is expected to exceed 57.0% at the end of the three-year period. Removing barriers will provide for a wide dispersion, directed by incentive measures to the tradeable sector and the service activities generating a high level of GVA per employee. The sustainability of external debt, external liquidity, and solvency will be ensured by the simultaneous reduction of goods and services deficit and current account deficit to 6.0% and 3.9% of GDP, respectively, at the end of 2020.

**Employment and wages.** By improvements in labour legislation structural obstacles to employment have been removed, labour market flexibility increased, and foundations for curbing informal employment laid, which will contribute to the continuation of positive trends despite public sector rightsizing. The so-called productive employment, aimed at adapting knowledge, skills, and employment levels to the needs of the labour market, will be of utmost importance in the following period, and will depend on the success of harmonisation of employment, education and scientific and technological development. In this regard, continued growth of employment is expected in the coming medium-term period, primarily based on projected growth of GDP and investment, and supported by labour market and educational system reforms, particularly introduction of the dual education system, which will ensure that the skilled labour force matches the real needs of the labour market. In the coming period, the growth of real net wages in the private sector is expected to follow the growth of productivity in the economy, and will be faster than in the public sector. Real net wages growth is

projected to be slower than the real growth of GDP, but in line with the growth of productivity, which will result in lower unit labour costs and improvement of the competitive position of the country. Real wage growth will also be supported by the increase of public sector wages, as well as the increase of the minimum cost of labour from 1 January 2018 from RSD 130 to RSD 143 per working hour. This will have a positive effect on aggregate demand.

**Monetary and exchange rate policy.** Since 2009, the NBS has been in the inflation targeting regime. Owing to a considerable improvement of macroeconomic fundamentals and the outlook for Serbia in the following period, primarily the sustainable reduction of external and internal imbalances, and the fact that inflation was low and stable for three consecutive years, and that inflation expectations of the financial and business sectors are down to about 2–3%, the target inflation rate has been lowered by 1.0 p.p. to  $3\% \pm 1.5$  p.p. from 2017 onwards. This has further demonstrated that the NBS and the Government are determined to keep the inflation low, stable, and predictable over the medium term. Moreover, setting a lower inflation target contributes to the improvement of business and investment climate, a fall in long-term interest rates, reduction of costs and currency risk for the economy, the population, and the government, which also contributes to the dinarisation process which is our strategic goal. The target inflation rate has been set at  $3\% \pm 1.5$  p.p. until 2020.

The main instrument for achieving the inflation target is the interest rate applied in reverse repo operations with one week transaction maturity, while other monetary policy instruments (open market operations, credit and deposit facilities, required reserve, and intervention on the foreign exchange market) have a supporting role. A temporary deviation from the inflation target is allowed if believed to be temporary or that the required monetary policy change could cause macroeconomic instability. This particularly refers to abrupt changes of primary commodity prices on the global market or the price of products that are directly or indirectly affected by Government decisions.

The cycle of the NBS monetary policy relaxation started in mid-2013 when the key policy rate was 11.75%. Owing to low inflationary pressures, consistent implementation of fiscal consolidation, and successful implementation of the arrangement with the IMF, with significant overperformance against targets, lowering of the key policy rate was the fastest in 2015 (from 350 b.p. to 4.5%), and continued in 2016 at a cautious pace (by 50 b.p., to 4.0%), primarily bearing in mind the effects of the previous monetary policy relaxation and the uncertainty present in international financial and commodity markets.

Cautious monetary policy has continued in 2017 due to uncertainties surrounding the developments in international commodity and financial markets. The uncertainty on the global commodity market above all related to the movements of the price of oil and other primary products. The uncertainty in the financial market stemmed from the normalisation of the FED's monetary policy and increasing divergence from the ECB's monetary policy, which made global capital flows towards emerging countries, including Serbia, more uncertain. The decision on further easing of the monetary policy by 25 b.p. in September and in October, to 3.5%, which is its lowest level in the inflation targeting regime, allowed the inflation pressures based on the factors from the domestic and international environment to weaken. The deceleration of both headline and core inflation since May has been greater than expected, and inflation expectations of the financial and business sectors moved around the central target value for inflation. The effects of drought on inflation were smaller than anticipated, and lower import prices in dinar terms had also acted in favour of lower inflation. In addition, the risk premium is at its lowest since monitoring began for Serbia. Greater investor willingness to invest in Serbia is also reflected in the capital inflow, which was several times higher than the current account deficit in the third quarter and contributed to appreciation pressures. In a situation of low inflationary pressure, by relaxing its monetary policy, the NBS provided additional support to credit growth and, in turn, to economic growth.

The confirmation of further improvement of Serbia's macroeconomic prospects and achieved structural reform results was given both by the IMF and credit rating agencies. Towards the end of 2017, rating agencies Standard & Poor's and Fitch raised Serbia's credit rating to BB, with stable outlook for further growth.

With respect to the monetary policy in the following period, the NBS will continue implementing a carefully balanced and combined set of monetary policy measures directed at the maintenance of low and stable inflation while preserving the stability of the financial system and supporting the growth of economic activity on sustainable grounds.

In line with the chosen monetary strategy, the NBS will continue pursuing the managed floating exchange rate regime. That means interventions on the foreign exchange market in three cases: to reduce excessive short-term oscillations of the foreign exchange rate, preserve the stability of the financial system, and maintain an adequate level of foreign exchange reserves. In the short term, some pressures on the dinar exchange rate are possible from volatile capital flows due to different nature of leading central banks' monetary policies. However, the reduction of internal and external imbalances contributes to a greater resilience of the domestic economy to external shocks, and the stability of the dinar exchange rate over medium term.

The required reserve policy was developed in a manner that encourages longer term and dinar sources of bank funding through the differentiation of required reserve rates depending on the term and currency of liabilities. For dinar sources of funding with contractual maturities of up to two years it is currently 5.0%, and for the source with maturities of over 2 years it is 0%. The required reserve rate for foreign exchange sources of funding with contractual maturities of two years is 20.0%, and for maturities over two years is 13.0%.

**Medium-term inflation projections.** It is expected that after falling at the beginning of the year, inflation will stay below 3.0% but within the tolerance band for most of 2018, to move closer to target during 2019. Lower inflation during 2018 will result from exiting the year-on-year calculation of one-off price hikes in early 2017 driven by factors on the supply side and the fall in import inflation, while the rise in aggregate demand will act in the opposite direction.

The uncertainty regarding the achievement of inflation projection relates primarily to the further development in the global commodity and financial markets, i.e. to the movements of global prices for primary commodities (oil and primary agricultural products) and the leading central banks' decisions on monetary policy.

**External sector and its medium-term sustainability.** Progress in the process of European integrations, ongoing economic recovery in the EU, successful implementation of the arrangement with the IMF, and a more conducive business environment resulting from the implementation of structural reforms, should be positively reflected in further growth of FDIs over the medium term.

The product composition of exports improved in the previous period owing to FDI inflow to certain export oriented sectors, which should contribute to their further growth over the medium term. After a successfully completed investment in the manufacturing of cars, parts, and accessories for motor vehicles, the share of these products in total Serbian exports in 2013 reached 20.5%. The following years saw a decline in automobiles export, which was gradually offset by the growth in exports of parts and accessories for motor vehicles. In the first ten months of 2017, the total growth of automotive industry exports was 8.0% y-o-y.

Broken down by stages of processing, intermediate goods accounted for the largest share (31.6%) of exports in the first ten months of 2017. Resource-based products had the second-largest share of 24.1%, followed by upstream products (iron and steel, clothing, footwear, furniture) with a share of 21.5%, while primary products accounted for 13.6% of total exports. The share of high technology products (mostly electric machines) in total exports was 6.2%, and other products (electricity, non-classified) accounted for 3.0%. The reactivation of production in the ferrous metals

processing industry had the largest effect on the change of export structure towards the increase of the share of upstream products.

In terms of geography, the goods from Serbia are sold mostly on the EU market. The share of exports to this group of countries went up from 60.4% in 2010 to 66.5% in the period January-October 2017. The most important destinations are Italy<sup>5</sup> and Germany, accounting for almost 40.0% of exports to the EU in the previous part of 2017, or 26.0% of the total Serbian exports. The share of exports to CEFTA countries dropped from 25.6% in 2010 to about 17.3% in 2017, while the share of exports to Russia increased from 5.5% in 2010 to 5.9% of the total Serbian exports in 2017.

After the depreciation of the real effective exchange rate<sup>6</sup> by 8.6% cumulatively<sup>7</sup> in the period 2014-2016, the real effective exchange rate appreciated by 2.6% y-o-y the period January-October 2017. Such trend is a result of the nominal appreciation of the effective rate which averaged 1.1%, and a faster rise of domestic than foreign prices (1.5% y-o-y). In the period January-September 2017, the rise of unit labour costs of the domestic economy was higher (5.3% y-o-y) than the rise of unit labour costs in the euro area (1-3% y-o-y) which, coupled with nominal appreciation of the dinar against the euro (0.7% y-o-y), translated into a reduced cost competitiveness of Serbia, measured by the real exchange rate calculated on the basis of unit labour costs<sup>8</sup>, by 4.8% y-o-y.

Unlike price and cost competitiveness, which mostly has a short term effect, structural competitiveness of Serbia, which has a decisive effect on the improvement of competitiveness of an economy in the long term, continued to improve in 2017. In 2017 Serbia made progress on the World Economic Forum list by 12 places (to 78<sup>th</sup> place) owing mostly to the improvement of the macroeconomic environment, which is the result of low and stable inflation, reduced budget deficit, increased share of savings in GDP, and improvement of the credit rating. At that, Serbia made an evident improvement in all three pillars of the competitiveness index. Serbia also further improved its ranking on the *Doing Business* list of the World Bank. According to the latest 2018 report, it moved 4 places up (ranked 43<sup>rd</sup> of 190 countries) owing to continued improvement of legislation in the field of issuing building permits (ranked 10<sup>th</sup>), starting a business, registering property, and enforcing contracts.

The current account deficit should stand around 4.0% of GDP in the following years, where the expected decrease in the goods and services deficit and a stable inflow of current transfers should compensate for the expected increase in the primary income deficit. The improvement in the foreign trade deficit will primarily be contributed to by the execution of new investments that have in the past also increased the competitiveness of our products and services in foreign markets, and by the recovery of external demand from the EU countries. The real growth of goods and services exports is expected average at about 8.0% per year in the following three years, bringing their share in GDP up to about 56.0% in 2020 (from 32.9% in 2010 and 50.2% in 2016). After a sharp increase in 2013, the share of goods and services exports in global exports continued to rise and is projected to reach 0.1% in 2017. The expected faster increase in the exports of goods and services (about 7.0% on average in the next three years) than their imports will allow the nominal goods and services deficit to drop from around 8.0% in 2017 to around 6.0% of GDP in 2020.

The expected increase in the stock of non-resident direct investments will result in profit from their ownership remaining a significant expense item in the primary income account in the future, which will be partially offset by a lower outflow from interest on loans and securities, due to private sector deleveraging and public sector borrowing under more favourable terms. In the following period

<sup>5</sup> Most automobiles exports are registered as exports to Italy, regardless of the final destination

<sup>6</sup> The basket of foreign currencies and basket of prices are made up of the euro and US dollar, and consumer price indices in the euro area and USA in the ratio of 80:20 respectively.

<sup>7</sup> By 2.2% in 2014, by 5.1% in 2015, and by 1.3% in 2016

<sup>8</sup> Calculated as a product of euro to dinar nominal exchange rate and ratio of the unit labour costs in Serbia and the euro area.

the secondary income account is expected to have a stable inflow of remittances of around 8-9% of GDP.

The structure of capital inflows will be dominated by FDIs (around 4.5-5.0% of GDP on average annually), which will fully cover the current account deficit. In addition, the private sector is expected to continue deleveraging in the following period, but to a lesser extent, whereas the public sector, considering good fiscal results, will only borrow to repay a part of its due debts.

From the standpoint of international investment position (hereinafter: IIP), Serbia is a net debtor, in the amount of EUR 35.8 billion (101.7% of GDP) at the end of June 2017, which by 0.8 p.p. lower than at the end of 2016. In the observed period, the government decreased its negative international investment position by EUR 1.2 billion. Due to a higher FDI inflow, the negative position of other sectors increased by around EUR 1.0 billion, while due to the drop in bank deposits abroad, the negative position of the banking sector increased by EUR 0.1 billion. On the other side, the positive position of the NBS decreased by around EUR 0.85 billion towards the end of the first half of the year, as a result of foreign reserve decrease in the first half of the year. Broken down by instruments, at the end of the second quarter of 2017 foreign direct investments accounted made up 75% of the net IIP, which indicates less vulnerability to external shocks.

On the liability side of IIP, debt instruments account for about 54.7%, including debts to related parties (amounting to 24.3% of total debt). Half of external debt is related to the public sector (51.6%), and all of it is long-term. Public external debt is dominated by three currencies – the dollar (47.0%), the euro (38.7%), and the dinar (8.6%). At the same time, the share of the euro and the dollar in foreign reserves is 58.2% and 30.4%, respectively, so the currency structure of foreign reserves is in line with the foreign public debt currency structure. Over two thirds of public debt is contracted at a fixed interest rate, so interest rate risk is significantly lower than foreign exchange risk. Most of the private sector debt structure (81.5%) refers to corporate debt. Over 90% of corporate debt is euro-denominated, but the fact that over 90.0% of exports collection is executed in euros as well contributes to lower foreign exchange risk on external corporate debt. In terms of residual maturity, around 86.7% of corporate debt is long-term. About 78.8% of bank debt is contracted at a variable interest rate, while over 90.0% is euro-denominated. In terms of residual maturity, around 56.8% of the external debt of the banking sector (excluding deposits) is long-term.

As a result of capital inflow that should provide full current account deficit coverage, in the following years foreign reserves are expected to remain at an adequate level. At the same time, the expectations are that the value of the negative international investment position will increase, in particular relating to direct investment, but that its share will remain at around 100.0% of GDP. Greater investment inflow will result in the growth of imports (primarily of equipment), but maintaining the coverage of average monthly imports at a level of around six months, foreign reserves will continue to provide adequate protection of the domestic economy against external shocks. At the same time, it is estimated that the coverage of short-term debt (observed by residual maturity) with foreign reserves will increase from 248.3% at the end of June 2017 to about 300.0% in 2019.

**Financial sector.** During 2017 there were no major changes in the structure of Serbia's financial system, i.e. the banking sector still presents the dominant form of financial intermediation (with a share of over 90.0% in total financial sector assets).

As of 31 October 2017, 30 banks operated in Serbia's banking sector, of which 21 with majority foreign ownership (members of banking groups from 13 states), while six banks were majority-owned by the Republic of Serbia, and three banks were majority-owned by domestic legal entities. Banks with majority foreign ownership dominate the market and account for 75.9% of total balance-sheet assets, 81.4% of total gross loans and 74.0% of total deposits of Serbia's banking sector. In terms of individual share of banks, the banking sector of Serbia is fragmented in all relevant market categories, indicating a high degree of competition among banks.

The banks' total assets and capital at the end of October 2017 amounted to RSD 3,320 billion and RSD 662 billion respectively. At the end of September 2017 the capital adequacy ratio was 22.5%, (at its highest in the last nine years), which is significantly above the regulatory threshold (8%). Additionally, the growth rate of own funds was sufficient to enable the preservation of capital as share of total liabilities at the level of 19.9% at the end of October 2017.

The Decision Amending the Decision on Reporting Requirements for Banks, adopted in December 2016 as part of execution of the Strategy for the Implementation of Basel III Standards in the Republic of Serbia, established the regulatory framework for monitoring the leverage indicator levels in banks. The leverage indicator, in accordance with the new regulations, is calculated as a ratio of Tier 1 capital to total exposure of the bank<sup>9</sup>. The leverage indicator for the banking sector calculated in such manner was 10.95%<sup>10</sup> as at 30 September 2017.

The banks in Serbia are characterised by high liquidity, which is confirmed by the evolution of the key liquidity ratios and asset maturity structure, which are at very satisfactory levels by all reference criteria. The average monthly current ratio for the banking sector was again above 2 during 2017 and 2.07 in October (the regulatory minimum limit is 1.0). The quick ratio was 1.71 in October 2017 (the regulatory minimum limit is 0.7). As at 31 October 2017, liquid assets accounted for 37.7% of total balance-sheet assets and 54.6% of total short-term liabilities.

The liquidity coverage ratio (LCR) has been introduced with the aim of further strengthening the resilience of the banking sector<sup>11</sup>. This indicator is the ratio of the protective layer for liquidity (comprising high quality liquid assets) and net outflows of liquid funds of the bank over the next 30 days from the date of calculation of this indicator in the assumed stress scenario. The banks are obligated to keep this ratio at no less than 80.0% until 31 December 2017, and at no less than 100% as from 1 January 2018 (the prescribed minimum values are identical to those in the EU). As at 31 October, the liquidity coverage ratio for the banking sector was 256.2%.

The banking sector's profitability in the first ten months of 2017 was 63.0% higher than in the same period of 2016 and total net pre-tax profit amounted to RSD 58.8 billion (EUR 492.6 million). The above translated into the rise in *ROA* and *ROE* profitability ratios, which at the end of October 2017 stood at 2.15% and 10.90%, respectively.

A relatively high share of non-performing loans in total loans was one of the key risks and greatest challenges in the past few years. As of October 2017, non-performing loans amount to RSD 244.8 billion, or 11.9% of total loans. Non-performing loans of the banking sectors have been reduced by 10.4 p.p. in just over two years. During 2016, the NBS carried out all the activities specified in the Action Plan for Implementation of the NPL Resolution Strategy, which resulted in strengthening the banks' capacity to address non-performing loans and significant reduction of the NPL level. The NBS demonstrated its commitment to resolving this complex issue in the banking sector in accordance with its responsibilities aiming to preserve and strengthen the stability of the financial system by continuing regulatory activities in this context in 2017. The Decision on the Accounting Write-off of Balance Sheet Assets was adopted in August 2017 and implemented as from 30 September 2017, mandating banks to transfer non-performing loans that are completely (100%) impaired to off-balance sheet assets of the bank. The direct effect of implementing this decision is best reflected in the total amount of direct write-offs which, in September 2017 alone, amounted to RSD 53.6 billion, where 80% of write-offs related to exposures to businesses.

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<sup>9</sup> Total exposure is the sum of on balance-sheet and off-balance sheet exposures, derivatives, and increases for the counterparty risk from repo and reverse repo transactions, securities financing transactions, cross product netting, and long settlement transactions.

<sup>10</sup> Under the Basel III standards, the minimum value of this indicator is set at 3.0%.

<sup>11</sup> The Decision on Liquidity Risk Management was adopted in December 2016 as part of execution of the Strategy for the Implementation of Basel III Standards in the Republic of Serbia.

Since the adoption of the NPL Strategy, the most important channels for achieving the reduction of NPLs have been write-off and assignment of receivables. In 2017, direct write-off of receivables brought NPLs down by RSD 69.0 billion, while assignments of receivables reduced the NPL level by RSD 14.1 billion<sup>12</sup>. In terms of sectors, the exposure to the corporates still contributes the most to the overall level of NPLs (NPL ratio 12.9%), while the NPL ratio for households is traditionally lower, standing at 6.3% at the end of October 2017. It is important to note that the non-performing loans are for the most part covered, both by allowances for impairment in accordance with international accounting standards (at end-October 2017 62.5% of NPLs were covered by the pertaining allowance for impairment), and by regulatory provisions for balance-sheet exposures (130.6% as at end-October 2017).

As part of the efforts undertaken by the NBS as Serbia's banking system regulator to harmonise the regulatory framework with the EU acquis and best international practice and standards, aiming to establish a regulatory framework for the implementation of Basel III standards in Serbia, that is, for transposing the requirements of the Regulation (EU) no. 575/2013 into the domestic regulatory framework, in December 2016, the NBS Executive Board adopted the following regulations applicable as from 30 June 2017:

- Decision on Capital Adequacy of Banks,
- Decision on Disclosure of Data and Information by Banks,
- Decision on Reporting on Capital Adequacy of Banks,
- Decision Amending the Decision on Reporting Requirements for Banks,
- Decision on Liquidity Risk Management by Banks,
- Decision Amending the Decision on Risk Management by Banks.

The adoption of the above regulations, and their successful past implementation by banks, is a significant step towards the harmonisation of the domestic regulatory framework of banks, considering that the provisions on prudential requirements for credit institutions applied in the EU have for the most part been implemented through the above implementing legislation. In addition to the harmonisation with the relevant EU legal acts in the banking field, the main goals of their adoption are the following: increasing the resilience of the banking sector through increasing the quality of capital and introducing capital buffers, better monitoring and control of bank exposure to liquidity risk, further strengthening of market discipline and transparency of bank operations in the Republic of Serbia by disclosing all relevant information on bank operations, as well as adapting the reporting system to new regulatory provisions.

In line with its strategic commitment to continuous improvement of the legal framework for banks while taking into account the specific features of domestic regulations and market, and considering the fact that the Republic of Serbia has accepted the EU acquis in Chapter 9 – Financial Services, the NBS continues to monitor the changes in the regulations governing the operation of credit institutions in the EU and attempts to adapt the regulations in this field. In this regard, the NBS adopted the Decision Amending the Decision on Consolidated supervision of a Banking Group in June 2017 to provide for the harmonisation of new, already adopted regulations implementing Basel III standards in the Republic of Serbia on a consolidated basis as well. In July 2017, the NBS also adopted the Guidelines for the Identification of Default, providing solutions based on those offered by the European Banking Authority, while in September 2017 it adopted the Guidelines for the Implementation of Specific Provisions of the Decision on Capital Adequacy for Banks Relating to Bank Capital, to achieve harmonisation with delegated EU acts and create additional regulatory preconditions for the achievement of one of the main goals of Basel III standard – increasing banking sector resilience through the increase of the banks' regulatory capital quality.

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<sup>12</sup> Calculated on the bases of data from NPL3 report that banks submit to the NBS.

In the coming period the NBS will continue on a path of harmonisation of the regulations and practice within its purview accordingly.

With the start of application of the Law on Payment Services (as of 1 October 2015) and implementing legislation adopted on the basis of this law, the NBS finalised its numerous activities aimed at the establishment of a comprehensive regulatory framework in the field of payment services and issuance of electronic money. Since the above legislation set up an effective legal basis for the establishment and operation of payment institutions and electronic money institutions, until 31 December 2017, the NBS issued 12 decisions granting the same number of licences for the provision of payment services to interested companies that applied and met the prescribed requirements. In addition, one company was granted a licence for the issuance of electronic money as an electronic money institution. The above new market operators are developing their business network and the accessibility of payment services to customers also through their network of representatives (legal entities and entrepreneurs entered in the relevant NBS register). To further develop this segment of the financial market, the NBS is undertaking activities on harmonisation of the national legislation with the EU *acquis* in the field of payment services, primarily through the implementation of the new Payment Services Directive (PSD2). The national regulatory framework will, thus, be in line with the EU standards introducing new payment service providers (*payment initiation service providers* and *account information service providers*) that will engage in innovative and technologically advanced services.

#### 4. ALTERNATIVE SCENARIOS AND RISKS

The analysis of endogenous and exogenous factors and the simulation of their various alternative movements identified the main risks to the realisation of the medium-term scenario.

A part of external risks is determined by the pace of growth of our main foreign trade partners. The materialisation of improved outlook for growth in the euro area, but also Russia and China, may result in greater external demand, which would additionally contribute to growth through increased exports. Pulling politically motivated decisions that are not grounded in economics, and are contrary to signed agreements, with the intention of blocking the export of Serbian products, is a downside risk which, in addition to short-term adverse effects, can cause more far reaching problems in terms of breaking of trade chains and loss of market position. Another part of the risk is determined by the trends in goods and capital markets. The symmetry of the risks relating to the uncertainty of prices of goods is determined by the role of our country as net importer or net exporter. A stronger rise in oil prices from projected would have an adverse effect on the economic trends in the Republic of Serbia as a net importer. The rise in prices of primary agricultural products and base metals in the international market would have an opposite effect, and thus give an additional positive contribution, since the position of the Republic of Serbia is that of a net exporter. The movements in the international financial market are largely determined by the FED and the ECB policies. Geopolitical tensions, as well as political instability in the EU, triggered by Brexit and Catalan referendum, can have an indirect negative effect on the Serbian economy through a spill-over of possible instability in the economies of our major trading partners. The unknowns relating to future steps and a vague perception of the effects of the measures undertaken so far is associated with the risk of uncertainty about the behaviour of foreign investors and the availability of the sources of financing.

The internal risks to the realisation of the macroeconomic scenario are mostly linked to the pace of structural reforms implementation. Successful reform of public enterprises would make production processes more profitable and efficient, which in turn would speed up investment activity. Such an impetus would produce effects on the supply side in the short term as a large number of these enterprises are drivers of economic activity in their industries. Further improvement of public

administration would reduce the costs of doing business for all economic operators and accelerate economic trends. Conversely, any delay and postponement of these activities is associated with an adverse effect on economic growth, so the risk of reforms implementation can be considered symmetrical. The pace of execution of public projects also carries a symmetrical risk, since in the case of deceleration relative to plan it would have a negative effect on investment activity, while the acceleration would make an additional positive contribution to the overall economic growth. Uncertainty with respect to the operations of Agrokor company may, through the supply chain, adversely affect domestic producers, but considering the elasticity of demand for such goods, we predict that negative factor will have a short-term effect. The significant share of agriculture in the Serbian economy and high level of dependence on the weather, which is a determinant of the annual yield volatility, generates a constant risk to the realisation of the projected GDP growth. As the growth of agriculture for the next year is projected on the basis of multiannual averages, we believe this risk to be symmetrical.

The baseline development scenario for the following three years is based on an increase in investment, goods and services exports, as well as a reduction of the share of public expenditure while preserving the fiscal stability. The pace of implementing structural reforms will determine the pace of economic activity growth in the medium term. Any slowdown in the implementation of structural measures, which are to provide an enabling economic environment, would result in a deterioration of the country's macroeconomic position. Such trends would aggravate external and internal macroeconomic imbalances. Apart from that, there would be a slowdown and interruption of vital foreign capital inflow.

Taking into account a possibility of materialisation of the above risks and their respective impact on the macroeconomic projection for the period 2018–2020, an alternative scenario was prepared, with a more moderate economic growth relative to the presented baseline scenario for the following medium-term period. The risks for the baseline scenario presented by this Programme are symmetrical. A sensitive external position of Serbia as a small and open economy whose exports are above all determined by the pace of growth of the EU economies is built into the alternative scenario. In addition, a higher-than-projected rise of the price of oil would have a direct impact on economic growth through the increased cost of production processes and lower generated GVA, as well as through the decreased disposable income of households and thus slower growth of personal consumption. Slower pace of structural reform would be reflected in slower growth of investment spending as a key driver of economic activity. The materialisation of these risks would result in economic growth lower by 1.5 p.p. annually on average than the baseline scenario.

### III FISCAL FRAMEWORK FOR THE PERIOD FROM 2018 TO 2020

#### 1. MEDIUM-TERM FISCAL POLICY GOALS

Fiscal policy goals for the following medium-term period are the achievement of relatively low fiscal deficits of around 0.5% of GDP, which additionally accelerates the downward path of the public debt. The main goal of fiscal consolidation, interrupting further debt growth and its gradual reduction, was achieved as early as year two of the implementation of the precautionary arrangement. General government debt, after peaking at 76.0% of GDP in 2015, started to decline, and already in 2016, primary fiscal surplus and reduction of public debt by three percentage points of GDP were achieved. The planned deficit of 0.5% of GDP per year in the following period and primary fiscal surplus will ensure continued maintenance of the achieved fiscal stability and reduction of public debt to 56.3% of GDP in 2020.

The estimated structural adjustment for the duration of the arrangement amounts to 6.0% of GDP, considerably higher than the initial goal. In the first two years of programme implementation, structural adjustment amounted to 4.4% of GDP. The key contribution to structural adjustment stemmed from expenditure (wages and pensions) reduction, while the favourable macroeconomic environment, with the strengthening of tax and financial discipline, enabled a strong revenue increase. Although the fiscal policy in 2016 was mildly relaxed by raising pensions and wages of employees in some parts of the public sector, achieved fiscal deficit was three times lower than initially planned, while for the first time since 2005, primary fiscal surplus was achieved. The fiscal policy in 2017 has been additionally relaxed without jeopardising the achievement of the primary goal relating to the reduction of deficit and debt. The planned deficit of 1.7% of GDP in this year has been revised downwards several times, and according to the current estimate the expectations are that the fiscal surplus will be 0.7% of GDP, primary fiscal surplus 3.4% of GDP, while debt as a share of GDP will be reduced by close to 10.0 p.p. relative to the end of the previous year. As a result of implemented measures, structural fiscal adjustment in 2017 is expected to be about 1.6% of GDP. This result, significantly better than planned, is for the most part due to better revenue collection. On the expenditure side, the most important contribution comes from lower interest expenses. The costs of interest payments are even lower than the previous year, which has had an additional effect on the size of the structural fiscal adjustment this year compared to the previous one, given the fact that in the previous period this cost to the government reduced or neutralised the effects of implemented measures. The completion of the process of rightsizing and restructuring of public and former socially owned enterprises work towards minimising the likelihood of fiscal risks materialisation and their impact on expenditures, while the favourable macroeconomic trends and continued fight against informal economy will lead to revenue growth. This will increase the available fiscal space for implementing new and relaxing the current policies.

The success in the implementation of fiscal consolidation measures was also confirmed by international rating agencies that have improved the credit rating, and thus reduced the government's borrowing costs on the global financial market. Lower interest rates and restoration of creditors' confidence will result in cheaper sources of financing thus further improving the country's fiscal position. In addition to a direct effect of easier access to funds at lower cost, the indirect effect stems from the multiplier effect of investing in infrastructure, not only by the government but also by the private sector, and their contribution to a stable and sustainable economic growth.

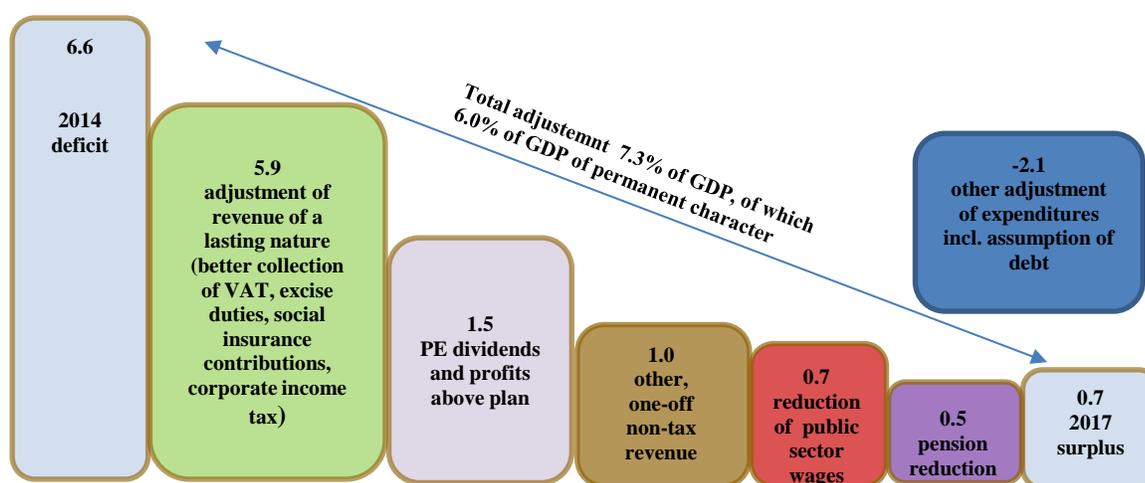
On the back of the fiscal results achieved in the past three years, fiscal space has been created of about 1.5% of GDP per year, which will be used for the fiscal policy relaxation and a more intensive government investment activity, while staying on the downward path of the general government debt. The fiscal space in 2018 will be used on the expenditure side for capital investments, increasing total investments and significantly contributing to economic growth. Part of the space will be used for

raising wages and pensions. On the revenue side, the fiscal space will be used for reducing the tax burden on labour, by increasing the personal tax allowance.

## 2. FISCAL TRENDS IN 2017

The fiscal consolidation programme implementation as part of the IMF arrangement continued successfully in 2017. The estimated structural primary adjustment will be 1.6% of GDP in 2017, while the cumulative structural fiscal adjustment achieved in the first two years of arrangement implementation was 4.4% of GDP. The total structural adjustment of 6.0% of GDP during the three years of fiscal consolidation programme implementation is much higher than the goal provided for by the IMF arrangement, which is an adjustment by 4.0% of GDP in the same period.

Graph 4. Effects of the three-year fiscal consolidation programme, % of GDP



No additional consolidation measures on the revenue side have been implemented in 2017, while on the expenditure side the fiscal policy relaxed somewhat without jeopardising the level of structural adjustment. The economic reform programme has been implemented in 2017 with negligible changes. In 2015 and 2016 the wage and pension policy was relaxed while minimal compensatory measures were implemented on the revenue side. Structural adjustment also continued in 2017 by rightsizing employment in the public sector, primarily through the hiring freeze, by which the overall goals of this measure have been achieved. The moderate decline of the number of pension beneficiaries has continued due to the implemented parametric reform of the pension system. On the revenue side, the rising trend of efficiency in collecting tax revenue continued.

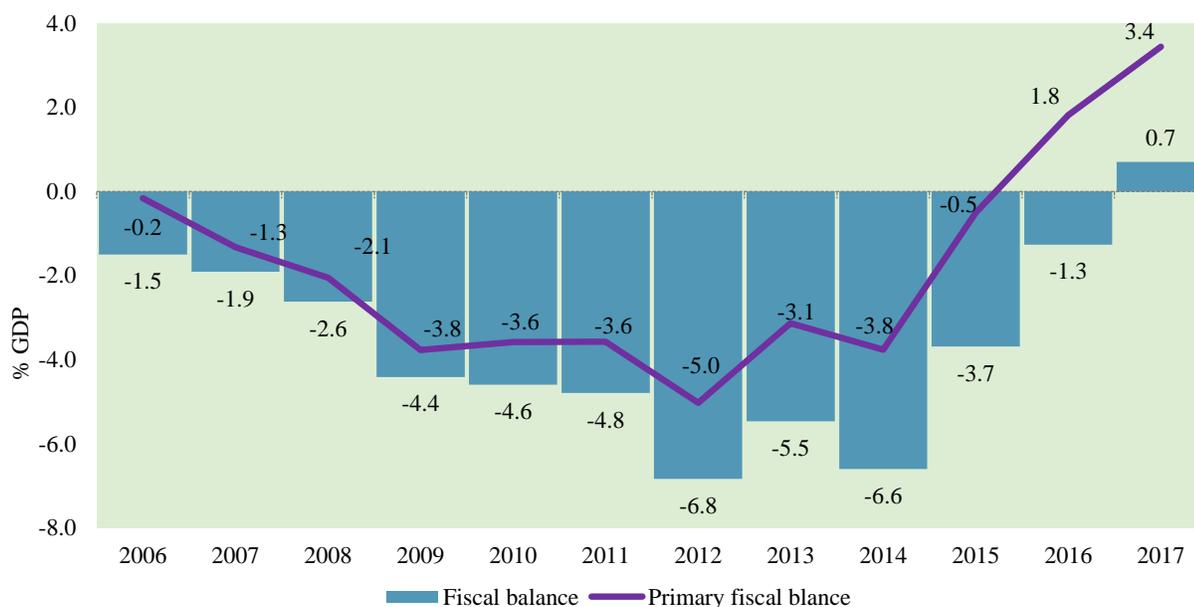
According to the latest estimates, the fiscal result of the general government in 2017 will amount to 0.7% of GDP and will be improvement of 2.4% of GDP than planned; at that, the overall and primary fiscal surplus will be achieved at the same time, which is a first since 2005. A new estimate was prepared for revenues, expenditures and the general government result, with the projected fiscal result better than planned by about RSD 107.0 billion.

It is estimated that the primary fiscal surplus of 3.4% of GDP in 2017 will be one of the main factors of the reduction of public debt share in GDP. This result shows that the fiscal consolidation measures achieved the desired effects and that public consumption was sufficiently reduced. On the other hand, favourable fiscal trends and the improvement in the debt interest structure have already

ensured a stabilisation of the absolute level of interest expenses and a decrease of their share in GDP. This has created space for certain fiscal relaxation that will not jeopardise the main medium-term goals of the fiscal policy.

After the growth of public debt share in GDP slowed in 2015, and started declining the following year, in 2017, the public debt as the share of GDP has been significantly reduced. The public debt share was planned to go down from its 2016 level of 73.0% of GDP to 63.7% of GDP at the end of 2017. The overall and primary surplus in 2017 are the most important factors that caused the accelerated downward trend of the public debt share in GDP. On the other hand, significantly higher disbursements of proceeds from project loan financing were planned, which is considered desirable given their developmental component.

Graph 5. Primary and overall fiscal result, % of GDP



A much better fiscal result in 2017 is for the most part due to a better-than-planned public revenue collection. The revenue projection has been revised upwards by RSD 96.6 billion, with the largest contribution to better collection coming from corporate income tax. The expenditure projection has been revised downwards by a somewhat smaller amount, but with significant changes in structure. Lower interest payment expenses contributed most to a lower execution of total expenditures.

Fiscal trends in the period January – September 2017 mostly reflect the current favourable macroeconomic trends, above all in the labour market, but also other factors that contributed to better public revenue collection. The general government surplus of RSD 82.0 billion in the observed period is a significantly better result both relative to plan and relative to the result achieved in the same period the previous year.

The developments on the labour market during 2017, translated into the increase in average wages, employment as well as consumption, are strongly manifested in fiscal aggregates through their impact on the personal income tax, mandatory social insurance contributions and VAT collection. In the domain of VAT audit and collection efficiency improvement, excellent results were achieved in 2015, and a similar trend continued in 2016, while the current year has seen further but more modest increase. The main determinants of VAT collection are the total level of consumption (C), effective tax rate and collection efficiency (C-efficiency). The VAT is the second largest tax type in total public

revenue, and its trend is also driven by factors such as credit activity, trends in other income sources, collection efficiency and the size of informal economy, consumption structure and foreign trade trends.

Gross VAT collection has recorded a strong 11.3% increase, exceeding the growth of the wage bill. The reasons for this deviation lie in the fact that wages are not the only source of disposable income, but they include pensions, loans, remittances, savings, social benefits, etc. The trends in gross collection are also to a significant extent driven by export demand, through domestic and import component of the realised exports. The last group of factors affecting gross collection includes the consumption structure (effective tax rate) and improved collection efficiency (*C-efficiency*). The net VAT collected in the first nine months of 2017 observed a slower growth than gross collections, unlike the previous year, above all due to the increase in the level of VAT refunds caused by the growth of foreign trade. The trends in the first nine months indicate that the original plan will be exceeded by over RSD 14.0 billion.

Excise revenue witnesses higher growth than planned due to increased consumption of certain excise products and partly due to better collection achieved towards the end of the previous year. The revised projection of excise revenue mostly results from the increase of consumption of petroleum products and electricity. The estimate of excise revenue on petroleum products assumed the previous year's consumption level with an application of new, higher specific excise duties, based on regular adjustment. However, at the macroeconomic level, it is difficult to differentiate reliably between the effects of real consumption growth (price elasticity and the effect of economic growth) and those that are a consequence of changes in the size of informal economy. The tobacco excise revenue has been minimally revised and is currently as expected. It is important though that the situation has not deteriorated in terms of volume of the informal economy in the excise goods market. Total excise revenue has been revised upwards by RSD 8.1 billion.

Customs revenue is growing faster than planned, but unlike the previous years, their pace does not follow the movements of import VAT. Various trade agreements, customs-free import regimes for certain categories of goods, change of customs tariffs, etc. as well as the change in the structure of imports affect the collection of customs revenue. 2017 has seen a large increase in the import of goods for which no customs duties are paid, and that is why the divergence between the total import and VAT growth rates is significantly greater.

The corporate income tax projection has increased significantly relative to the plan, so the collection of this tax type will be higher by about RSD 30.0 billion. Corporate income tax is the most volatile public revenue item and economic growth is not always the most reliable collection indicator for this tax type. Since the final data on profitability are not known during the preparation of projections for the following year, the practice is to assume for these purposes that it is unchanged and to accept a certain level of risk in the collection of this revenue type. According to the Business Registers Agency data, the total gross profit earned in 2016 is RSD 534.4 billion, or 17.5% higher than in 2015. The growth of corporate income tax collection will exceed that in the previous year by 35.0%. A part of the 2017 revenue, however, is a result of the implementation of accounting regulations governing the treatment of increase (registration) of property value in accounting books. Consequently this part of collected revenue can be considered a one-off inflow. When excluding the part identified as on-off revenue from total revenue, the growth rate exceeds the growth of profitability to a much lesser degree.

In addition to corporate income tax, non-tax revenue is a revenue category whose plan was revised upwards by most, both in absolute and in percentage terms. The adjustment of non-tax revenue amounts to RSD 25.1 billion. It is mostly the result of cautious planning, as the inclusion of certain potential revenue items in the budget plan was abandoned. The total increase of the estimate of non-tax revenue belonging to the central budget amounts to RSD 19.7 billion and is a combination of the movement of regular non-tax revenue (charges, fines, and fees) and initially unplanned payment of

profits of JP EPS (PE Serbian Electricity Industry), collected claims of the Deposit Insurance Agency, premium payments for bond issue re-opening, NBS profit, etc. The projection of the non-tax revenue at the local level has been increased, partly due to the collection of one-off revenue, but mostly due to the improved collection of local fees and other revenue types. Unlike the previous year, there were no methodological changes in 2017 that would affect the coverage of non-tax revenue at the local level.

According to the new estimate of public expenditure, the total level of expenditure should be lower by RSD 10.2 billion or 0.5%, with a changed structure relative to the budget plan for 2017. The largest decrease relative to plan was recorded in interest expenses, repayment for guarantees, pensions, and capital expenditure. The largest increase on the other hand will be achieved in expenditures for goods and services, net lending, and other current expenditure. In the period January – September 2017 public expenditure grew at the rate of 0.9%, and the growth is expected to accelerate to 1.8% by the end of 2017. The reasons for this acceleration towards the year end are the changes in the execution schedule of certain expenditure items from previous years, and the execution of the so-called one-off expenditures towards the end of the year. The acceleration of the expenditure rate until the end of the year is expected in respect of personnel expenditure, due to the planned payment of bonuses in part of the public sector, as well as the accelerated execution of capital expenditures in the last quarter.

The estimated personnel expenditures increased by 3.2% relative to the 2017 budget, primarily due to the planned payment of bonuses to certain employee categories. When making projections of this type of expenditure in the 2017 budget, the following elements were used: 1) increase of the nominal amount of wage for certain employee categories, 2) volume and pace of rightsizing, and 3) volume and payment schedule for severance pays for the personnel that will be laid-off in the process.

According to the latest data available, by the fourth quarter of 2017 the number of employees decreased by around 28,500 relative to the end of 2014. The public sector rightsizing plan envisaged a reduction in the number of employees by 75,000 by the end of 2017. After the analyses of the employee number and structure by competent domestic and international institutions, the rightsizing plan was revised to 25,000–30,000 people. The savings on this basis were also made due to a slower rate of employee replacement for those positions. The implemented rightsizing measures have led to the drop of the wage share in GDP from around 12.0% in 2014 to 9.8% in 2017. The Budget System Law provides for the lowering of the level of wages excluding the social insurance contributions paid by the employer to 7.0% of GDP. However, it seems that such wage level target is set quite low, considering that the current share of wages defined in such a way is 8.3% of GDP.

Interest expenditure is a category where significant savings are expected relative to the amount planned in the budget. The overall fiscal result trend has an indirect impact on the interest expense trend. In addition to the deficit level, the amount of interest is affected by interest risk and foreign exchange risk for foreign-currency denominated liabilities. The significantly lower fiscal deficit had an impact on the general level of new borrowing. On the other hand, a favourable trend in the US dollar exchange rate and a stable EUR rate neutralised the foreign exchange risk, which, along with lower interest rates in the international market, decreased interest expenses. In 2017, almost all the above factors have had a favourable effect, so that, for the first time since 2008, there has been a nominal decrease of the interest expenditure amount, while its share of GDP continued to drop and will be around 2.7% of GDP at the end of 2017. The new estimate of interest expenditure provides for the amount that is over 16 billion lower than originally planned.

The pension expense trend during 2017 and the decrease in the number of pensioners instead of the expected increase caused a downward revision of the planned pension expenditure. A certain reserve was left in the projection of this expenditure category in late 2016, considering that a faster inflow of new pensioners was expected based on the rightsizing process in the public sector (including public enterprises) and the completion of restructuring of the remaining enterprises in the privatisation

process. The other factors that had an impact on the estimate of overall pension expenses are the increase in the nominal amount of pensions, anticipated increase in the number of pension beneficiaries above 1.0%, which was in accordance with the trend from the previous period, but also reflects a certain amount of caution when projecting such a large expenditure category.

The downward trend of the number of pension beneficiaries continued in 2017. After a ten-year period of increase in the number of pensioners, the total number of pensioners decreased for the first time in 2015. Such trend continued during 2016 and 2017, and the total number of beneficiaries is down by 24,000, which is a drop of about 1.4%. Moreover, the type structure also changed, so there was a decrease in the number of disability pension beneficiaries and, to a slightly lower extent, in the number of survivor's pension beneficiaries. This was contributed to by the measures aimed at prevention of abuse in this area. The number of old-age pensions is still increasing, but at a noticeably lower rate. Such trends are a result of parametric measures, such as phased raising of the age requirement, but also of the introduction of penalties for early retirement. In accordance with these trends, the estimate of total pension expenditure is revised down by 2.3% relative to the planned amount, with a note that the planned one-off payment to pensioners was not presented as a part of total pension expenditure, but is treated as a form of other transfers to households. The share of pension expenditure has dropped from 11.6% of GDP in 2016 to 11.2% of GDP at the end of 2017, which is close to the target set under the arrangement with IMF and the Budget System Law.

Other expenditure for social benefits and other transfers to households will increase relative to the planned amount, primarily due to the payment of bonus to pensioners. Each individual pension beneficiary was paid RSD 5,000 regardless of the level of pension they receive. The total effect of the one-off payment on this basis is RSD 8.9 billion. Due to an expected increase in the number of beneficiaries of the National Employment Service (as a result of bringing the process of public sector restructuring and rightsizing to a close), unemployment benefits were planned at a somewhat higher level. This expenditure in 2017 has so far been considerably underexecuted. An improved situation in the labour market and unemployment decrease are factors that contributed to this development. Also, severance pays paid out to workers of enterprises undergoing restructuring will also be underexecuted.

Total guarantee repayments and net lending will deviate relative to the amounts planned in the budget by over RSD 4.0 billion. These two categories are deviating from the planned amounts. Guarantee expenditure is lower than anticipated by the plan, namely by RSD 5.8 billion. The biggest reason is that the plan anticipated a repayment of part of the JP Srbijagas debt to its creditors. However, due to an improvement in the liquidity position of this enterprise, it is able to honour part of its liabilities by itself. On the other hand, expenditure on net lending is higher than planned by over RSD 10.0 billion. Most of this increase relates to the funding of the defense industry modernisation.

Public investment will not be executed in the planned volume. The execution of capital expenditure for the first nine months of 2017 compared to the previous year is 10.5% lower. Such a development of government capital expenditure is in part caused by a change in the institutional coverage of budgets of some local governments. Specifically, with the exit of the institution in charge of investment from the system of City of Belgrade budget beneficiaries and, consequently, from the institutional coverage of the general government, the volume of capital expenditure that is covered by execution reports fell significantly. This methodological change can explain almost half of the actual drop in public investment. The other factor that contributed to the fall of capital expenditure compared to the previous year is extremely unfavourable weather conditions during the first quarter of the current year. The execution picked up in the second half of the year, but part of the delays cannot be cancelled out for objective reasons.

A more favourable fiscal position in 2017 is primarily a result of an increase in public revenue collection. The factors that contributed to the revision of the estimated fiscal result in 2017 are classified into the following groups: base impact (the 2016 outturn), labour market developments and

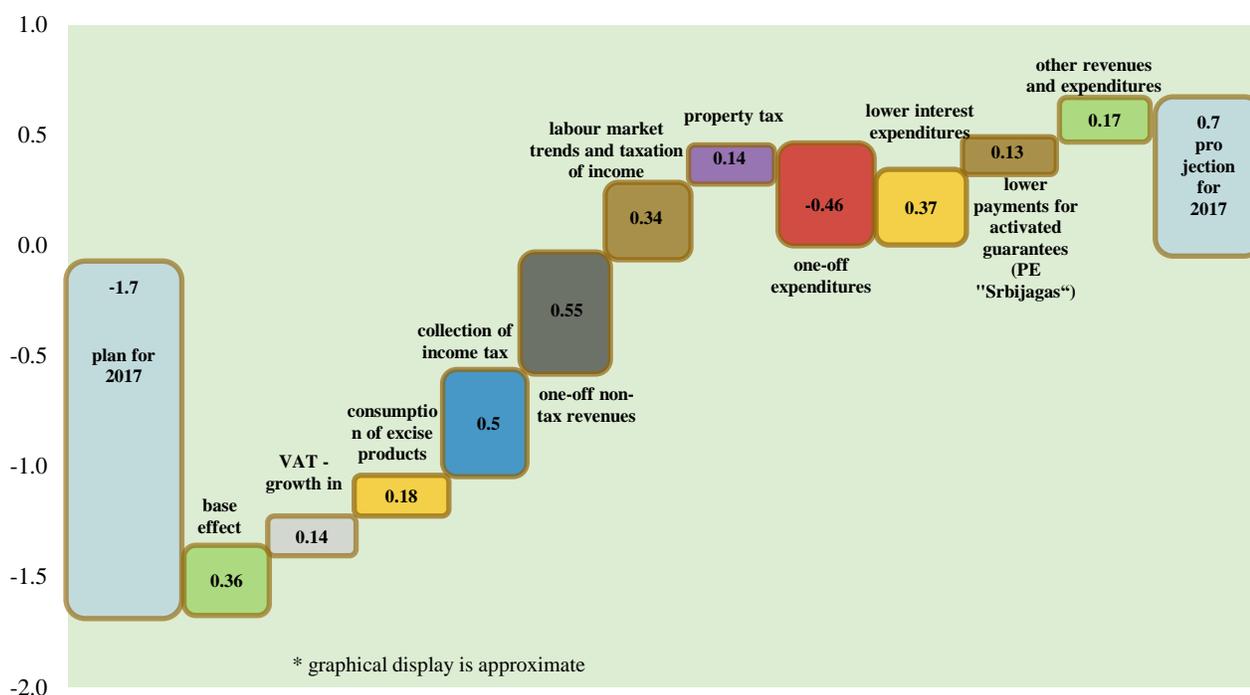
their impact on consumption and labour taxes, estimated one-off non-tax revenue, the development of excise product consumption and significantly better corporate income tax collection.

Total revenue collected in 2016 was RSD 23.0 billion above the estimate used as the base for the preparation of the 2017 plan. Of this amount, RSD 7.0 billion have no permanent impact on the result, so the base effect in 2017 was estimated at RSD 16.0 billion, i.e. 0.36% of GDP.

The downward revision of the real GDP growth rate in 2017 relative to the planned one, had no negative impact on fiscal developments due to changes in the structure of growth, as well as one-off factors that caused the downward revision of GDP. In the growth structure, there was a slight increase in private consumption due to which the nominal growth of consumption was faster than planned, which had a direct impact on revenue collection. The improved situation in the labour market and faster employment growth caused an increase in total wages paid. Wages paid account for the largest portion of the population's disposable income, so they had a positive impact on the nominal growth of private consumption. Apart from that, consumption growth was also predicated on faster lending growth. Faster import growth caused higher indirect tax collection during 2017, when there was a simultaneous increase in import volume and faster growth of import prices than initially planned. Apart from the indirect impact on the VAT movement, the more favourable situation in the labour market had a direct impact on the collection of wage tax and mandatory social insurance contributions. Stronger growth of economic activity is primarily reflected in an increase in mandatory social insurance contributions and personal income tax, but also in other revenue types. It should be noted that in the initial excise revenue projection, the consumption of excise products was assumed to be constant (except for tobacco products).

The other factors that resulted in the country's better fiscal position include the movement in total tax revenue collection efficiency, the trend of the level and pace of VAT refunds relative to the initial plan, significantly better corporate income tax collection, extraordinary non-tax revenue and underexecution in certain expenditure categories.

Graph 6. Contribution of individual factors to the correction of the deficit in relation to the plan for 2017,% of GDP



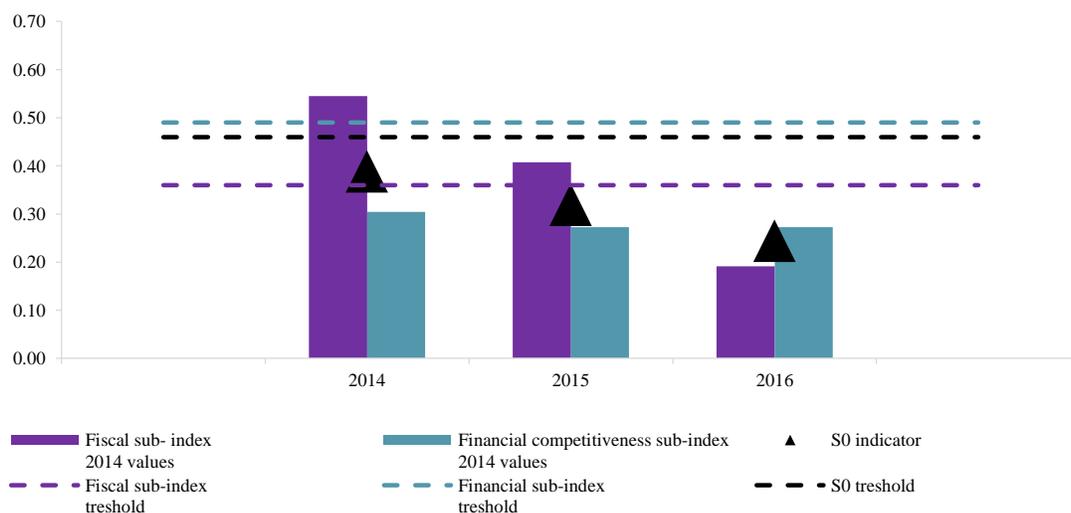
### *S0 indicator of short-term fiscal sustainability*

*“The farther back you can look, the farther forward you are likely to see”- Winston Churchill*

The EC designed the S0 composite indicator for assessing short-term fiscal sustainability the aim of which, through the identification of potential short-term risks in the current year, is early detection of fiscal stress<sup>13</sup> in the coming year. If the value of the S0 indicator exceeds the predefined threshold, the country is considered to be at short-term risk of fiscal stress<sup>14</sup>. Apart from the value of the overall indicator, in order to locate the source of risk, subindex values and their components are also considered. The S0 composite indicator is composed of two subindices which contain a series of fiscal and macrofinancial sustainability variables<sup>15</sup>. The value of these subindices which is below the defined threshold points to the absence of short-term fiscal risk.

The calculation of the S0 indicator for the Republic of Serbia, carried out by the Ministry of Finance, is based on the EC methodology<sup>16</sup>. Although the value of the S0 indicator in 2014 was below the defined threshold, the value of the fiscal subindex clearly pointed to potential challenges in the fiscal sphere. Positive effects of fiscal consolidation measures, initiated in 2014 as part of the implementation of the arrangement with the IMF, are reflected in the lower value of the fiscal subindex already for 2015, which then, albeit still above the defined threshold, started to fall, which significantly lowers the value of the overall S0 indicator as well. Further implementation of fiscal consolidation measures, along with significant improvement of the macroeconomic environment, led to an even stronger decrease in the fiscal subindex compared to the defined threshold in 2016. In that year, the entire composite indicator, as well as both subindices, were below the defined thresholds.

Graph 7. The S0 indicator with fiscal subindex and macrofinancial competitiveness subindex for the Republic of Serbia for the 2014-2016 period



Source: MoF

The values of the S0 indicator and the subindices for the Republic of Serbia in 2016 point to the general absence of short-term risk of fiscal instability, as well as of any pronounced risks stemming

<sup>13</sup> Fiscal stress occurs in the following situations: 1) annual inflation rate exceeds 35%, which reduces the possibility of amortization, 2) the rate of return on foreign bonds within two standard deviations is above the average for the particular country, which indicates the significant pressure on financial markets 3) restructuring is carried out or a debt-waiver is declared, based on the S&P definition, 4) a significant implementation of IMF support programme is ongoing.

<sup>14</sup> The evaluation of short-term fiscal sustainability obtained from the calculation of SO indicators, must be interpreted carefully, and during the interpretation of results, specific macroeconomic circumstances of the concerned country must be taken into account.

<sup>15</sup> Subindices are composed of 25 variables in total (12 fiscal and 13 macrofinancial). Thresholds are redefined every couple of years.

<sup>16</sup> European Commission *Fiscal Sustainability Report 2015* 25, January 2016, pp. 157-158.

from the areas covered by the subindices. Consistent implementation of fiscal consolidation measures and the establishment of macroeconomic and fiscal stability in the previous period secured the room for easing monetary policy measures during 2017.

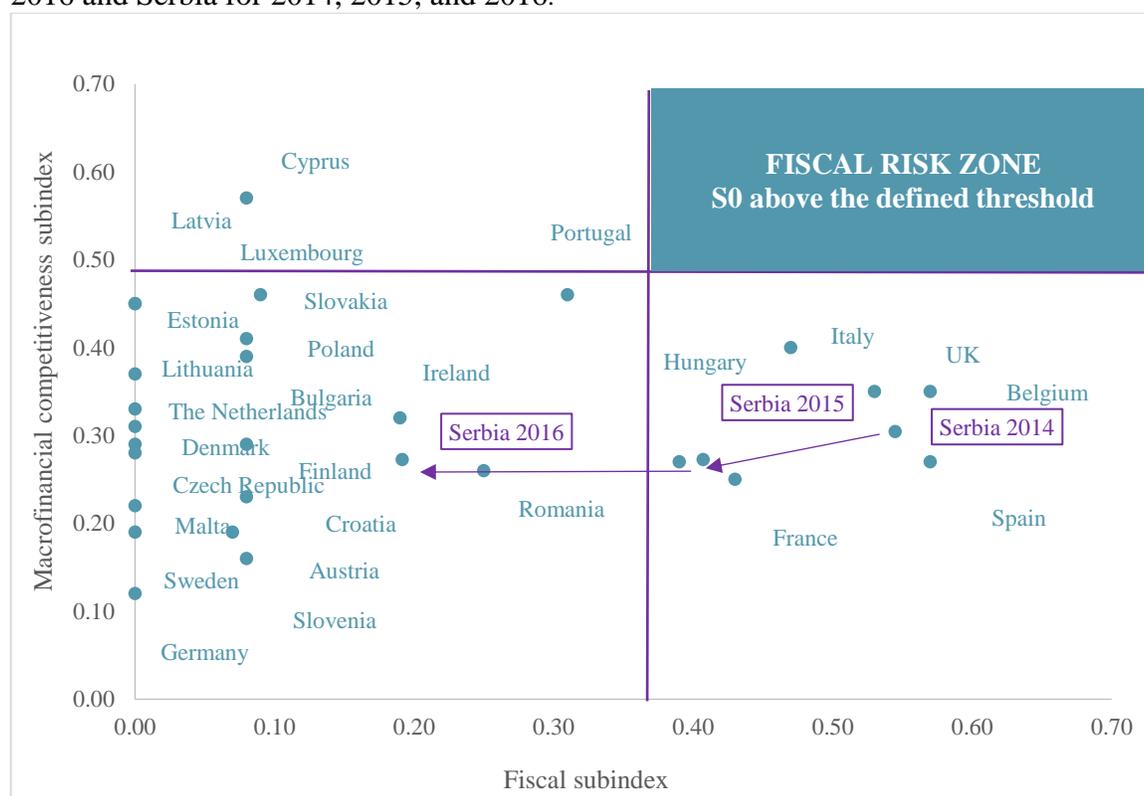
The analysis of the components of SO indicators shows that significant improvements have been achieved within the given period. Having regard to the signal power of variables, the largest contribution, from the fiscal point of view, to more favourable value of SO indicators was given by the cyclically adjusted fiscal and primary balance, whereas from the macroeconomic point of view by the reduction of the balance of payments current account deficit.

Table 3. The SO indicator and its components, values for the Republic of Serbia, for the period 2014-2016.

Variables	Safety	Threshold	Signaling power*	Values for Serbia, %		
				2014	2015	2016
<b>Fiscal sub index</b>	<	<b>0.36</b>	<b>0.28</b>	<b>0.54</b>	<b>0.41</b>	<b>0.19</b>
1. Balance, % GDP	>	<b>-9.61</b>	0.07	-6.6	-3.69	-1.27
2. Primary balance, % GDP	>	<b>0.23</b>	0.13	-3.66	-0.48	1.82
3. Cyclically adjusted balance, % GDP	>	<b>-2.5</b>	0.23	-6.21	-3.17	-1.10
4. Stabilizing primary balance, % of GDP	<	<b>2.34</b>	0.08	0.55	0.81	0.03
5. Gross debt, % of GDP	<	<b>68.44</b>	0.12	71.85	75.98	72.99
6. Change in gross debt, % GDP	<	<b>8.06</b>	0.12	10.73	4.13	-2.99
7. Short-term debt gen. gov., % GDP	<	<b>13.2</b>	0.2	9.10	12.14	13.05
8. Net debt, % GDP	<	<b>59.51</b>	0.2	71.85	75.98	72.99
9. Gross financing need, % GDP	<	<b>15.95</b>	0.26	15.94	14.87	13.11
10. Interest rate-growth rate differential	<	<b>4.8</b>	0.08	4.03	1.17	-1.12
11. Change in expenditure of gen. government, % GDP	<	<b>1.9</b>	0.11	2.92	-2.47	-1.10
12. Change in final consumption expend. of gen. government	<	<b>0.61</b>	0.07	-0.56	-8.47	-1.23
<b>Financial-competitiveness index</b>	<	<b>0.49</b>	<b>0.55</b>	<b>0.30</b>	<b>0.27</b>	<b>0.27</b>
1. net international investment position, % GDP	>	<b>-19.8</b>	0.29	-98.28	-102.9	-103.99
2. net savings of households, % GDP	>	<b>2.61</b>	0.33	24.96	26.52	26.21
3. private sector debt, % GDP	<	<b>164.7</b>	0.18	45.99	47.67	47.47
4. private sector credit flow, % GDP	<	<b>10.7</b>	0.37	-2.40	2.04	1.39
5. short-term debt, non-financial corporations, % GDP	<	<b>15.4</b>	0.2	11.85	7.88	6.39
6. short-term debt, households, % GDP	<	<b>2.9</b>	0.21	2.65	1.70	1.17
7. construction, % value added	<	<b>7.46</b>	0.22	5.07	5.13	5.50
8. current account, 3-year backward MA, % GDP	>	<b>-2.5</b>	0.34	-9.55	-7.89	-5.60
9. change (3 years) of real eff. exchange rate, based on	<	<b>9.67</b>	0.11	9.54	-2.73	-0.80
10. change (3 years) in nominal unit labour costs	<	<b>7</b>	0.18	-0.50	0.90	-5.60
11. Yield curve	>	<b>0.59</b>	0.37	2.72	4.55	5.00
12. Real GDP growth	>	<b>-0.67</b>	0.1	-1.83	0.76	2.80
13. GDP per capita in PPP, % of US level	>	<b>72.7</b>	0.22	26.09	25.29	25.11
<b>Overall index</b>	<	<b>0.46</b>	<b>0.55</b>	<b>0.39</b>	<b>0.32</b>	<b>0.24</b>

Based on Eurostat data for the EU countries and the calculations of the Ministry of Finance for the Republic of Serbia, in 2016 none of the countries considered were exposed to short-term risk of fiscal stress materialisation, given that the SO value does not exceed the defined threshold anywhere. Certain countries are facing fiscal or macrofinancial challenges, while the Republic of Serbia, together with the majority of EU countries, is within the defined thresholds of the SO indicator.

Graph 8. The fiscal subindex and the macrofinancial competitiveness subindex for EU countries for 2016 and Serbia for 2014, 2015, and 2016.



Source: Eurostat for the EU, Ministry of Finance for the Republic of Serbia<sup>17</sup>

### 3. FISCAL PROJECTIONS IN THE PERIOD FROM 2018 TO 2020

In the following medium-term period, the fiscal policy goals are aimed at maintaining fiscal stability, leading to further reduction of the share of public debt in GDP. The medium-term fiscal framework provides for a general government deficit at the level of 0.5% of GDP by 2020, and a decrease in public debt to 56.0% of GDP. Fiscal aggregate projections in the period from 2018 to 2020 are based on macroeconomic indicator projections for the stated period, planned tax policy which implies further alignment with the EU legislation and directives and fiscal and structural measures, including the reforms of large public enterprises.

Owing to fiscal consolidation measures, fiscal space was created for new policies, which will be used in 2018 for increasing capital investment, increasing pensions and wages in one segment of the public sector and reducing the tax wedge. These measures and their fiscal implications are designed so as not to jeopardise the stability of public finances or the pace of public debt reduction, while, on the other hand, raising the standard of living for the population, stimulating private consumption and accelerating economic development.

<sup>17</sup> The EC did not take into account Greece, to which a special monitoring procedure is applied.

Table 4. Fiscal aggregates in the period 2016–2020, in % of GDP

description	execution	estimate	projection		
	2016	2017	2018	2019	2020
Public revenue	43.2	43.9	42.4	41.8	41.2
Public expenditure	44.5	43.2	43.1	42.3	41.7
Consolidated fiscal result	-1.3	0.7	-0.7	-0.5	-0.5
Primary consolidated result	1.8	3.4	1.9	1.8	1.6
General government debt	73.0	63.7	62.8	59.8	56.3
Real GDP growth rate	2.8%	2.0%	3.5%	3.5%	4.0%

Source: MoF

Public debt trajectory was reversed in 2016, when the public debt share in GDP started to decrease. The main goals of fiscal consolidation and the IMF-supported programme were public finance stabilisation and reduction of the public debt share in GDP. Debt reduction is closely related to the reduction of deficit as the main factor of borrowing, so the pace of deficit reduction determines the change in debt trajectory. Financial transactions, such as replacing expensive debt with cheaper debt, as well as a better position of the country in the international financial market, could also contribute to further debt reduction.

Graph 9. Debt and deficit in % of GDP



In the following period the general government deficit will stabilise at around 0.5% of GDP, which is a sustainable level conducive to further public debt reduction. With expected macroeconomic performance, in the following medium-term period the public debt level should come down to around 56% of GDP. Good fiscal consolidation results have allowed for fiscal policy easing, primarily on the expenditure side, in the form of wage and pension increases, without increasing their share in GDP. The key measure on the revenue side will be an increase in personal tax allowance, which will lead to a reduction of the tax wedge and a mild increase in taxation progressivity. The process of restructuring public and former socially-owned enterprises continues in order to reduce the burden on public finance and the whole economy. In the event of favourable macroeconomic and fiscal trends and

overperformance, the created fiscal space could be used for a further reduction of tax burden on the economy and individuals or prepayment of expensive debt.

The revenue projection for the period from 2018 to 2020 is based on:

- Projections of development of the key macroeconomic indicators: GDP and its components, inflation, foreign exchange rate, foreign trade, employment and wages;
- Current tax policy and its planned changes;
- Estimated effects of fiscal and structural measures in the following period.

Table 5. Total revenue and grants in the period 2016–2020, in % GDP

description	execution	estimate	projection		
			2018	2019	2020
	2016	2017			
PUBLIC REVENUE	43.2	43.9	42.4	41.8	41.2
Current revenue	43.0	43.7	42.1	41.5	40.9
Tax revenue	37.2	38.4	37.3	37.1	36.6
Personal income tax	3.6	3.7	3.6	3.6	3.5
Corporate income tax	1.9	2.5	2.0	2.0	2.0
Value added tax	10.6	10.7	10.6	10.5	10.4
Excise duties	6.2	6.3	6.0	5.8	5.6
Customs duties	0.9	0.9	0.9	0.9	0.9
Other tax revenue	1.6	1.6	1.6	1.5	1.4
Contributions	12.4	12.7	12.7	12.7	12.7
Non-tax revenue	5.8	5.3	4.7	4.5	4.3
Grants	0.2	0.2	0.3	0.3	0.3

Source: Ministry of Finance

Part of the budget space of around 0.2% of GDP, or around RSD 10.0 billion, will be used for a reduction of tax burden in 2018. Apart from increasing the personal tax allowance, no other changes to tax policy have been envisaged. Revenue projection implies maintaining the existing collection level.

The personal income tax is projected at a stable level of around 3.6% of GDP during the entire medium-term period in line with expected effects of structural and fiscal measures, public sector wage policy and favourable labour market trends, primarily related to employment and average private sector wages. The predominant type of the personal income tax is the wage tax, so the wage bill and employment trends are the main factors affecting this tax type. Measures that will also affect the level and taxation of wages are increases in the personal tax allowance and the minimum wage. The personal tax allowance will rise from RSD 11,790 to RSD 15,000 and have a negative impact on revenues from the wage tax and contributions, which is estimated at RSD 11.6 billion. Considering that at the general government level, there are savings on the basis of gross income reduction, the impact on the fiscal result is smaller and amounts to RSD 9.0 billion or about 0.2% of GDP. On the other hand, it is estimated that the minimum wage increase will mostly compensate for the general government revenues lost on the basis of the allowance increase. Other personal income tax types include dividend tax, interest income tax, annual personal income surtax, etc. and follow the trend of overall economic activity and wages. With regard to the wage tax, the fight against the informal economy is of key importance, considering the significant number of unregistered workers and direct cash wage payments. Inspections and sanctions have been stepped up during the past three years, which has produced significant results in combating the informal economy in the area of labour and employment, but it is very important to continue such efforts in this area in the upcoming period as well.

A stable share of mandatory social insurance contributions in GDP is projected for the following medium-term period. The trend of this revenue's share in GDP follows a similar path as the trend of the wage tax's share since the same assumptions on wage and employment trend were used in their projections. The only difference lies in contributions collected on the insurance of farmers and

entrepreneurs. The effects of higher personal tax allowance and minimum wage are also taken into account because these changes also affect contribution revenue. Contributions are a tax category with the lowest level of tax compliance and the largest taxpayer debt, so the consequences of an increase in fiscal non-compliance are most felt on these revenues.

Stable revenue from the corporate income tax is projected in the period 2018–2020 (2.0% of GDP). The collection of corporate income tax revenue in the upcoming three-year period will depend on the economic growth trajectory, relative dinar exchange rate stability and general profitability of the economy. The estimate of this revenue may be uncertain due to economic factors, as well as the possibility of using tax credits or refunds. In 2017 the collection of corporate income tax hit a record high (2.5% of GDP), primarily as a result of high profitability in 2016. One part of this year's revenue, however, is a result of the application of bookkeeping regulations and may be considered one-off and is, therefore, not taken into account in the 2018 corporate income tax projection. The medium-term projection does not assume major amendments to legislation. The revenue projection on this basis is conservative and does not include the effects of 2013 tax benefit abolishment, which, due to a transitional period of several years, are now felt.

The VAT revenue trend is characterised by a moderate decline of the share in GDP, since private consumption is projected to grow more slowly than the nominal GDP. The key factor determining the VAT trend is domestic demand driven by disposable household income. Disposable income as the largest factor determining consumption, depends on the movement of public wages, pensions, social benefits, the private sector wage bill and other types of income, including remittances, as well as on the level of bank lending to households. In the coming period, revenue from foreign tourists' spending will also be of greater importance. Likewise, the easing of fiscal policy in the field of public sector wages and pensions will contribute to an increase in disposable household income. However, due to the economy's rebalancing, the VAT revenue share in total GDP is projected to decrease gradually from 10.7% of GDP in 2017 to the 10.4% in 2020. At the same time, the projected exports growth will result in a VAT refund growth and will consequently affect the level of collected VAT. The risks for VAT projection in the following period are similar to those for the personal income tax and relate to the trend in private sector wages, economic growth, as well as the prevalence of informal economy and efficiency of its combating.

The results of more efficient collection and taxpayer audit are evident and this trend is expected to continue in the following period, but the effects of fight against the informal economy are not explicitly included in the medium-term public revenue projection. The increase in the VAT collection, in terms of implementing independent anti-evasion measures for the VAT, gave certain results in the previous period. There is room for further improvement in this area through the strengthening and modernisation of the Tax Administration.

According to estimates, an improvement in collection efficiency by about 5.0 p.p. in the coming four-year period, would enable a cumulative increase in VAT revenue by 1.9% of GDP.

The projection of excise duty revenue was prepared based on the current excise duty policy and projected consumption of excise products. As regards excise policy for tobacco products, a further gradual alignment with EU directives is envisaged in line with a medium-term plan for gradual increase in excise burden. For cigarettes, it will be reflected in a gradual increase in excise duties, so that within an acceptable period of time the EU minimum level of EUR 1.8 per pack would be reached. For the sake of caution, for the purposes of projecting excise duty revenue, a further decline of the legal market of tobacco products by around 3% annually on average is anticipated in the following period. In the event of improvement of conditions in the tobacco product market and reduction of informal economy, there is a certain upside risk related to the collection of this revenue type.

Unlike tobacco products, the situation in the oil product market is significantly less volatile. Better control and effects of oil product marking reduced the possibility and profitability of illegal

activities. In the following years, for the sake of caution, no continuation of increase in oil product consumption is assumed, although accelerated economic activity can contribute to consumption growth. In this case as well, there is a certain upside risk when it comes to revenue collection, if the trend of oil product market growth continues.

The revenue from excise duties on alcoholic beverages, coffee and electricity is projected in line with the existing consumption structure. The current nominal amounts of excise duties on alcoholic beverages and coffee are adjusted to the expected levels of inflation rate in the medium-term period. During 2015 the ad-valorem excise duty of 7.5% on electricity consumption was introduced. For the period 2018–2020, annual revenue from this excise duty is planned in the amount of around RSD 17.0 billion, taking into account the current annual consumption and current prices.

Customs revenue currently accounts for 0.9% of GDP and can be expected to remain at this level in the future. Proceeding from the projected movement of imports, exchange rate and consumption, as well as the completion of the process of customs tariff harmonisation due to the application of the Stabilisation and Association Agreement, a gradual nominal increase in this revenue is planned, while the share of customs duty revenue in GDP is not projected to change in the upcoming period.

Other tax revenues are not significantly expressed related to economic activity, their level is relatively stable and a slight drop in the share of these revenues in GDP is projected. The most important tax revenue in this category is the property tax, whose share is around 70.0%. This revenue may be expected to increase due to tax base expansion. As part of the Property Tax Reform project, property inventory is underway in 40 local government units, which may increase property tax collection in certain municipalities by as much as several times. An increase in the collection rate, through the increase in the coverage of properties taxed (i.e. on the basis of expanding the tax base), is not included in medium-term projections and constitutes an upside risk. Apart from property taxes, other tax revenues include taxes on the use, possession and carrying of goods, as well as other types of local taxes. They have been projected based on movements in inflation, since the inflation component is built into a considerable part of these tax types.

The projection of non-tax revenue in the coming medium-term period excludes extraordinary (one-off) payments, while recurring non-tax revenue is planned in accordance with the development of their determinants. The share of non-tax revenue in GDP is decreasing over the medium term, after a surge in 2015 and 2016. This surge is a result of the payment related to the public sector wage cuts (public enterprises and local governments), higher revenue from dividends and profits from public enterprises, as well as the introduction of a fee for mandatory oil reserves. The share of non-tax revenue in GDP is projected to decrease from 5.8% of GDP in 2016 to 4.2% in 2020. The reasons for the decline in the projected share include the exclusion from the base year (2017) of all those revenues that are not considered structural, i.e. recurring, which primarily refers to extraordinary non-tax revenue. Recurring non-tax revenue includes various fees, charges, fines, revenue of government bodies and organisations and all other revenue collected according to the standard schedule over the year, in more or less similar amounts on a monthly basis with some seasonal variations. Certain non-tax revenues are indexed to last year's inflation, others follow the changes in the value of the base to which they are applied and due to which they are adjusted by projected inflation. Extraordinary non-tax revenues are mostly one-off, to a certain extent uncertain, both with regard to the amount as well as the time of payment. Most of them are extraordinary payments of profits of public enterprises and agencies, dividends belonging to the budget, revenues from receivables collected by the Deposit Insurance Agency, share premiums, etc.

As the country's EU accession process progresses, the available IPA funds increase, making up the predominant portion of grant revenue. The projected amounts of grants include the EU sectoral

budget support funds. Grant-based revenue is result-neutral since it is equal to the corresponding expenditure.

A restrictive fiscal policy combined with good macroeconomic performance has led to the creation of fiscal space in the period 2017–2019, which may be used, *inter alia*, for new policies on the expenditure side, primarily for increasing capital investment as a key component of economic development. The unfavourable expenditure structure in the previous period was characterised by high expenditure for subsidies and payments for guarantees stemming from the inefficient operation of parts of the public sector, followed by high interest rates, with low execution of capital investments. In the coming period, special attention will be paid to the improvement of the efficiency of government capital investment execution. Likewise, the social component of the budget will be improved by better social benefit programme targeting and higher allocation for health care and education. The share of wages and pensions in GDP will have stabilised by 2020, which will be yet another factor that will enable a more equitable income reallocation, with a reduction of pressure on public finance.

Table 6. Total expenditure in the period 2016–2020, in % of GDP

description	execution	estimate	projection		
	2016	2017	2018	2019	2020
<b>PUBLIC EXPENDITURE</b>	44.5	43.2	43.1	42.3	41.7
Current expenditure	40.3	39.2	38.9	38.3	37.7
Personnel expenditure	9.8	9.8	9.8	9.7	9.6
Purchases of goods and services	6.7	6.8	7.0	7.0	7.0
Interest payment	3.1	2.7	2.5	2.3	2.1
Subsidies	2.6	2.4	2.4	2.3	2.2
Social assistance and transfers	16.8	16.2	15.7	15.5	15.3
<i>of which pensions</i>	11.6	11.2	11.1	11.0	11.0
Other current expenditure	1.3	1.3	1.5	1.4	1.4
Capital expenditure	3.3	3.0	3.6	3.7	3.7
Net lending	0.1	0.3	0.1	0.1	0.1
Guarantee repayment	0.9	0.6	0.4	0.3	0.1

Source: MoF

Due to the fiscal space created by fiscal consolidation measures, and as part of the arrangement with the IMF, general government wages will increase by RSD 35.0 billion. Since those are total labour costs, or the wagebill that includes taxes and contributions, the impact on fiscal result reduction will amount to RSD 21.0 billion, i.e. 0.4% of GDP. Wage reduction, hiring freeze and public sector rightsizing are measures that have contributed the most to lowering expenditure and to the success of fiscal consolidation. Implementation of these measures brought about a decrease in the share of wages in GDP from about 12.0% in 2014 to 9.8% in 2017, and an additional reduction in the level of wages relative to GDP is planned for the coming medium-term period as well. The Budget System Law envisages lowering the level of wages to 7.0% of GDP; however, it seems that this targeted level of wages is set quite low. Currently, the share of wages defined in this way in GDP is 8.3%. The average general government wages in the EU are around 10.0% of GDP, so, for the Republic of Serbia, the adequate share of wages is about 9.5% of GDP (wages without contributions payable by the employer around 8.0% of GDP), which would be reached already in 2020. During 2016 a comprehensive wage system reform was initiated with a view to ensuring equity and reducing discrepancies between public sector employees, but it is not expected to have a significant effect on the total wage bill. The application of this system will begin in 2019.

The share of expenditure for goods and services will stabilise at 7.0% of GDP. The growth of this group of expenditure is partly a result of methodological changes at the local government level expanding the coverage for some revenue and associated expenditure. On the other hand, an increase in

this group of expenditure will enable the improvement of a wide spectrum of government bodies' services.

Reduction of interest expenditure is one of the best indicators of the success of fiscal consolidation. As a consequence of an extremely high public debt level and high fiscal deficits, interest has become one of the biggest public expenditure categories. Good results in the previous period reduced the need for borrowing, which led to a reversal in the interest rate trend. In 2017 the nominal amount of interest was reduced for the first time after peaking in 2016. In 2020 the level of interest expenditure will fall to almost 2.0% of GDP. Improving the Republic of Serbia's position in the international financial market will lead to a further interest reduction.

Social benefits and transfers to households present the largest expenditure category of the general government budget. Cuts in the amounts of pensions and pension system reform made a significant contribution to the lowering of the pension-to-GDP ratio. Their share in GDP is falling from 13.0% in 2014 to 11.0% in 2019, in accordance with the Budget System Law. In addition to the nominal pension cuts, the absence of indexation and amendments to the pension system adopted in 2014 also contributed to such a trend. In 2016 pensions were increased by 1.25%, and in 2017 by 1.5%. In 2018 pensions will increase by 5.0%, total pensions will increase by RSD 25.0 billion, which amounts to 0.5% of GDP. Other forms of social benefits and transfers to households in the coming period will be adjusted by applying the prescribed indexation, current and planned policy changes in this area, and by the projected number of beneficiaries. During the past three years, spending on certain types of social benefits increased due to the implementation of fiscal consolidation measures such as severance pay. The share of expenditure on social benefits is falling from 17.8% of GDP in 2014 to 15.3% in 2020.

Reducing subsidies that support inefficient segments of the public sector would enable an increase in those subsidies which provide proper stimulus to the economy, primarily to agriculture and which would lead to an acceleration of economic activities. In the coming three-year period, a reduction in subsidies for restructuring and rightsizing is also planned. The goal is to redirect funds for subsidies to development programmes in the economy and agriculture.

Categories of other current expenditure include miscellaneous outlays, such as grants to NGOs, political parties, religious and sports organisations, fines, damages, etc. In the previous period, this category amounted to between 1.0% and 1.3% of GDP, and by 2020 this expenditure will be at the level of 1.4% of GDP.

In the coming medium-term period all efforts will be directed at reaching an acceptable and desirable level of investment in public infrastructure. The share of capital investment in GDP which in the previous period was around 3.0% is considered to be insufficient and an increase to at least 4.0% is desirable. By reducing the government sector's current spending, fiscal space has been created, part of which would have to be used to increase investment. Capital expenditure suffers from inefficient and insufficient use of funding from contracted international loans that are not disbursed to a sufficient extent. The most significant infrastructure works are on Corridors 10 and 11, which are mostly financed from international loans. After strong growth in 2016 and the completion of most of the planned works on road infrastructure, there was a slowdown during 2017. The drop in capital investment is in part a result of a change in methodology, i.e. a change in the coverage of the general government's institutional units. Belgrade Land Development Public Agency changed its status and became a public enterprise, thus exiting the institutional coverage of the general government. With the start of a new phase of infrastructural projects in 2018, the execution of capital expenditure is expected to accelerate and reach 3.6% of GDP.

The level of net lending and repayment of guarantees is a good indicator of success of fiscal consolidation. Total share of these two categories in GDP in 2014 amounted to 2.2% of GDP, and in

2018 it will be reduced to 0.5% of GDP. By the end of 2020, this expenditure will be minimal, with a share in GDP of up to 0.2%.

In the event of resolution of structural problems in the public sector, net lending will not exceed 0.1% of GDP. In the previous period those funds were provided mostly for liquidity and recapitalisation of state-owned enterprises and banks, while in 2017 most of this expenditure pertained to the funding and modernisation of the arms industry.

Payments under issued guarantees and payments under guarantees for commercial transactions are liabilities arising from debts of public enterprises assumed by the central budget, since these companies were unable to honour them on their own. This expenditure presents a major burden for the budget bearing in mind the longstanding inefficient operation of a large number of state-owned enterprises and companies. The largest outlays on this basis refer to JP Srbijagas, Železnice Srbije (Serbian Railways), Železara Smederevo (Smederevo Steel Mill), JAT and Galenika. It is worth noting that significant payments on this basis are also made on behalf of JP Putevi Srbije (PE Roads of Serbia), but these outlays are classified as standard debt repayment bearing in mind that this company constitutes part of general government. As in the case of net lending, this expenditure will also be reduced if the problems of inefficiencies in public enterprises are resolved in an appropriate manner. In 2017 this expenditure was significantly lowered, with the repayment plan envisaging that in 2020 it will amount to only around 0.1% of GDP.

### *Reforms Aimed at Decreasing Various Forms of Budget Support*

Cuts in budget support to public and state-owned enterprises imply: a) constraints on direct and indirect subsidies, b) strict constraints on the issuance of guarantees for new loans, and c) strengthening of accountability and transparency in the operation of these enterprises.

With the start of the fiscal consolidation process, reforms have been initiated that relate to three large groups of public and state-owned enterprises. The first group of enterprises includes those in the portfolio of the former Privatisation Agency, whose status will be resolved either through bankruptcy or privatisation. By September 2017, over 275 companies were put into bankruptcy, with more than 45 privatised since the end of 2014. Around 26,000 employees from around 320 companies received severance pay. A solution needs to be found for around 120 additional companies with almost 50,000 employees.

From the other group of companies, which, according to a Decision taken by the Government, was initially made up of 17 strategic companies from the portfolio of the former Privatisation Agency, a solution was found for 7 companies, while a solution for the rest is being sought (PKB, RTB Bor, JP PEU Resavica, HIP Petrohemija and others), either through privatisation tenders, or bankruptcy or prepacks. Likewise, for a certain number of state-owned companies, strategic partnerships or other privatisation models are being sought, while in the case of some, such as Aerodrom Nikola Tesla (Nikola Tesla Airport), the search is focused on finding a concession partner.

The third group of companies comprises public and state-owned enterprises in the energy, rail transport and road infrastructure sectors:

1) *JP Elektroprivreda Srbije (PE Electric Power Industry of Serbia)*. In cooperation with experts from the World Bank, JP EPS adopted a business optimisation plan for the period 2016-2019, which also includes a rightsizing plan. By the end of 2016, 2,000 employees left the company, of whom 1,500 voluntarily, and 500 through attrition. By the end of the current year, another 1,000 employees are planned to leave through attrition. After the increase in the price of electricity for end buyers totalling 12.0% during August 2015, of which 4.5% referred to the increase in the kWh price, and 7.5% to the excise duty, a 3.8% price increase ensued in 2016, and an additional 2% increase from October 2017,

which will secure the funds needed for capital maintenance. With the help of the World Bank and EBRD, the possibilities of further improvement to company governance with regard to management, planning and procurement system are being considered. The company is to be transformed into a joint-stock company, while considering other possibilities for the continued development of the company with the aim of improving company performance and providing professional management.

2) *JP Srbijagas*. From August 2015 the organisational structure of the company has been altered establishing special units in charge of gas transport and distribution. A plan envisaging the sale of non-core assets has been implemented, while for the companies that were the main debtors (HIP Azotara, HIP Petrohemija and MSK Kikinda) a more permanent solution is being sought, aimed at reducing, in the future, the risk of debt accumulation and the subsequent need for funds from the central budget. Following the adoption of the Financial Restructuring Plan in March 2016, which was prepared with the support of the World Bank, and the implementation of measures from November 2016, improving the collection level, there has been an improvement in debt collection. The adoption of the new methodological framework, which was suggested by the World Bank, and based on the economic and financial cost-benefit framework, also including other relevant criteria, will enable the evaluation of all future projects. The goal of these measures is to improve the financial position of JP Srbijagas, set the company on a sustainable path, thus eliminating the need for additional financial support from the budget.

3) *Railroad companies*.<sup>18</sup> Implementation of the financial reorganisation plan, which was adopted in October 2015, in cooperation with the World Bank, EBRD and competent EU institutions, is underway. Based on the proposed new organisational structure, in consultation with the World Bank, a modified rightsizing plan was adopted in June this year. After the implemented rightsizing, at the end of 2016 the number of employees was reduced by 3,146, and the new plan envisages an additional reduction by 2,344 employees by the end of the current year. Likewise, in 2016 and 2017 traffic was suspended along around 1,099.7 km of the lines that were out of service or identified as unprofitable, which will have a significant impact on the company's financial performance. The companies created through the reorganisation of Železnice Srbije a.d. (Serbian Railways) are obliged to honour fully their liabilities regarding electricity towards JP EPS, which also implies that there will be no growth in arrears to this public enterprise.

4) *JP Putevi Srbije (PE Roads of Serbia)*. With the aim of ensuring adequate infrastructure maintenance, the road toll was increased by ten per cent as of 1 January 2017. Further toll increases will take place in stages, and the required amounts will be estimated in cooperation with the World Bank. A plan was adopted with the aim of improving the road maintenance contracting system, under which these works will, for the first time, be awarded based on tenders. The first such agreement encompassed the maintenance of 3,000 km of state roads in 2017, with the aim of generating significant savings, along with ensuring quality and respecting the construction deadlines. For the construction of new highway sections E-763 (Corridor 11) and maintenance of the existing sections, options involving concessions are being considered. Corporate and financial restructuring plans will also be developed in cooperation with the World Bank during 2017 and 2018.

Given the amount of the payments for called guarantees and their impact on the deficit, the government has limited the issuance of new guarantees to state-owned enterprises since the beginning of 2015. Issuing guarantees for liquidity loans has been suspended entirely. The option to issue

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<sup>18</sup> Železnice Srbije a.d (Serbian Railways), Infrastruktura Železnice Srbije a.d (Serbian Railways Infrastructure), Srbija Voz a.d. (Serbia Train) and Srbija Kargo a.d (Serbia Cargo).

guarantees was only kept for capital project loans, while adhering to the limit set by the public debt sustainability objective.

#### 4. CYCLICALLY ADJUSTED FISCAL BALANCE

The cyclically adjusted fiscal balance is the fiscal balance from which the isolated impact of the business cycle has been removed, and the baseline identity is the following<sup>19</sup>:

$$FB = CB + CAB$$

A part of the fiscal balance (*FB*) that is unaffected by cyclical fluctuations is called cyclically adjusted fiscal balance (*CAB*), and the purpose of this procedure is to isolate the cyclical component of the fiscal balance (*CB*) which is a result of the output gap. The actual fiscal balance will be equal to the cyclically adjusted one if the output gap equals zero, i.e. if the real GDP growth rate equals the potential one.

The cyclically adjusted primary deficit had been falling at an accelerated pace since 2012 and in 2015 it turned into a surplus. The structural primary balance net of one-off factors in 2017 is posting an impressive positive value. Structural changes in the tax and expenditure systems during 2012 and 2013 started to produce results, and the fiscal consolidation process effectively began at that time. The next phase of fiscal consolidation, implemented during the arrangement with the IMF has significantly improved the country's fiscal position. Analysis and quantification of the structural primary balance can isolate, first of all, one-off effects on the expenditure side even though in certain years one-off effects on the revenue side were not insignificant either. The thus assessed structural primary balance is an efficient tool for a final assessment of the fiscal position, especially for the period 2014-2017 when the fiscal position was significantly improved. It is precisely the analysis of the structural primary balance that enables the review of the consolidation programme's success, as well as the quantification of possible fiscal space for further fiscal policy easing.

Table 7. Fiscal balance and components for calculation of the cyclically adjusted balance in the period 2005–2020, in % of GDP\*

	Output gap	Fiscal balance	Primary fiscal balance	Cyclical component of the fiscal balance	Cyclically adjusted fiscal balance	Cyclically adjusted primary fiscal balance	Structural primary fiscal balance **	Fiscal policy nature fiscal impulse
2005	0.2	1.1	2.0	0.1	1.0	1.9	2.2	
2006	-0.1	-1.5	-0.2	0.0	-1.5	-0.1	0.6	2.0
2007	1.5	-1.9	-1.3	0.6	-2.5	-1.9	-1.5	1.8
2008	3.9	-2.6	-2.1	1.5	-4.1	-3.5	-3.6	1.6
2009	-0.9	-4.4	-3.8	-0.3	-4.1	-3.4	-3.5	-0.1
2010	-1.0	-4.6	-3.6	-0.4	-4.2	-3.2	-3.3	-0.2
2011	0.1	-4.8	-3.6	0.0	-4.8	-3.6	-3.8	0.4
2012	-1.0	-6.8	-5.0	-0.4	-6.5	-4.6	-4.6	1.0
2013	1.3	-5.5	-3.1	0.5	-6.0	-3.6	-3.4	-1.0
2014	-1.1	-6.6	-3.7	-0.4	-6.2	-3.3	-2.3	-0.4
2015	-1.4	-3.7	-0.5	-0.5	-3.2	0.0	0.7	-3.3
2016	-0.4	-1.3	1.8	-0.1	-1.1	1.9	2.0	-1.9
2017	-0.8	0.7	3.4	-0.3	1.0	3.8	3.7	-1.8
2018	-0.4	-0.7	1.9	-0.2	-0.5	2.0	2.0	1.7
2019	-0.3	-0.5	1.8	-0.1	-0.4	1.9	1.9	0.1
2020	0.2	-0.5	1.6	0.1	-0.6	1.5	1.5	0.4

\* For the period 2018- 2020 the table presents projected values.

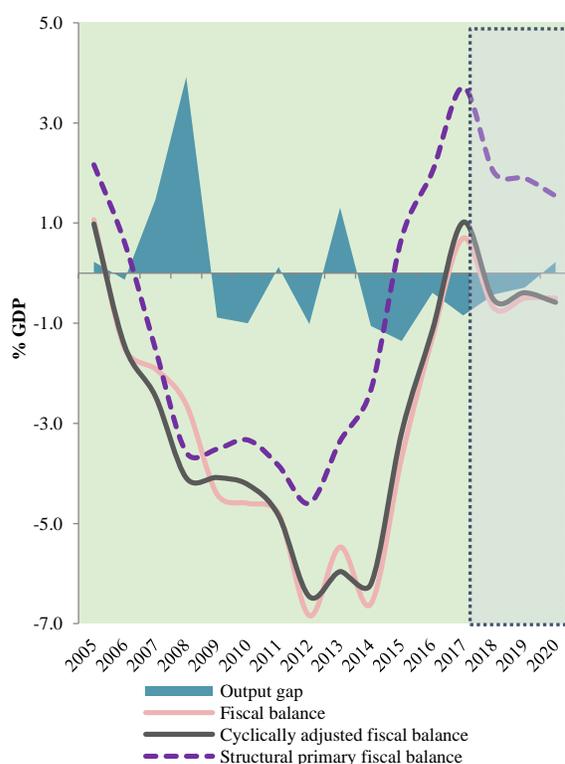
<sup>19</sup> A more detailed description of the used methodology and the results can be found in the Fiscal Strategy for 2013 with Projections for 2014 and 2015 or at <http://www.mfin.gov.rs/pages/article.php?id=8626>

\*\* The structural primary balance obtained by excluding the estimated one-off revenue and expenditure. The results showing the change in the structural primary deficit do not exclude explicitly the effects of increase in the efficiency of revenue collection, and therefore the estimate of structural adjustment in 2015 and 2016 differs partially from the previously shown effects.

Source: MoF

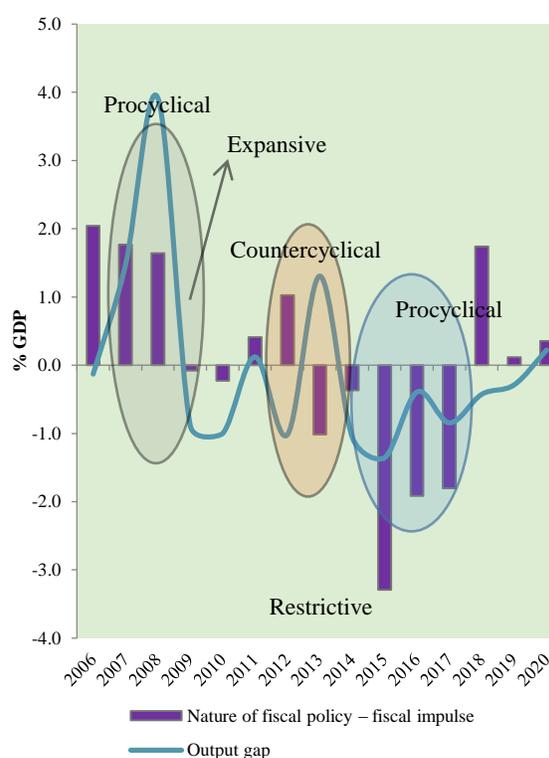
The positive effect of the economic cycle is evident in 2007, 2008 and 2013, where there were positive output gaps. The effect of the cycle is such that it leads to a fiscal result that is better than it would have been had the economy been on a lower potential growth path<sup>20</sup>. Conversely, in the period of the most severe crisis, from 2009 to 2012, the impact of the cycle was negative, the output gap was negative, and the actual fiscal deficit was higher than the cyclically adjusted one. In 2014 and 2015 the output gap reached relatively high negative values, to be subsequently reduced and closed after 2017.

Graph 10. Output gap, actual, cyclically adjusted, structural fiscal balance in the 2005-2020 period, in % of GDP



\* Projected values are presented for the period 2018 – 2020.

Graph 11. Nature and effects of fiscal policy in the period 2006-2020\*, in % of GDP



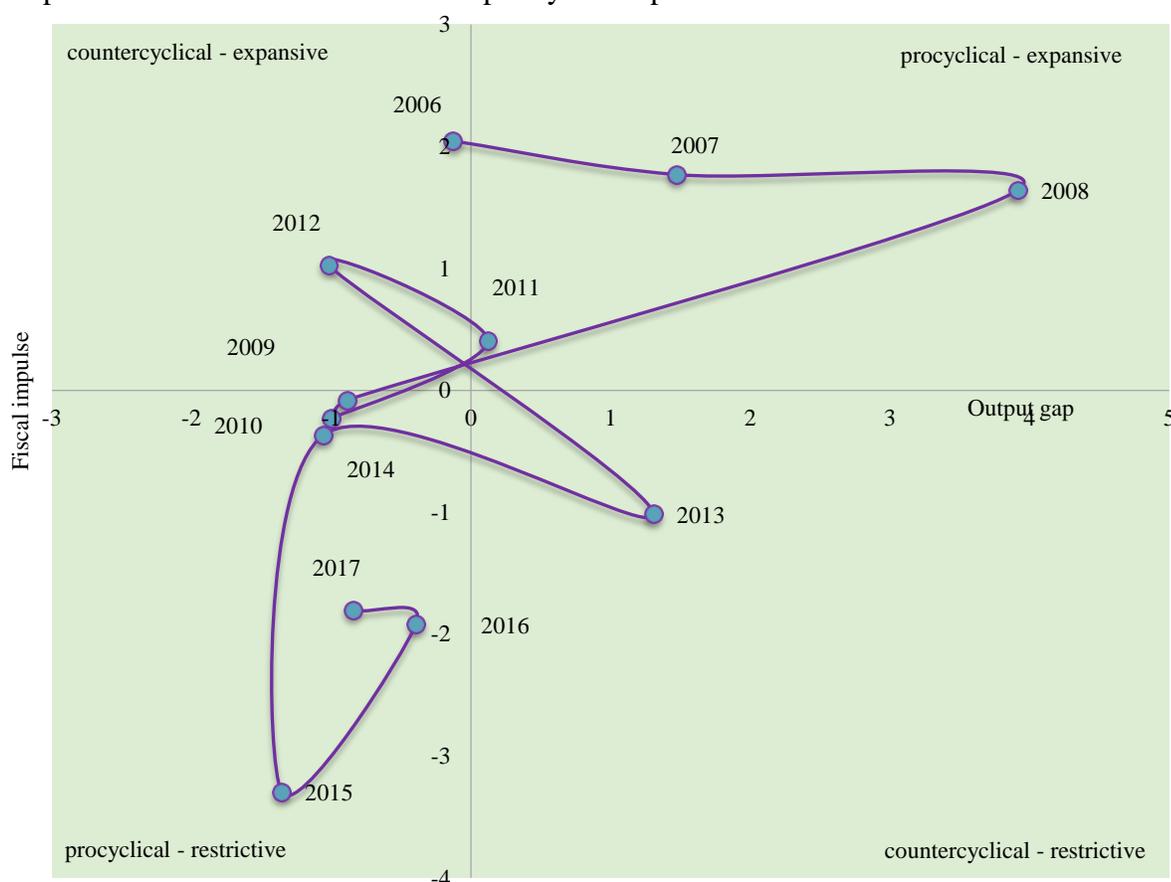
The measures adopted in the previous period, as well as the fiscal consolidation measures implemented in the period 2015-2017, caused a significant structural improvement in the country's fiscal position. The negative fiscal impulse in 2016 and 2017 was partly mitigated by the relaxation of fiscal policy in the form of increasing pensions and some public sector wages. In the period 2016–2020, the effects of the public sector reform, the completion of the restructuring process and the elimination of some subsidies will result in permanent savings on the expenditure side. At the same

<sup>20</sup> By including the output gap, the effect of fiscal policy in terms of its procyclical or countercyclical nature can be assessed. Procyclical policy is characterised by the presence of expansionary fiscal policy in the periods of growth above the potential one (or restrictive policy amidst recession), while the opposite applies to countercyclical policy. As a result of procyclical fiscal policy, changes in public expenditure follow the nominal GDP trend. Cyclically designed revenue growth component is then used either for the reduction of tax burden or in most cases for expenditure increase, primarily for the purpose of reducing the fiscal deficit.

time, space is opening for a further relaxation of fiscal policy first on the expenditure side and then on the revenue side as well. The result achieved in 2017 and the significant primary surplus provides room for easing fiscal policy in a way that will not jeopardise sustainability and downward debt path. The anticipated fiscal deficit of 0.5% of GDP in the coming period continues to enable the achievement of a high level primary surplus. That factor, apart from accelerating economic growth, will primarily result in an accelerated reduction in the share of public debt in GDP.

The negative output gap did not prevent the successful implementation of fiscal consolidation in the period 2014–2016. Certain internal and external factors mitigated the effects of fiscal consolidation. The following are among the most important factors: 1) significant improvement in the efficiency of tax revenue collection, 2) collection of one-off non-tax revenues that largely set off allocations for one-off expenditures, 3) easing of the NBS monetary policy, 4) favourable international environment (oil prices, economic growth of foreign trade partners, ECB policy), 5) relatively low values of fiscal multipliers.

Graph 12. Nature and effects of fiscal policy in the period 2006–2017



In the period 2018–2020, the fiscal impulse is positive because consolidation in the previous period has created significant fiscal space. A certain minimal degree of restrictiveness stems from the further improvement in collection efficiency at the central and local level. With the actual growth rates approaching the potential level, in combination with achieved fiscal results, the need for restrictive fiscal policy in the future is significantly reduced. And besides relatively low values of the fiscal multiplier, the positive fiscal impulse will certainly have a certain effect on economic trends in the coming medium-term period. Through careful design of the revenue and expenditure policy in the coming period such an effect may also be amplified. The created fiscal space can also be used to

simplify and harmonise the tax system, additionally improving the business environment and creating space for the acceleration of potential growth.

## 5. PUBLIC DEBT MANAGEMENT

In line with international practice and under the Law on Public Debt (RS Official Gazette, nos. 61/05, 107/09, 78/11 and 68/15), the Ministry of Finance of the Republic of Serbia - Public Debt Administration prepares a Public Debt Management Strategy for the upcoming medium term. The public debt management strategy is consistent with the overall medium-term macroeconomic framework of the Government of the Republic of Serbia, and it constitutes an integral part of the Fiscal Strategy.

The Public Debt Management Strategy is based on the principles defining the need for a transparent and predictable borrowing process, while constantly developing the market for government securities, and an acceptable level of exposure to financial risks.

At end-September 2016, the stock of total general government public debt was RSD 2,913.2 billion, or 65.2% of GDP. Of this amount, direct liabilities amounted to RSD 2,651.7 billion, contingent liabilities RSD 220.1 billion, while RSD 41.0 billion was related to non-guaranteed debt of local government units, and RSD 389.6 million to non-guaranteed debt of JP Putevi Srbije (PE Roads of Serbia).

According to the data as of 30 September 2017, the bulk of the Republic of Serbia's public debt is still euro-denominated, with a 41.5% share. The next most prevalent currency is the US dollar with a share of 30.8%, followed by the dinar with a 22% share. The rest of the debt is denominated in Special Drawing Rights - 3.3% and other currencies - 2.4%. The interest rate on the largest portion of the Republic of Serbia's general government public debt of 79.0% is fixed, while the variable interest rate is applicable to 20.7% of total public debt. Most of the public debt at variable interest rates is linked to Euribor and Libor, on the euro, and this type of debt accounts for 74.4% of the total public debt at variable interest rates; liabilities linked to the NBS key policy rate account for 2.8%; liabilities linked to Libor on the US dollar account for 8.9%, while other liabilities linked to other types of variable interest rates account for 14.0% (for the most part, to the variable interest rate on SDRs).

Having in mind the projected primary surplus of the Republic of Serbia's budget for 2017-2020, including the amount of loan proceeds to be disbursed for project financing, the effects of changes in the exchange rate of the dinar against the euro and the US dollar in the baseline macroeconomic scenario the stock of central government debt should stand at 55.2% of GDP at end-2020, while the stock of general government debt should amount to 56.3% of GDP.

Table 8. Baseline projection of the general government public debt stock by 2020

	2017e	2018e	2019e	2020e
Primary surplus (central government), in billions of RSD	142.1	84.2	88.5	89.6
Interest (central government), in billions of RSD	119.0	117.8	111.9	111.3
Public debt (central government), in billions of RSD	2,807.5	2,938.7	2,979.7	2,995.1
Central government debt, in % of GDP	62.8	61.8	58.8	55.2
Non-guaranteed debt of local government, in % of GDP	0.9	1.0	1.0	1.1
General government debt, in % of GDP	63.7	62.8	59.8	56.3

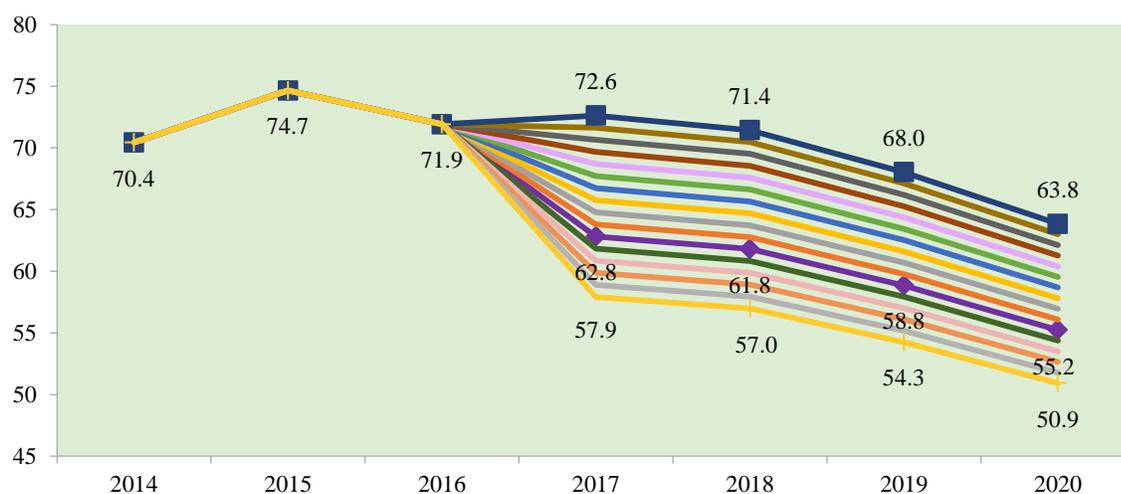
Non-guaranteed local government debt is projected in the coming period at around 0.9% of GDP in 2017 to 1.1% of GDP in 2020.

The stock of general government public debt presented according to the Maastricht criteria should be at the level of 53.4% of GDP at the end of 2020.

In cooperation with the World Bank experts, the Public Debt Administration has prepared an analysis of the costs and risks of alternative borrowing strategies, by using a World Bank model (Medium Term Debt Strategy Model – MTDS), with a view to optimising the portfolio and improving the efficiency of public debt management. By using the MTDS model, the baseline scenario and three alternative scenarios have been analysed (four analysed strategies), while also taking into account shocks on the side of interest rates and exchange rates (sensitivity analysis).

Financial and fiscal risks may cause public debt to grow more than anticipated in the baseline scenario. The underlying risks that can bring about a rise in the debt and the cost of public debt servicing include: refinancing risk, foreign exchange risk, market risk (interest rate risk, inflation risk), liquidity risk, credit risk, operational risks, risks associated with the distribution of servicing costs (debt structure, liability concentration).

Graph 13. Effect of changes in the dinar exchange rate against a basket of currencies from the public debt portfolio on the change in the public debt-to-GDP ratio - central government



The graph above presents movements of the public debt-to-GDP ratio for central government, depending on changes in the exchange rate of the dinar against a defined basket of currencies. It shows the baseline projection with alternative scenarios, depending on the appreciation or depreciation of the dinar exchange rate ranging from a 10% appreciation to a 20% depreciation of the dinar against the basket of currencies. By applying these scenarios, it is possible to see that the ratio for 2020 would range from 50.9% of GDP to 63.8% of GDP, while for the baseline scenario it would be at the level of 55.2% of GDP.

With a view to mitigating the exposure to variable interest rates, amidst the expectations that the variable interest rate with the highest share in the public debt – Euribor - would go up, new liabilities are contracted at fixed interest rates, where possible, especially for loans intended for financing investment projects, with lenders such as the European Investment Bank, the German Development Bank - KfW and the EXIM Bank of China.

Bearing in mind the limitations and potential risks related to the financial market, the public debt management strategy for the upcoming medium-term period will be based on the financing of the Republic of Serbia's budget outlays predominantly through issues of government securities in the domestic and international capital market. The objective for the next long-term period is to secure funding mainly by issuing dinar-denominated securities in the domestic market. However, the current

situation suggests that, despite the strong resolve to continue with the development of the domestic market for government securities, in the next medium-term period part of the financing will have to be secured in the international financial markets.

The annual borrowing decision is passed as part of the Budget Law for a specific fiscal year, and in line with changes in the main fiscal aggregates it is possible to change the borrowing plan in the course of the fiscal year.

In the period to which this Strategy pertains an improvement in the efficiency of the primary market is expected through the concept of primary dealers, as a mechanism of sale of government securities which directly, in the longer run, contributes to the reduction in borrowing cost, as well as the reduction of the refinancing risk. Introducing a system of sale of government securities in the domestic financial market through primary dealers, provides a good foundation for improving the efficiency of the secondary market of government securities. With the development of the secondary market, in time a concept of market efficiency in the process of valuation of government securities will be established. Through the introduction of benchmark bond issues a positive effect on the volume and continuity of secondary trading was achieved, as well as the improvement of market efficiency in the process of sale of government securities in the primary market.

## 6. SENSITIVITY ANALYSIS AND A COMPARISON WITH THE PREVIOUS PROGRAMME

***Fiscal risks.*** In previous years Serbia faced significant expenditure stemming from materialised fiscal risks. These were primarily repayments of debt arising from issued guarantees, payments against court orders, resolution of state-owned financial institutions, assumption of debts of public enterprises into public debt, and the like.

Fiscal risks imply exposure of public finances to certain circumstances that can cause short-term and long-term deviations from the projected fiscal framework. These deviations can occur in revenue, expenditure, fiscal result, as well as in government assets and liabilities, against what has been planned and expected.

Identification of major fiscal risks that can affect government finances over the medium term is a starting point for better fiscal risk management. Detailed information is available on some fiscal risks, and it is easy to identify whether and how likely it is that these will affect fiscal aggregates over the medium term. However, sufficiently detailed information is lacking for some other ones, but even identifying those raises the awareness of the possibility of deviations from the projected fiscal framework in the upcoming period.

***Macroeconomic assumptions and sensitivity of fiscal aggregates.*** Deviations of macroeconomic assumptions from the baseline scenario may lead to the deviations of fiscal aggregates from the projected level.

A negative scenario that implies economic contraction or lower growth in the coming period would lead to substantially lower capital inflows, and a drop in foreign trade. In that case, revenue would underperform and, consequently, the deficit would widen, if no further adjustments were made on the expenditure side. According to the assessments of fiscal balance sensitivity, any change in real growth of 1.0 p.p. of GDP leads to a change in the fiscal result of around 0.36% of GDP. In the case of lower-than-planned real GDP growth rates in the next three years (on average lower by 1.0 p.p. a year), the cumulative increase in the fiscal deficit would amount to over RSD 50.0 billion.

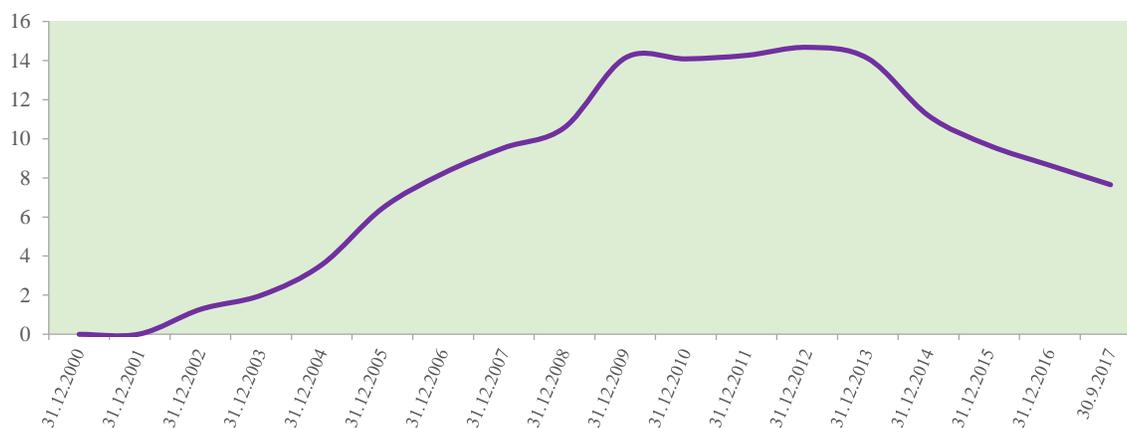
Inflation is the main determinant of overall macroeconomic stability. Due to the modification of fiscal rules on indexation of salaries and pensions, in the coming period inflation will have less of an impact on the movement in the overall expenditure level than in the past. As for the revenue side, the impact of inflation on indirect taxes can be beneficial in the short run, but due to the inevitable adjustment of the real level of spending, this effect is lost if the income level is limited. The exchange rate has a similar short-term effect. Some revenue items are indexed annually to inflation (mainly non-

tax revenue and the levels of certain excise rates), so certain risk comes from that side; nevertheless, due to the low projected inflation rates, it is not high. Inflation, on the other hand, can indirectly affect the size of the deficit and public debt. In case it is significantly above the targeted levels, in the process of relevant interest rate adjustments, interest rates on public debt may go up. On the other hand, the consumer price index strongly affects the movement of the overall GDP deflator, and consequently the nominal GDP level, as the denominator for the deficit- and public debt-to-GDP ratios.

Interest expenditure is affected, besides the amount and composition of public debt, by factors such as the exchange rate and interest rates in the international and domestic markets. Given the unpredictable trends of certain variables, more funds may be needed for interest payments in the coming period. Interest rate policy pursued by certain international institutions (FED, ECB, etc.) can influence the general level of interest rates in the global markets, and for the Republic of Serbia, as a small, open economy, this poses an additional fiscal risk.

**Government guarantees.** Guarantees issued by the government affect the level of public debt, but also the level of deficit, if the government assumes the repayment of such debt from the original debtor. Issued guarantees, according to the definition stipulated in the Law on Public Debt<sup>21</sup>, are a part of contingent liabilities and are included in public debt<sup>22</sup> in the full amount. In late 2016, the share of contingent liabilities (guarantees issued by the Republic of Serbia) in total public debt amounted to 8.6%, according to the national methodology. The share of these liabilities in public debt has been decreasing in the current year as well, so in late September 2017 it was at 7.6% of total public debt. The share of these liabilities in public debt, just above 14.0% on average, peaked in the period between 2009 and 2013.

Graph 14. Share of contingent liabilities in public debt of the Republic of Serbia, %



At end-2016, the stock of public debt arising from issued guarantees amounted to EUR 2.1 billion, i.e. 6.2% of GDP. The guarantee-related debt stock was reduced by around EUR 300 million relative to the end of 2015. By the end of September of the current year, the stock of guarantee-related debt was reduced by additional EUR 300 million.

<sup>21</sup> Law on Public Debt, RS Official Gazette, nos. 61/2005, 107/2009, 78/2011 and 68/2015.

<sup>22</sup> The debt definition under the Maastricht criteria differs from public debt definition in the local legislation in its treatment of issued guarantees. According to the Maastricht criteria, public debt (general government debt) includes only called guarantees. The local legislation takes a more conservative approach in this matter, including all issued guarantees in public debt.

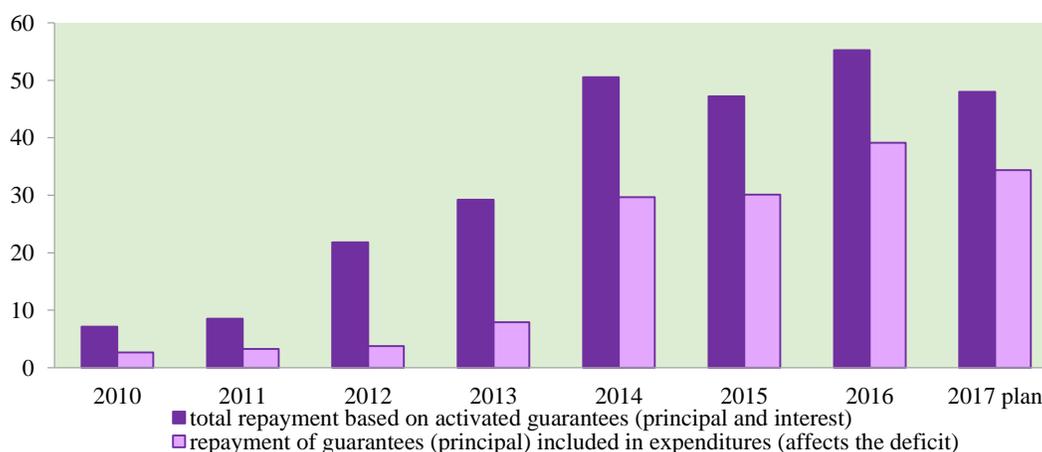
Table 9. Stock of debt arising from issued guarantees, in EUR million

Beneficiary	31 December 2015	30 November 2016
JP Srbijagas	430.6	266.6
JP Putevi Srbije (PE Roads of Serbia)	393.5	367.2
Železnice Srbije a.d. (Serbian Railways)	305.6	278.6
Infrastruktura Železnice Srbije a.d. (Serbian Railways Infrastructure)	-	10.6
Srbija Voz a.d. (Serbia Train)	-	0.0
Air Serbia a.d. Beograd	22.5	16.9
Galenika a.d.	21.0	15.3
EMS a.d.	41.6	39.7
JP EPS	382.8	379.8
Building Directorate of Serbia	0.0	0.0
RTB Bor	120.5	92.3
Serbia and Montenegro Air Traffic Services	16.8	12.1
JP Jugoimport – SDPR	33.4	19.0
FIAT d.o.o.	96.0	80.4
Aerodrom Nikola Tesla (Nikola Tesla Airport)	6.5	6.0
JAT Tehnika d.o.o.	4.8	4.3
JP Emisiona Tehnika i Veze (PE Transmission Equipment and Links)	16.7	15.6
Local government units (towns and municipalities)	245.9	239.8
Development Fund	0.8	0.0
Serbian Export Credit and Insurance Agency	5.4	0.0
<b>TOTAL</b>	<b>2,144.3</b>	<b>1,844.2</b>

Source: Ministry of Finance, Public Debt Administration

The total planned repayment under guaranteed loans in 2017 amounts to RSD 48.0 billion. Before 2014, the accounting methodology did not include repayments under guarantees<sup>23</sup> in expenditure. From 2014 onwards, a part of this expenditure has been included in the budget expenditure<sup>24</sup>. Regardless of the budget and accounting presentation, the debt repaid by the government instead of the original debtor increases the overall need for borrowing.

Graph 15. Repayment of debt under guarantees, in RSD billion



<sup>23</sup> Repayments under guarantees from the central budget are included on the cash basis. Accrual basis international standards include the whole amount of outstanding debt in the expenditure at the moment of guarantee calling, while the debt repayment on this basis is treated as a financial transaction.

<sup>24</sup> A portion of expenditure arising from the repayment under guarantees issued for JP Putevi Srbije (PE Roads of Serbia) is not included in budget expenditure, since this enterprise is a part of the general government, so the expenditure financed by guaranteed loans was included in the general government expenditure at the moment funds were spent, while the repayment is treated as a financial transaction (below the line).

Table 10. Total paid guarantee obligations by beneficiary, in RSD billion

Beneficiary	2016			2017 (as of 30 September)		
	Principal	Interest	Total	Principal	Interest	Total
JP Srbijagas	23.5	2.9	26.4	16.2	0.5	16.7
JP Putevi Srbije (PE Roads of Serbia)	4.4	1.7	6.1	4.2	1.6	5.8
Železnice Srbije (Serbian Railways)	6.1	0.8	7.0	2.7	0.5	3.1
JAT	1.3	0.2	1.4	0.7	0.0	0.7
Galenika a.d.	4.5	0.4	4.9	0.7	0.0	0.7
Local governments	0.2	0.0	0.3	0.4	0.0	0.4
Železara Smederevo (Smederevo Steel Mill)	3.8	0.0	3.8	0.4	0.0	0.4
RTB Bor	0.0	0.0	0.0	0.0	0.0	0.0
Other beneficiaries	5.5	0.0	5.5	0.0	0.0	0.0
TOTAL	49.2	6.0	55.3	25.3	2.7	28.0

Source: Ministry of Finance, Public Debt Administration

Execution of guarantee repayment expenditure by the end of 2017 will be below the initial plan. The guarantee repayment schedule (total principal and interest) in the 2017 budget amounts to RSD 48.0 billion, of which expenditure affecting the result includes RSD 34.4 billion for the repayment of the guarantee principal. Since during 2017 JP Srbijagas settled liabilities under guaranteed loans on its own, the execution of this category by the end of the year is estimated at around USD 29.0 billion.

The growing indirect debt and inclusion of a portion of payments under guarantees into the budget expenditure, and the consequent deficit increase have raised awareness of the growing fiscal risks resulting from issued guarantees. Therefore, measures have been taken to limit the issuance of new guarantees. Amendments to the Law on Public Debt prohibit any issuance of guarantees for liquidity loans. Amendments to the Law on the Development Fund of the Republic of Serbia suspended any further issuance of counter-guarantees for guarantees issued by the Development Fund of the Republic of Serbia.

In addition to restrictions on the issuance of government guarantees, the key step in the reduction and prevention of fiscal risks on this basis lies in the reform of state-owned and public enterprises, guarantee beneficiaries, to make them capable of repaying their own loans. Quite a number of these enterprises, the main beneficiaries of these guarantees, are in the restructuring process, or in the process of implementation of restructuring plans prepared in cooperation with international financial institutions.

The annual budget for 2017 plans for the issuance of guarantees of up to EUR 200 million, specifically for loans intended for the implementation of infrastructural projects. In the first half of the year, guarantees were issued to the German Development Bank, through the adoption of corresponding laws, in the amount of EUR 60.0 million for JP EPS and EMS a.d. projects.<sup>25</sup>

The stock and composition of public debt based on contingent liabilities and the rising budget expenditure for guarantees suggest that significant fiscal risks can materialise in the following few years. In the years to come payments under guarantees are planned, but with a declining trend, from 0.6% of GDP in 2017 to 0.1% of GDP in 2020. Owing to the measures taken in the previous period, as well as to the negotiations with domestic commercial banks that resulted in lower interest rates for the guaranteed liabilities of JP Srbijagas and Galenika a.d., exposure of the Serbian public finances to this risk has been reduced<sup>26</sup>.

<sup>25</sup> New contingent liabilities of the Republic of Serbia under issued guarantees in 2017 are regulated by the following laws: 1) Law on the Issuance of a Guarantee of the Republic of Serbia to the German Development Bank KfW, for the Loan Granted to JP EPS, Beograd (*Modernisation of Deashing System of TPP Nikola Tesla A project*); 2) Law on the Issuance of a Guarantee of the Republic of Serbia to the German Development Bank KfW, for the Loan Granted to Elektromreža Srbije a.d. Beograd (Regional Programme of Energy Efficiency in the Distribution System).

<sup>26</sup> Euro-denominated loans with residual maturities of less than 2 years, as of 18 November 2016 have the interest rate of 1.75%+3 month Euribor; Euro-denominated loans with residual maturities of more than 2 years, as of 18 November 2016 have the interest rate of 2.75%+3 month Euribor; USD- denominated loans, as of 18 November 2016 have the interest rate of 3.00%+3 month Libor

Structural reforms of public and state-owned enterprises, making them capable of competing in the market and financially sustainable, on the one hand, and limited and targeted issuance of new guarantees, on the other, will contribute to the reduction of the corresponding fiscal risks and maintenance of expenditure at the planned, i.e. projected level in the coming medium-term period.

**Assumption of liabilities into the public debt of the Republic of Serbia.** Assumption of liabilities of public and state-owned enterprises is a significant source of risk for public finances, and directly results in the increase in public debt and government deficit. In the previous period, there were several occasions when liabilities of public and state-owned enterprises were assumed, directly increasing public debt by the amount of assumed liability of the debtor. At the same time, this amount becomes a budget expenditure, thus increasing the general government deficit.

In addition to assuming liabilities of public and state-owned enterprises, the rise of public debt and related deficit were also a result of court decisions as well as inadequate planning of certain expenditure (subsidies). In 2015, the Constitutional Court decision increasing military pensions and inadequate planning of subsidies to farmers increased the debt and deficit, resulting in the inclusion of this debt in the public debt and payment to the farmers in instalments.

Table 11. Assumption of liabilities into public debt in 2015, in RSD billion

Description	2015
JP Srbijagas	23.4
Military pensioners	10.0
Agricultural subsidies	10.1
TOTAL	43.5

Source: Ministry of Finance

Towards the end of 2016, as part of financial restructuring of HIP Petrohemija, liabilities of this company in the amount of EUR 105.0 million were assumed into public debt, as agreed under the IMF-supported programme. The assumption of this debt combined with financial restructuring of the company has eliminated possible fiscal risks and future budget expenditure for the provision of support to this company.

The budget plan and the revised estimates for 2017 do not envisage any assumption of corporate liabilities into the public debt.

**Public enterprises.** Operations of public enterprises are a significant source of fiscal risks both on the budget revenue and expenditure side. In their operations public enterprises are faced with numerous problems ranging from the collection of receivables to regular servicing of liabilities to creditors, state, employees, etc. The state as the founder and the only owner is responsible for operations, and is their protector of last resort in the case of illiquidity. Fiscal risks related to operations of public enterprises can materialise through several channels. Government guarantees issued for public enterprise loans are the greatest, but not the only risk. Sustainability, efficiency, and profitability of public enterprises affect budget revenue, i.e. the amount of profit they pay into the budget. The quality of products and services provided by public enterprises affects the efficiency and profitability of the private sector in general and, ultimately, the level of taxes they pay into the budget.

Public enterprises represent an important segment of the Serbian economy since they employ close to 73 thousand people. Public enterprises are set up as companies that perform activities of general interest. Their operations are regulated under the Law on Public Enterprises adopted in February 2016, as well as subsectoral laws regulating some specific areas that remained beyond the scope of the Law on Public Enterprises (Energy Law, Company Law, etc.).

In order to reduce the fiscal risks related to operations of public enterprises, restructuring processes have been initiated in the largest public enterprises (Železnice Srbije a.d, Infrastruktura

Železnice Srbije a.d, Srbija Voz a.d, Srbija Kargo a.d, JP EPS and JP Srbijagas). The whole process is implemented in cooperation with the leading global financial institutions – the IMF, the World Bank and the European Bank for Reconstruction and Development (EBRD), so that these companies can be placed on solid foundations and can start operating in line with market principles, thus reducing any potential fiscal costs that can result from their operations.

### Key Financial Performance Indicators of Public Enterprises

**Operating results of public enterprises in 2016.** At end of 2016 the total capital of central-level public enterprises amounted to RSD 1,681 billion, while the net profit generated in 2016 totalled RSD 4.6 billion.

Table 12. Key financial performance indicators for public enterprises, in RSD billion

Description	2015	2016
Total assets	2,481.0	2,714.3
Own capital	1,530.7	1,680.9
Total revenue	499.7	516.8
Net profit (loss)	-2.7	4.6
Subsidies	23.4	29.6
Subsidies, excl. JP Putevi Srbije	16.5	22.5
ROE, in %	-0.2%	0.3%
ROA, in %	-0.1%	0.2%
Subsidies, as % of total revenue	4.7%	5.7%

Source: Official financial statements published on the Business Register Agency's website

The operations of central-level public enterprises were additionally improved in 2016. Public enterprises generated in total a net profit amounting to RSD 4.6 billion, which is a major progress compared to a loss of RSD 2.7 billion in 2015, or the RSD 65.3 billion loss in 2014.

In 2016 subsidies increased and accounted for 5.7% of public enterprises' total revenue. Most of the growth of received subsidies was a result of the growth of subsidies to railway companies intended for restructuring, especially the payout of inducement severance pays, as well as due to additional subsidies to JP PEU Resavica for the settlement of debts to workers. Twenty-two companies receive subsidies, while Srbija Kargo a.d. (a company that is not a regular subsidy beneficiary) received funds from the budget for the payout of severance pay. Some subsidies take the form of capital investment, such as subsidies for JP Putevi Srbije totalling RSD 7.1 billion and intended for road infrastructure reconstruction.

**Public enterprise performance in 2017.** In 2017, on aggregate, the positive trend of performance of central-level public enterprises continued.

Table 13. Estimated operating results of public enterprises for the first 9 months of 2017, in RSD billion

Operating results	As at 30 September 2016	As at 30 September 2017
Operating income	317.9	327.6
Operating expenses	229.3	292.0
EBITDA	88.6	81.0
Depreciation	40.8	45.4
Operating result (EBIT)	47.8	35.6
Result before tax	31.1	28.9
Net result	22.5	22.2
Received subsidies	18.7	17.7
Number of companies that generated profit	26	26

The operating results are somewhat lower than in the same period of the previous year, but are still positive. The net result for the first 9 months is a profit of RSD of 22.2 billion, while the profit generated in the same period of the previous year amounted to around RSD 22.5 billion. Still, the results in both periods under consideration were overestimated since they included the depreciation expenses of JP Putevi Srbije (around RSD 9.0 billion), because the company records the entire amount of these expenses for the year in question only at the end of the year. The biggest impact on the positive net result in the period under consideration belongs to JP Srbijagas, which generated net profit amounting to RSD 9.5 billion. The second ranked was JP Jugoimport – SDPR, with RSD 4.7 billion, while EMS generated profit amounting to RSD 2.9 billion and JP EPS RSD 2.1 billion. Such results of JP EPS are much lower compared to the same period of the previous year (RSD 15.3 billion) and are a result of higher operating expenses caused by electricity imports in the winter period.

The net result of public enterprises was generated with a smaller amount of subsidies, primarily referring to JP Putevi Srbije (by RSD 0.9 billion) and the railway companies – Srbija Voz a.d. and Infrastruktura Železnice Srbije a.d. (by RSD 0.3 billion).

**Payment of profit into the central budget.** Payment of profit by public enterprises and dividends by the companies in which the state has an equity interest, accounts for a significant part of non-tax revenues. Operating success of these companies determines the amount of budget revenue from this source. Payments of recurring profits and dividends are recurring budgetary non-tax revenue, while payments from retained earnings are treated as one-off revenue, and do not represent a permanent source of revenue.

In 2016 budget revenues from the payments of public enterprises, either of recurring profit and retained earnings from previous years, amounted to 0.6% of total budget revenue<sup>27</sup>. The 2015 Budget specified that the central-level public enterprises were obliged to pay 50% of the profit generated in the previous year into the central budget. The same obligation extends to the companies for the relevant share of profits to be paid to the state as one of the owners. In addition to the recurring profit, the government demanded payment of retained earnings from the period before 2013 up to the amount that would not jeopardise regular operations of public enterprises. In 2015, approximately RSD 6.5 billion was paid into the central budget on this basis (profits of public enterprises).

The duty of public enterprises to pay no less than 50% of profit generated in the previous year was again stipulated in the 2016 Budget Law of the Republic of Serbia. On this basis alone, it was

<sup>27</sup> In 2016, the total amount of profit of public enterprises and public agencies, and dividends of companies in which the state has an equity interest, amounted to RSD 20 billion. We focus here only the profit of public enterprises from the standpoint of fiscal risk assessment.

planned to have approximately RSD 5 billion paid into the budget in 2017. The initial plan was exceeded and RSD 5.5 billion were paid into the budget by September.

Mitigation of potential risks stemming from public enterprise operations includes a series of measures related to accountability, profitability, and transparency in operations of these enterprises. Namely, in early 2016, a new Law on Public Enterprises was adopted, which is expected to strengthen the management structure and accountability of public enterprises in general. Restructuring processes have been initiated in JP EPS, JP Srbijagas, and Železnice Srbije a.d. Success of the restructuring process and speed of implementation of adopted measures will determine the future efficiency of operations.

**Banking system and deposit insurance.** Deposit insurance is a mechanism set up to preserve financial stability and protect depositors. The deposit insurance system ensures that each protected depositor<sup>28</sup> has his/her entire deposit paid out in each bank up to the insured amount of EUR 50,000 in the case of the bank's bankruptcy or liquidation. Deposit insurance is regulated under the Law on Deposit Insurance.

In the deposit insurance system, the Republic of Serbia is the ultimate guarantor for the payment of insured deposits. In order to secure funds for deposit insurance, the Agency charges a deposit insurance premium from banks, and deposits these amounts into the account of the Deposit Insurance Fund, manages the Fund assets and pays out deposits up to the insured amount in the case of bank bankruptcy or liquidation. In the event of the Deposit Insurance Fund lacking the required resources, the Republic of Serbia shall provide for the payment either from the budget funds or by issuing a guarantee for loans taken by the Deposit Insurance Agency.

These guarantees of payment of insured deposits by the government, either directly from the budget funds, or indirectly by issuing guarantees for loans taken by the Deposit Insurance Agency, are a source of fiscal risks and possible fiscal expenditure. However, owing to the achieved stability of the banking sector, since the beginning of 2014 there has been no need to use government funds for payments arising from insured deposits.

Mitigation of fiscal risks on this basis depends on stability and sustainability of the banking system. Supervision of the banking system, caution in fund placement, and improved quality of bank assets, are the main pillars of a stable banking system.

In February 2015, the regulations governing the Serbian financial system<sup>29</sup> were reformed. One of the features of this reform includes the transfer of competences for monitoring of operating results and management bodies in banks, insurance companies, and other financial institutions in which the Republic of Serbia is a shareholder, and organising and conducting the sale of shares in them, from the Deposit Insurance Agency to the Ministry of Finance as of 1 April 2015. Also, the regulatory reform included the transposition of the Bank Recovery and Resolution Directive (BRRD) entrusting the bank restructuring function to the NBS. In December 2016 a set of regulations was adopted implementing Basel III standards in the domestic regulatory framework, thereby achieving a significant level of alignment of domestic regulations with the corresponding EU regulations in this area, while during 2017 activities on improving domestic regulations regulating the operations of banks resumed, with the aim of ensuring further alignment with EU regulations. The basic goals of adopting these regulations include increasing the resilience of the banking sector by increasing the quality of capital and introducing protection layers of capital, improving the monitoring of banks' exposure to liquidity risk, further strengthening market discipline and the transparency of banks' operations in the Republic of

<sup>28</sup> The protected depositors are individuals (both residents and non-residents), sole traders (residents only), micro, small and medium-sized enterprises (residents).

<sup>29</sup> The National Assembly adopted amendments to the Law on National Bank of Serbia and the Law on Banks, as well as the new Law on the Deposit Insurance Agency, Deposit Insurance Law, Law on Bankruptcy and Liquidation of Banks and Insurance Companies. The amendments to the set of financial laws required the adoption of amendments to the Law on Ministries.

Serbia by publishing all relevant information regarding bank operations, as well as adapting the reporting system to new regulatory provisions.

The results of the banking sector in Serbia at the end of 2016 and during 2017 suggest the trend of bank profitability improvement. The banking sector of the Republic of Serbia operated at a profit in 2016, with the net financial result before tax amounting to RSD 21.3 billion, while in the first 9 months of 2017 a positive net financial result before tax was recorded, amounting to RSD 53.5 billion, which constitutes an increase of 63.1% compared to the net profit before tax in the same period of the previous year.

The high rate of banking sector capitalisation, from the standpoint of capital adequacy ratio and of regulatory capital structure, has additionally increased, guaranteeing the resilience of the banking sector. At the end of September 2017, the capital adequacy ratio at the level of the banking sector of the Republic of Serbia was 22.46%, (an increase of 0.63 p. p. compared to the start of the year), which is significantly above the legal regulatory minimum level of 8% and more than enough to cover all the risks to which the sector is exposed, which is also confirmed by the macroprudential stress tests regularly conducted by the NBS.

One of the limiting factors of credit activity growth is a relatively high level of non-performing loans (NPLs). In August 2015, the NPL Resolution Strategy was adopted, and is implemented through two action plans: one prepared by the Government, and the other by the NBS. Both are aimed at reducing the level of NPLs. The key areas of implementation include building bank capacity to resolve NPLs, improvement of regulations for collateral valuation, development of NPL market, etc.

The implementation of NPL resolution measures has continued to yield fairly good results. In the first nine months of 2017, total gross NPLs loans were reduced by RSD 94.4 billion, or 27.3%. As a result of that, as well as the increase in lending activity, the share of NPLs in total loans dropped further to 12.2% in September, which is the lowest value of this ratio since January 2009. This share is 4.8 p. p. lower than at the end of 2016, and 10.1 percentage points lower than in August 2015, when the NPL Resolution Strategy was adopted. Strengthening banks' capacities for resolving NPLs and further development of the market of these loans were among the Strategy's main goals, and the progress achieved in those areas is also confirmed by the fact that the reduction in the amount of NPLs was mostly brought about by their write-offs and assignment. On September 30, 2017, the implementation of the Decision on Bookkeeping Write-off of Bank Balance Sheet Assets (RS Official Gazette, no. 77/17) began, according to which banks are obliged to transfer to off-balance sheet records all loans that are fully impaired. In September alone NPLs worth RSD 53.6 billion were written off, or RSD 7.9 billion more than in the whole of 2016, with additional positive effects of the Decision expected in the coming months.

Mitigation of risks and reduction of fiscal costs related to the deposit insurance scheme implies complete alignment with the European standards in this area.

**Other fiscal risks.** In addition to the aforementioned fiscal risks, there are some other circumstances that, if they materialise, can also result in fiscal costs. Some risks are not substantiated with systematised data, but considering that some did materialise in recent past, their impact on public finances can be assessed. Their identification helps understand possible impact on fiscal standing of the country in the upcoming period.

Significant fiscal risks are associated with decisions by domestic and foreign courts, fines, and damages payable by government bodies. In the period 2009–2016, the Republic of Serbia paid the amount of RSD 55.2 billion from the budget on the basis of court decisions<sup>30</sup>. The outstanding debt to military pensioners totalling RSD 10.0 billion that was assumed in 2015, although according to the court decision the debt was not recorded in these accounts, was treated in accounting terms as debt

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<sup>30</sup> Expenditure recorded in the accounts for fines and penalties ruled by courts and judiciary bodies, and damages for injuries or loss inflicted by government bodies.

repayment, while in the report on fiscal aggregates of the general government, it was recorded as expenditure for social protection (pensions). Regardless of the manner in which this expenditure was accounted for, it represents a materialised fiscal risk arising from court decisions. A decision of the International Court in Strasbourg placed the Republic of Serbia under an obligation to pay the public debt stemming from unpaid foreign currency saving deposits that citizens of former Yugoslav republics and citizens of the Republic of Serbia placed with banks seated in the territory of the Republic of Serbia and their branches in the territories of the former Yugoslav republics. Among the fiscal risks stemming from the court decisions is also the judgement of the International Court of Arbitration, according to which the Republic of Serbia is obliged to pay USD 40.0 million in damages to the Greek company Mitilneos.<sup>31</sup> Contingent liabilities can also result from judgements of the International Court in Strasburg, on the basis of claims of workers of former socially-owned enterprises (unpaid wages and contributions).

The ever-present risk of natural hazards and disasters necessitates investment in prevention programmes to mitigate potential fiscal costs related to recovery. In 2014 Serbia was faced with catastrophic consequences of flooding. Total damage (including losses) was estimated at over EUR 1.7 billion.<sup>32</sup> According to the Law on Eliminating the Consequences of Floods in the Republic of Serbia, the funds for recovery were provided from the budget sources at all levels of government, from donations, contributions and gifts, loans, EU financial aid, etc. A grant in the amount of approximately EUR 220.7 million together, with about USD 300 million from the World Bank loan were provided for reconstruction. Having in mind the ever-present risks of natural hazards, mitigation of the related fiscal risks implies investment in prevention programmes. In December 2014 the Government adopted the National Natural Disaster Risk Management Programme, which will be implemented in cooperation with the World Bank, UN and the EU. So far, EUR 70.0 million has been provided for the implementation of prevention programmes.

#### *An Alternative Scenario of Fiscal Developments in the Period 2017- 2020*

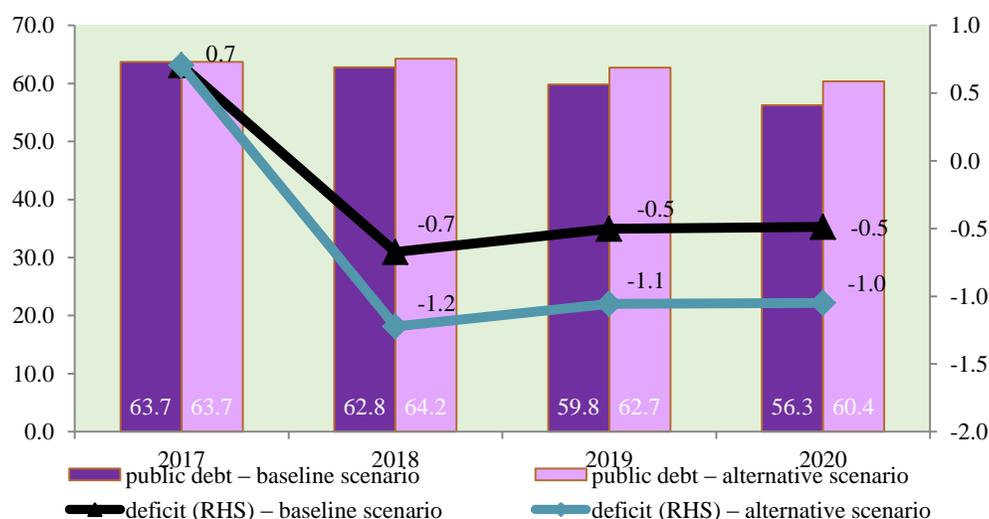
The following graph shows the developments related to the respective shares of the deficit and public debt in GDP under an alternative macroeconomic scenario, which implies GDP growth rates of 2%, 2% and 2.5%, respectively in the next three-year period. Graph 16. A comparison of respective

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<sup>31</sup> Since the judgement is still not final, the related contingent liability has not been included in the presented fiscal framework for the period 2018-2020.

<sup>32</sup> <http://www.obnova.gov.rs/uploads/useruploads/Documents/Kancelarija-za-pomoc-poplavljenih-podrucja-infograf-15-04-2016-eng.pdf>

shares of public debt and fiscal deficit in the baseline and alternative scenario, in % of GDP



A slower GDP growth would also affect, through its components, the actual fiscal aggregates, primarily the revenue side, predominantly labour-related revenues and consumption taxes. Such GDP development would lead to a higher fiscal deficit and public debt. In 2018 the share of public debt in GDP would grow compared to 2017 and in the following period the pace of its reduction would be slower. In the case of this or a similar scenario, or the materialisation of other negative risks for the planned fiscal result and if the debt-to-GDP ratio increases, fiscal consolidation measures will be taken both on the revenue and the expenditure side.

#### *Comparison with the Previous Programme*

A comparison of total consolidated general government revenue, expenditure and deficit with the previous Economic Reform Programme (2016-2018) shows certain differences, both on the revenue and on the expenditure side of the general government budget. Reasons for discrepancies in the projections, compared to the previous programme, relate to, inter alia: different levels of nominal GDP, a change in the assumptions for real GDP growth and its components, as well as changes in policies that affect the revenue and expenditure side.

Table 14. A comparison of fiscal indicators of the two programmes, in % GDP

	2016	2017	2018	2019	2020
<b>ERP 2017 - 2019</b>					
Revenue	43.3	42.4	41.6	41.1	
Expenditure	45.4	44.1	42.9	42.1	
Deficit	-2.1	-1.7	-1.3	-1.0	
<b>ERP 2017 - 2019</b>					
Revenue	43.2	43.9	42.4	41.8	41.2
Expenditure	44.5	43.2	43.1	42.3	41.7
Deficit	-1.3	0.7	-0.7	-0.5	-0.5
<b>Difference</b>					
<b>Revenue</b>	<b>-0.1</b>	<b>1.5</b>	<b>0.8</b>	<b>0.7</b>	
<b>Expenditure</b>	<b>-0.9</b>	<b>-0.9</b>	<b>0.2</b>	<b>0.2</b>	
<b>Deficit</b>	<b>0.8</b>	<b>2.4</b>	<b>0.6</b>	<b>0.5</b>	

Source: MoF

The Economic Reform Programme (2017-2019) projected a GDP growth in 2017 of 3.0% and an acceleration of growth to 3.5% in the coming years. Although the real GDP growth will be lower than expected, at 2%, in the coming period growth rates of up to 4% are expected in 2020.

Lower-than-expected GDP growth was not reflected in the revenue side considering the development of revenue-intensive growth components, such as employment, consumption and imports. Apart from that, the fight against the informal economy continued and the improvement of operating results of public enterprises led to higher budget revenue from profits and dividends. The structural improvement of revenues resulted in an upward revision of the revenue projection in the entire period under consideration.

On the expenditure side, budget execution was below the plan during 2017, which created room for some one-off expenditure, such as the payment of bonus to pensioners and some public sector employees. In the coming period a slight increase in expenditure along with a change in its composition is envisaged.

In the previous Economic Reform Programme, one part of the expenditure constituted the fiscal space, i.e. unallocated expenditure. The fiscal space was mostly divided between the wages and pensions. Due to expectations of faster and more efficient implementation of infrastructure projects funded by loan proceeds, capital expenditure was also increased significantly. The funds earmarked for the purchase of goods and services were also increased, while interest and guarantee repayment expenditure was decreased, in line with the public debt reduction.

The slight increase in the expenditure side in the coming period, along with solid revenue growth, will result in the stabilisation of the deficit at 0.5% of GDP.

## 7. INSTITUTIONAL FRAMEWORK

Reform efforts within different sub-systems of public finance management (PFM) are included in the Public Finance Management Reform Programme 2016-2020 (the PFM Reform Programme). The objective of the PFM Reform Programme is to provide a comprehensive and integrated framework for the planning, coordination, implementation, and monitoring of progress in the implementation of sustainable activities in order to improve macroeconomic stability, ensure efficient and effective allocation and use of public resources aimed at achieving national priorities, and improve services provided by the public administration in the Republic of Serbia, while increasing transparency and overall functionality of public finance management, and fulfilling the requirements for accession to the European Union. In May 2017 the Government adopted the Strategy for the Development of Public Internal Financial Control of the Republic of Serbia for the period 2017-2020, while the Anti-Fraud Strategy for Managing EU Funds in the Republic of Serbia for the Period 2017-2020 was adopted in October 2017.

In the field of improving the budget system, the following activities are planned for the coming period:

- 1) Continuation of work on improving programme budgeting. Further improvements are necessary in order to ensure the uniformity and stability among programme structures of all budget beneficiaries, and consequently the desired quality of the budget document as a whole, as soon as possible. To that end, the latest amendments to the Budget System Law created conditions for the improvement of the budget programme structure by regulating the process of monitoring and reporting on programme performance, building upon the system for programme budget planning and preparation. The information of the actual performance of programmes will be used to improve the effectiveness and efficiency of public spending, and to monitor the quality of public services.

Namely, monitoring and reporting provide key feedback on whether the activities of the users of budget funds are carried out in line with the set objectives and the financial plan, as well as what

impact the result achieved in the reporting period has on the performance and funds planned for the following period. If discrepancies are found, such information enables a timely modification of programme activities or projects, or a reallocation of budget funds in the following period with the aim of achieving better results. The mandatory publication of programme performance allows the public also to have insight into the results achieved through budget spending. Moreover, mandatory social insurance beneficiaries are obliged to abandon line budgeting model as from the adoption of financial plans for 2020.

In addition, in the following period, the procedure of integrating gender equality into the budget processes will be completed by all users of budget funds at all levels of government.

2) In June 2017 the Government adopted the Decree on the Contents, Manner of Preparation and Evaluation, as well as Monitoring and Reporting on the Implementation of Capital Projects, in order to ensure the assessment of all positive and negative effects of those projects and provide for the effective and efficient management of public funds.

3) The hiring freeze in the public sector will continue in 2018 as well, along with the exceptions considered by the Commission for the Issuance of Approval for New Hiring and Additional Work Engagement with Users of Public Funds, taking into account the maximum number of permanent employees with organisational units, funds in the budget, as well as the need for professional staff in the concrete organisational unit.

Within the framework of the EU accession process, one of the objectives is the transition to the ESA national accounts methodology, which was initiated in September 2014. The national accounts classification and reporting to the EU institutions are regulated in accordance with this methodology. The first (pilot) reports related to the Excessive Deficit Procedure have been sent, and significant improvement is expected in this area in the coming period.

The Tax Administration Transformation Programme for the period 2015-2020 was adopted in June 2015, with the aim of increasing the efficiency of revenue collection. The priorities for further implementation of the Programme include strengthening the TA management, streamlining the organisational structure in the Headquarters and branches/sub-branches, reducing non-core activities, implementing a modern approach to risk management, strengthening tax debt management, including write-off procedures, modernising IT and business processes, and improving coordination and exchange of information with other government agencies. By the end of 2017, the Government has committed to adopting the Action Plan for the Transformation Programme that will guide the reform in the direction of the organisational separation of the Tax Administration's core and non-core activities. Tax types and activities that are considered core and those activities that are considered non-core will be included in the Action Plan. The goal is to implement these reforms by mid-2019, and to reorganise the Tax Administration by 2023, so that no more than 14 organisational units engage in core activities.

Bearing in mind that foreign economic relations are based on an open, export-oriented economy and active integration into international economic flows, the customs system and policy will be designed in accordance with the above principles, in order to increase the competitiveness of the economy in the global market, and attract foreign investment. Further alignment of customs regulations with the EU acquis and World Trade Organization (WTO) rules is envisaged through the following:

- Adoption of a new Customs Law (the Ministry of Finance submitted to the Government a draft law in November 2017) and bylaws aligned with the new Union Customs Code (which entered into force in May 2016) and implementing acts, as well as WTO rules;
- Adoption of a Decree on the Adjustment of the Customs Tariff Nomenclature (annually) for the purpose of alignment with the Combined Nomenclature of the EU (the Government adopted the Decree for 2018 in November 2017) and transposition of preferential tariff rates in accordance with all free trade agreements concluded by the Republic of Serbia;

- Harmonisation of the Free Zone Law with the Customs Law;
- Adoption of a new Law on Customs Tariff after the accession of the Republic of Serbia to the WTO, with the aim of adopting the consolidated customs rates agreed upon with the WTO members during negotiations.

## IV STRUCTURAL REFORMS IN THE 2018–2020 PERIOD

### 1. IDENTIFICATION OF KEY OBSTACLES TO COMPETITIVENESS AND INCLUSIVE GROWTH

Following a period of GDP growth in Serbia in 2016 and a temporary downturn in the first half of 2017 (mostly due to adverse weather conditions), economic activity has recorded an accelerated growth, driven by industry, services and recovery of the construction sector. Fiscal consolidation has reversed public debt growth and balanced the current account deficit in the balance of payments, which has been fully covered by the net foreign direct investment inflow. Domestic demand is on the increase, with the recovery of private consumption owing to employment and wage growth in the private sector. Increasing foreign direct investment in export-oriented sectors, together with Eurozone recovery and growth, has accelerated export activity. After the successfully implemented fiscal consolidation, in the interest of sustaining the achieved results, ensuring further growth and enhancing competitiveness, it is crucial to continue the implementation of key structural reforms. The implementation of structural reforms within individual areas will be intensified in the coming period, in order to remove the key obstacles/challenges within each area that were identified on the basis of all available analyses and data.

Tax revenue growth is the key characteristic of fiscal developments in the current year. New electronic tax returns and services are continuously introduced with a view to fully implementing e-business of the Tax Administration as of 2018. In addition to further improving the tax system that fosters economic growth and provides for more efficient tax collection and reduction of the informal economy, efforts will be focused especially on establishing more efficient public investment management, improving the project appraisal process and forming a single list of planned projects, linked to budget planning.

Marked progress has been achieved in infrastructural project implementation. Building on the fiscal results in the past three years, investment will be intensified in the coming period. Efforts will be made to enhance traffic safety by implementing new standards applicable on the European road network, as well as to introduce performance-based road maintenance management. Energy market reforms will be focused on diversifying energy sources and reducing import dependence. More emphasis will be placed on the implementation of energy efficiency measures in order to reduce the remarkably high energy intensity.

The conditions for the development of agriculture, a key sector of Serbia's economy, are favourable, albeit with increasingly frequent and, in terms of their impact, increasingly severe crises caused by natural factors (floods, drought, hail etc.). Agricultural development is further hindered by the unfavourable structure of agricultural holdings (fragmented holdings without adequate incentives for consolidation), technical and technological obsolescence, primarily among medium-sized and small holdings, as well as intensified pressure on farmers owing to the standards and regulations being tightened in the process of harmonisation with the EU common agricultural policy. Industrial growth in recent years has been achieved in an economically sound way, driven by investments and exports. On the other hand, manufacturing industry made the greatest contribution to growth, although its structure is still dominated by low-processed, low-value-added products. In that respect, in the coming period, the implementation of the defined measures to address obstacles to the development of the identified industrial sectors with the highest growth potential will be intensified, and special efforts will be made to link the industrial, educational, and research and development policies. In the services sector, the focus will be on raising the knowledge and skills levels and improving e-commerce; the

implementation of horizontal measures in other sectors will have an impact on enhancing the functioning of the service sector as well.

Major progress has been recorded in improving the business and macroeconomic environment and Serbia remains committed to its further improvement. Serbia has improved its credit rating and significantly improved its ranking according to the most renowned international competitiveness indices by implementing regulatory reforms to reduce the complexity and cost and to improve the predictability of doing business. Improvement of the legal framework in the area of financial services will be continued (higher availability of the existing funding sources to small and medium sized enterprises - SMEs and provision of new ones), along with enhancing the sustainability of public enterprises' operation, restricting the fiscal risk, and intensified inspection of the operations of unregistered entities and engaged labour force, with a view to integrating the informal economy into the legal sphere. Also, the implementation of regulatory reform ("regulatory guillotine") will be continued through the simplification of administrative procedures and improving public services for businesses, as well as the digitalisation of the real estate cadastre in order to simplify the procedure for the registration of title to property and reduce costs.

The high scientific and research potential should be developed further and utilised more adequately, in order for Serbia to become a "knowledge-based economy". An efficient model for funding science will be established, as well as a stronger link between the business and academic communities. Higher availability and implementation of digital technologies, products and services will be facilitated, as well as the standardisation of communication infrastructure. A key challenge is reversing the emigration of highly educated population ("brain drain") and attracting domestic and international talents.

For Serbia's full integration into the international economic system, it is necessary, amongst other things, to define measures aimed at modernising technological processes and introducing technical regulations and standards, which will facilitate a shift towards a higher share of *high-tech* products in total exports. Further alignment of the standardisation, metrology and accreditation systems with the EU legislation and practice will be continued.

In the Serbian economy, increasingly dependent on knowledge and skills, higher investment in education is a prerequisite for further human capital development. The introduction of the dual education model will facilitate greater application of the attained knowledge and skills matched with the business needs. Special efforts will be directed towards regulating the system of qualifications attained through education, as well as matching the labour force qualifications with the labour market needs.

In recent years, Serbia's labour market has recorded an expansion, with employment growth, a rise in activation and a decrease in unemployment. Strengthening the public employment service capacities and reforming the active labour market policies will sustain and improve the quality of human capital (loss of skills, self-confidence and motivation will be prevented). Dedicated Government programmes will increase the capacities in terms of IT skills. The implementation of measures to stimulate youth employment and registration of those employed outside the formal sector will be intensified.

The level of allocations for social assistance is consistent with Serbia's current development level; hence, the key challenge in the area of social and child protection is the adequate reallocation of these funds among the existing schemes to increase their accessibility. Given that poverty is widespread and affects different population groups, often affected by multiple deprivation factors, in the coming period more attention will be devoted to linking centres for social work (to one another and

to other institutions), developing social maps, providing higher-quality services, and strengthening control and regulatory mechanisms.

Based on the thus identified key obstacles in the field of competitiveness, structural reforms have been defined, as summarised in Section 2, and elaborated in detail in Section 3. Bearing in mind that the ERP is a rolling programme establishing a system for monitoring and reporting on the implementation of the structural reforms whose implementation requires a longer period, in this year's cycle of ERP drafting, the priorities have not changed substantially, i.e. the reforms presented within the ERP 2018-2020 are rolled over from the ERP 2017-2019, slightly amended in terms of the scope and objectives, and an additional reform to stimulate the improvement of the investment climate has been included.

The chosen structural reforms, which have undergone a broad public consultation process, are in line with the three-year plan of total budget expenditures set by the Budget Law, the priorities defined in national documents, as well as the limitations in public administration's human capacities in terms of the required staff number and quality for consistent and coordinated reform implementation. In particular, the recommendations of the Economic and Financial Dialogue between the EU and the Western Balkans and Turkey of May 2017, as well as the recommendations and findings set out in the European Commission's 2016 Progress Report on Serbia, have been taken into account.

## 2. STRUCTURAL REFORMS SUMMARY

SR No	Title of area and PSR	Recommendations <sup>33</sup>	Reference documents
<b>PUBLIC FINANCE MANAGEMENT</b>			
1	<b>Tax Administration transformation</b> <i>Additional simplification and unification of the tax procedure and better training of staff, as well as improvement of operational activities on combating the informal economy.</i>	ECOFIN 2017 R2 – Support the fiscal scenario by reinvigorating reforms of the Tax Administration. ECOFIN 2017 R5 – Put in place risk management systems in order to improve the functioning of the Tax Administration. ECOFIN 2016 R2 – Further improve revenue collection in a systematic and business-friendly way by implementing the Tax Administration Transformation Programme. PR 2016, p. 48. – Continue to implement the programme to transform the Tax Administration, especially by simplifying tax procedures and allocating sufficient human and IT resources, in order to improve tax collection and fight the informal economy.	Public Finance Management Reform Programme 2016-2020 Public Administration Reform Strategy of the Republic of Serbia Tax Administration Transformation Programme Action Plan of the Transformation Program 2018-2023
2	<b>Improved capital investment management</b> <i>Establishment of a single platform for capital investment planning and a methodology for capital investment analysis and planning.</i>	ECOFIN 2017 R4 – Expand the scope of the Single Project Pipeline to cover all large investment projects regardless of their source of funding and establish clear links to the budgetary process. ECOFIN 2016 R4 – Address the under-execution of public capital expenditure by improving its prioritisation and management.	Public Finance Management Reform Programme 2016-2020

<sup>33</sup> ECOFIN – Recommendations by the EU Economic and Financial Affairs Council for the Western Balkans and Turkey of May 2016 (R1 – Recommendation 1)

PR – The EC 2016 Progress Report on the Republic of Serbia (Progress Report 2016)

IMF – Stand-by Arrangement

SR No	Title of area and PSR	Recommendations <sup>33</sup>	Reference documents
<b>ENERGY AND TRANSPORT MARKET REFORM</b>			
3	<p><b>Energy market development coupled with energy infrastructure construction</b>  <i>Harmonisation of the technical rules and codes governing the operation of the electric power and gas networks and construction of missing interconnectors to achieve reliability and facilitate trade in energy products in the national and cross-border markets (includes Niš-Dimitrovgrad trunk gas pipeline construction and Trans-Balkan Corridor).</i></p>	<p>ECOFIN 2017 R4 – Gradually adjust electricity tariffs to reflect actual costs. Further improve payment collection and avoid future accumulation of arrears in the energy sector. Advance the announced restructuring of Srbijagas debt and the implementation of EPS's optimisation plan.          ECOFIN 2016 R4 – Make significant progress in the preparation of the construction of the Bulgaria-Serbia gas interconnector.          PR 2016, p. 46. – Improve alignment with the <i>acquis</i>, strengthen capacity and promote investment in energy efficiency and renewable energy as well as achieve cost-reflective electricity tariffs.          PR 2016, p. 46. – Take measures to fully unbundle Srbijagas and develop competition in the gas market.          IMF – Ensure competitiveness on the energy market, develop the electricity and natural gas markets and their connection with the EU single energy market, as well as more intensive regional interconnection of the energy system of the RS.</p>	<p>Energy Sector Development Strategy of the Republic of Serbia until 2025 with projections until 2030.          2017–2023 Programme for the Implementation of the Energy Sector Development Strategy of the Republic of Serbia until 2025 with projections until 2030          Berlin Process (<i>Connectivity agenda</i>)          Energy Law          Law Establishing Public Interest and Special Procedures for Expropriation and Obtaining of Documentation for the Purpose of Implementation of Construction of the Trans-Balkan Corridor 400 kV Power Transmission System          Law on the Spatial Plan of the Republic of Serbia from 2010 to 2020</p>
4	<p><b>Improving the capacity and quality of infrastructure and services in the area of transport</b>  <i>Aligning standards and norms, i.e. the national legislation, with the EU legislation, with the aim of enhancing competitiveness and attracting traffic flows to Serbian transport routes.</i></p>	<p>ECOFIN 2017 R4 – Expand the scope of the Single Project Pipeline to cover all large investment projects regardless of their source of funding and establish clear links to the budgetary process.</p>	<p>Plan for the Development of Railway, Road, Waterway, Air and Intermodal Transport in the Republic of Serbia from 2015 to 2020          Berlin Process (<i>Connectivity agenda</i>)</p>
5	<p><b>Reform of railways</b>  <i>Establishing sustainable railway enterprises with clearly set aims and tasks, which will operate in accordance with market principles; Improving and streamlining the railway network and services, and market opening in accordance with the EU legislation, European standards and practices.</i></p>	<p>PR 2016, p 44. – Continue its focus on reforming the railways.</p>	<p>Law on Public Enterprises          Railway Reform Plan 2016-2020</p>
<b>SECTORAL DEVELOPMENT</b>			
<i>Development of the agricultural sector</i>			

SR No	Title of area and PSR	Recommendations <sup>33</sup>	Reference documents
6	<b>Improvement of the competitiveness and status of agricultural holdings</b> <i>Establishing the institutional framework for the implementation of the IPARD Programme 2014-2020, implementing national reforms to improve the competitiveness of holdings.</i>	PR 2016, p. 42. – Take all necessary steps to fulfil the requirement in order to be entrusted with budget implementation tasks for the IPARD II programme, including allocating adequate resources and strengthening the capacity of all IPARD bodies and improving implementation procedures; adopt and proceed with implementation of the action plan for <i>acquis</i> alignment in agriculture and rural development.	Law on Agriculture and Rural Development Agriculture and Rural Development Strategy of the Republic of Serbia 2014-2024; National Agriculture Programme for the period 2018-2020 National Rural Development Programme 2018-2020
<b>Industry sector development</b>			
7	<b>Raising the competitiveness of the processing industry</b> <i>Prioritisation of industries with the highest growth and development potential, formulation of a new industrial development strategy, formulation and implementation of action plans for priority industries, development of monitoring and evaluation system.</i>	ECOFIN R5 – Improve the business environment and promote private investment. PR 2016, p. 52 – Make efforts to improve the predictability of the business environment and SME support schemes, with emphasis on reducing the cost of access to finance.	Industrial Development Strategy and Policy of the Republic of Serbia 2011-2020
<b>Development of the services sector</b>			
<b>BUSINESS ENVIRONMENT AND REDUCTION OF THE INFORMAL ECONOMY</b>			
8	<b>Package of measures to improve access to finance for SMEs</b> <i>Improving the quality of offer of the banking sector, developing new financial instruments, as well as improving the readiness of SMEs to access different sources of finance.</i>	ECOFIN 2017 R5 – Develop the regulatory framework for new financial instruments, and improve the access to finance. ECOFIN 2016 R5 – Putting in place a guarantee scheme for loans to SMEs. PR 2016, p. 31. – Better regulating and reducing the scope of para-fiscal charges, in particular for SMEs. PR 2016, p. 52. – Make efforts to improve the predictability of the business environment and SME support schemes, with emphasis on reducing the cost of access to finance.	Strategy for Support for the Development of Small and Medium-sized Enterprises, Entrepreneurship and Competitiveness for the Period of 2015-2020
9	<b>The introduction of corporate governance in public enterprises</b> <i>Professionalisation of governance bodies in public enterprises and a public enterprise operation control system.</i>	ECOFIN 2016 R2 – Continuing the organisational and financial the restructuring of large <sup>34</sup> public enterprises.	Law on Public Enterprises
10	<b>Simplification of procedures and other conditions for doing business</b> <i>Establishing a single public portal on administrative procedures and other requirements for doing business and a point of single contact (PSC) with information</i>	ECOFIN 2017 R5 – Regulate the amount and number of para-fiscal charges at state level. ECOFIN 2016 R2 – Advance the reform of the public administration as envisaged. ECOFIN 2016 R5 – Improve the business environment and promote private investment by developing a more transparent and less burdensome system of para-fiscal	Strategy for Support for the Development of Small and Medium-sized Enterprises, Entrepreneurship and Competitiveness for the Period of 2015-2020

<sup>34</sup> The reform is all-encompassing and targets all enterprises, not only large ones.

SR No	Title of area and PSR	Recommendations <sup>33</sup>	Reference documents
	<i>for service providers; Regulatory reform (“regulatory guillotine”) to simplify procedures and improve public services for businesses, with the aim of reducing the cost of doing business, improving the business environment and the legal framework for doing business.</i>	charges, putting in place a guarantee scheme for loans to SMEs and re-launching the “regulatory guillotine”.	Strategy for Regulatory Reform and Improvement of the Public Policy Management System 2016-2020 National Programme for Countering the Informal Economy
11	<b>Improving the effectiveness of inspection oversight</b> <i>Improving the coordination of inspectorates, legal regulation and establishment of the information system.</i>	ECOFIN 2017 R5 – Ensure better targeting and efficiency of inspections. ECOFIN 2016 R2 – Advance the reform of the public administration as envisaged. PR 2016, p. 40. – Reinforce the capacity and independence of inspectors.	Public Administration Reform Strategy of the Republic of Serbia E-government Strategy 2015-2018
12	<b>Improvement of the geospatial sector as support to investment decision-making process</b> <i>Providing support for investment decision-making by the effective provision of geospatial sector data, thus producing a stimulative effect on investment climate improvement.</i>		Strategy for Measures and Activities to Enhance Service Quality in the Area of Geospatial Data and Registration of Title to Real Property in Official State Records – The Republic Geodetic Authority Reform Pathway until 2020
<b>RESEARCH, DEVELOPMENT AND INNOVATION, AND DIGITAL ECONOMY</b>			
13	<b>Programme supporting innovation and technological development in the public and private sectors</b> <i>Support for innovation and technological projects in scientific and research organisations and the private sector; Establishing the technology transfer system.</i>	PR 2016, p. 74. – Adopt the action plan to implement the strategy, and the science and research infrastructure road-map; foster cooperation between industry and academia and increase the level of investment in research.	Scientific and Technological Development Strategy of the Republic of Serbia 2016-2020
14	<b>Development and improvement of the national broadband communications infrastructure</b> <i>Consolidation of the broadband network owned by the public sector; Connection of public institutions to the national network; Construction of broadband access networks in municipalities across the country.</i>		Strategy for Information Society Development in the Republic of Serbia until 2020 Electronic Communications Development Strategy of the Republic of Serbia 2010-2020
<b>TRADE-RELATED REFORMS</b>			
15	<b>Improving the conditions for product safety and removing barriers to trade</b> <i>Providing the conditions for marketing safe and high-quality products, as a key prerequisite for enhancing the competitiveness of Serbia's economy, exports and</i>	PR 2016, p. 33. – Further align sectoral legislation and ensure better implementation of technical requirements and standards. PR 2016, p. 33. – Reinforce its administrative capacity to perform market surveillance. PR 2016, p. 33. – Ensure adequate administrative and surveillance capacities in order to implement the European Regulation on Registration, Evaluation,	Quality Infrastructure System Improvement Strategy for the Period of 2015-2020

SR No	Title of area and PSR	Recommendations <sup>33</sup>	Reference documents
	<i>economic growth.</i>	Authorisation and Restriction of Chemicals (REACH). PR 2016, p. 79. – Strengthen implementing capacity for export controls on dual-use goods.	
<b>EDUCATION AND SKILLS</b>			
16	<b>Qualifications oriented to the labour market requirements</b> <i>Vocational secondary education reform by introducing a dual and entrepreneurial education model; Adoption of the Law on the NQF, establishment of the Register of Qualifications and sectoral councils, as well as qualification standards</i>	ECOFIN 2017 P6 – Develop dual learning in vocational education and training in close cooperation with social partners and the business community. PR 2016, p. 75. – Continue implementing the action plan of education reforms according to schedule. PR 2016, p. 75. – Establish the national Erasmus+ agency.	Strategy for Education Development until 2020
<b>EMPLOYMENT AND LABOUR MARKET</b>			
17	<b>Improving the effectiveness of active labour market policies with special emphasis on youth, redundant workers and the long-term unemployed</b> <i>Development of a system for early screening of the unemployed and their inclusion in active labour market policies (ALMPs) through a package of services, and according to labour market needs and characteristics of the unemployed person concerned.</i>	ECOFIN 2017 R6 – Target active labour market measures to vulnerable groups, including social assistance beneficiaries. ECOFIN 2016 R6 – Step up the provision of targeted ALMPs to facilitate in particular the reintegration of workers made redundant in the resolution of state-owned enterprises and public administration rightsizing. Increase the capacity of the NES to roll out such measures to larger numbers of beneficiaries. PR 2016, p. 50. – Ensure financial and institutional resources for employment to more systematically target young and long-term unemployed persons. PR 2016, p. 51. – Significantly strengthen bipartite and tripartite social dialogue at all levels, including consultations on draft legislation. PR 2016, p. 51. – The Labour Inspectorate’s administrative capacity needs to be further strengthened, in order to support the implementation of the national programme for fighting the informal economy.	National Employment Strategy for the Period of 2011-2020 Annual National Employment Action Plans Employment and Social Reform Programme – ESRP
<b>SOCIAL INCLUSION, POVERTY REDUCTION AND EQUAL OPPORTUNITIES</b>			
18	<b>Improving the adequacy, quality and targeting of social protection</b> <i>Increasing the adequacy of cash benefits and improving the accessibility and quality of social protection services, as well as linking different sectors’ information systems.</i>	PR 2016, p. 50. – Ensure financial and institutional resources for social policy to more systematically target young and long-term unemployed persons. PR 2016, p. 50. – Increase the efficiency of social benefits for people below the poverty threshold. PR 2016, p. 62. – A sustainable institutional set-up for promoting gender equality (with adequate resources) is needed.	Law on Social Protection Employment and Social Reform Programme – ESRP

### 3. ANALYSIS BY AREA AND STRUCTURAL REFORMS

#### 3.1 Area PUBLIC FINANCE MANAGEMENT

##### a) Analysis of main obstacles

*Despite the tax revenue growth trend due to the more efficient and organised operation of inspection authorities and the Tax Administration (TA), challenges to public finance regulation still persist: reduction of the informal economy, more functional Tax Administration, more efficient public investment management, increasing capital expenditure at the local level, investment climate improvement.*

The key factor in the process of increasing budget revenue and improving public finance management is the ongoing TA reform. Through the inspections of businesses' operations in 2016, **3,656 unregistered entities were detected** (a total of 245,392 inspections were carried out). An important aspect of the reform is digital business; thus, by May 2017, **15 tax returns**, out of the planned 19, were provided **in the electronic form**.

**Significant results were achieved in the recent period in the area of reducing the informal economy**, as witnessed by the increased budget revenue. **The total government tax revenue rose by 5.4% in real terms in first eleven months in 2017** relative to the preceding year (by more than EUR 1 billion), primarily due to income tax collection increase (by EUR 233 million; real increase by 35%) VAT (by EUR 205 million; real increase by 3%) and excise duties (by EUR 120 million; real increase by 3%). **VAT evasion was reduced**, as indicated by the rise in the VAT revenue collection efficiency ratio<sup>35</sup> from 70% in 2015 to 75% in 2016, as well as a 33.8% rise in the recording of transactions via fiscal cash registers by small taxpayers in Q1 2017. However, the **high share of the informal economy** still persists, estimated at about 30% of the GDP.

**Although public investments are on the increase in Serbia, the achieved level of 3.3% of the GDP in 2016 is still insufficient**, given that the average share of investments in CEE countries stands at about 4.5% of the GDP (in the countries in the region<sup>36</sup>, it is even higher, at about 4.8%). **The realisation rate of capital investments planned by programmes rose** from 40% in 2015 to 76% in 2017, and a prerequisite for its further increase was provided by the adoption of the *Decree on the Content, Modality of Preparation and Assessment, and Monitoring of and Reporting on the Implementation of Capital Projects* (OG 63/2017). The implementation of this Decree from 1 January 2018 will address the existing shortcomings, reflected in the absence of adequate project documentation, difficulties in land expropriation, insufficient control of contractors, resulting not only in missing the contractual deadlines, but also in rises in the cost of works during implementation and slow issuing of the required permits. **At the local level**, poor financial management is reflected in a large decrease in the share of capital expenditure (from 22.8% of total expenditure in 2011 to 14.5% in 2016) and a rise in the share of current expenditure (especially expenditure on employees) in total local government expenditure, which has an adverse impact on the quality and availability of local infrastructure.

It is essential to continue implementing the measures to **improve the investment climate**, such as enhancing judicial efficiency, accelerating the issuing of permits, along with removing other administrative barriers to investment, improving competition protection, reducing corruption etc.

<sup>35</sup> Fiscal Council of Serbia, March 2017; C-efficiency ratio – computed as the ratio of the VAT amount actually collected to the hypothetical VAT amount assuming perfect collection. A higher value of this ratio indicates higher tax collection and lower scale of VAT evasion.

<sup>36</sup> Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Hungary, Macedonia, Montenegro and Romania; source: Fiscal Council of Serbia.

## **b) Report on policy guidance implementation since May 2017**

The realisation of *Structural Reform (SR) 1 – Tax Administration transformation* implements part of ECOFIN recommendation 2 – (*support the fiscal scenario by reinvigorating reforms of the Tax Administration*), as well as part of recommendation 5 – (*put in place risk management systems in order to improve the functioning of the Tax Administration*). The application of the detailed reform plan has led to the integration and simplification of tax procedures, as well as the improvement of the operational activities in suppressing informal economy which contributes to the reduction of costs in fulfilling tax obligations, provides easier and more equitable business conditions and improving tax collection which is also in line with the European Commission recommendations (*2016 EC Progress Report on Serbia, p. 55*). The 2017 Tax Compliance Plan was drafted based on the tax compliance risk map, IMF advice and TADAT (Tax Administration Diagnosis Assessment Tool) recommendations. In the context of improving services to taxpayers, new electronic tax returns and services have been continuously introduced so that in 2018 the electronic submission of tax returns for basic tax forms was fully enabled. A specific department for providing services to taxpayers, which applies the client approach in dealing with taxpayers, has been established.

With the Conclusion of the Government of the Republic of Serbia on 5 December 2017, the Action Plan of the Transformation Program for the period 2018-2023 was adopted, as well as the Decision on basic and secondary activities of the Tax Administration, by which the tax administration focuses on the basic tax activities and the first phase of consolidation of the organizational units.

The realisation of *SR 2 – Improved capital investment management* implements part of ECOFIN recommendation 4 (*expand the scope of the Single Project Pipeline to cover all large investment projects regardless of their source of funding and establish clear links to the budgetary process*). In June 2017, the RS Government adopted the Decree on the Content, Modality of Preparation and Assessment, and Monitoring of and Reporting on the Implementation of Capital Projects in order to provide for the evaluation of all positive and negative effects of those projects and ensure the effective and efficient management of public funds.

### **Structural reform 1. TAX ADMINISTRATION TRANSFORMATION**

#### **1. Structural reform outline**

The reform entails further simplification and unification of the tax procedure, training of TA staff, as well as improvement of operational activities to suppress the informal economy. The reform includes the development of a tax compliance plan and a plan for quality staff retention, adoption of a new organisational structure (consolidation of core business functions in fewer locations and differentiation between core tax revenue collection and administration of non-core tasks), redesigning of the human resources management system, establishment of a new risk management system, improvement of the audit and collection functions and tax law-related affairs, as well as more efficient management of material and IT resources. The measures are carried out in accordance with the Tax Administration Transformation Programme 2015-2020 through the Action Plan of the Transformation Programme for the period 2018-2023 (the time frame for the realization of the Programme has been updated), the Public Finance Management Reform Programme 2016-2020 and the Public Administration Reform Strategy of the Republic of Serbia.

#### **2. Activities conducted and planned with a view to structural reform implementation**

Tax Administration management has been improved by forming three committees (on operational affairs, on Transformation Programme management, and on risk management under the tax compliance plan) and by identifying non-core activities to be either transferred to other institutions or managed separately from the core TA functions from June 2019. The establishment of the Division for Strategic Risks marked the launch of the new risk management system under the tax compliance plan

(according to the OECD model), and the Tax Compliance Plan for 2017 was developed. The selection of taxpayers to be audited is based on the inputs from the Division for Strategic Risks and the Division for Operational Risks, and desk and field audits are combined in a single tax audit. The Human Resources Strategy was adopted in February 2016 (however, this was not accompanied by the implementation of human resources management software). The Concept for the Establishment of the Tax Academy is being developed. The business process of financial and inventory accounting has been upgraded and redesigned by implementing new software. Electronic tax returns system is introduced for all core tax types. The client approach in dealing with taxpayers is applied through the newly-established Department for Providing Services to Taxpayers and the “Your Tax Officer” desks (in 37 branch offices).

*The following has been planned for the next three-year period:* administration of core taxes in fewer organisational units and transferring non-core activities; identification of organisational units in the first stage of consolidating the core functions; preparatory activities and development of documents for the implementation of the activities to be funded under a World Bank project; provision of resources for the restructuring of the Headquarters; centralisation of the key function of administration of core taxes, such as collection and submission of tax returns, in one or multiple offices in the field.

### **3. Expected impact on competitiveness**

Beside reducing the costs of tax compliance (easier and more equitable conditions for doing business) and improving tax collection (stability of public finance), by introducing automatic/electronic, simple and free-of-charge tax procedures, the administration of tax compliance leaves more resources and time for domestic enterprises to improve the quality of their products and services, which constitute a measure of competitiveness.

### **4. Estimated costs and impact on budget**

Funds were provided in the amount of EUR 5.6 million based on the 2018 Budget Law. After considering the need for the funds necessary for the implementation of the Economic Reform Program for 2019 and 2020, the Tax Administration will plan the same within the limits of the budgetary funds that the Ministry of Finance will provide during the preparation of financial plan proposal for 2019 and 2020.

### **5. Expected impact on employment and gender**

Improving TA efficiency will make the process of assessing and paying taxes simpler, more predictable, more consistent and cheaper, thus improving the equality of market participants. Clear tax rules encourage citizens to start their own businesses and thus increase employment and the overall economic growth. Better collection of taxes improves the capacity to make budget allocations for social protection, education and health.

### **6. Potential risks in structural reform implementation**

Lack of support by donors and creditors for the implementation of the launched activities; Delays in the introduction of new legal frameworks based on ICT and TA reform needs or non-acceptance of amendments to existing ones; Lack of coordination/communication among state institutions; Distrust among taxpayers owing to fear of novelties; Insufficient IT resources and skills for reform implementation; Lack of human resources and knowledge needed for the functioning of the new, reformed TA.

### **7. Structural reform implementation monitoring indicators**

	2015/2014 (BV)	2016/2015
Ratio of newly registered taxpayers in two consecutive years – TV: 92.48 (2018/2017)	112.9	106.46

Ratio of newly identified revenue <sup>37</sup> in two consecutive years – TV: 100.5 (2018/2017)	100.6	87.93
Collection rate relative to the target level <sup>38</sup> – TV: 100.3 (2018/2017)	103.9	107.1

## **Structural reform 2. IMPROVED CAPITAL INVESTMENT MANAGEMENT**

### **1. Structural reform outline**

The reform entails the establishment of a single platform for capital investment planning and a methodology for capital investment analysis and planning. All potential projects must be linked to sectoral strategies and subjected to a cost-benefit analysis beforehand for the purpose of their prioritisation. Public investment planning includes: assessment of capital projects proposed by budget beneficiaries and development of the implementation plan, coordination of planning and selection of capital projects/investments and, finally, monitoring of the implementation of approved capital projects in order to detect and remove obstacles in a timely manner and manage risks more efficiently. Capital project management is covered by the Public Finance Management Reform Programme 2016-2020 as part of the reform activities under Pillar II “Public Expenditure Planning and Budgeting”. The process will also take into account the activities under the National Investment Committee (NIC) established in Serbia in 2014.

### **2. Activities conducted and planned with a view to structural reform implementation**

The Decree on the Content, Modality of Preparation and Assessment, and Monitoring of and Reporting on the Implementation of Capital Projects was adopted in June 2017 and will be applicable as of January 2018.

*The following has been planned for the next three-year period:* adoption of the rulebook for the implementation of the Decree; development of the terms of reference and procurement of the IT equipment for the establishment of a single database of capital projects; implementation and updating of the single database of capital projects; training of budget beneficiaries in applying the Decree and using the database of capital projects; assessment and selection of capital projects.

### **3. Expected impact on competitiveness**

Improving management and raising the realisation rate of capital/public investments is an anti-recession and development-oriented economic policy measure with positive effects on economic growth in the short term. In addition to direct effects on employment and growth resulting from capital projects construction itself, quality improvement of the physical capital, especially road and communication infrastructure, raises the competitiveness of the domestic economy and creates prerequisites for its faster growth. Public investments also have a long-term favourable impact on economic growth, as they raise the quality of the infrastructure used by the public sector.

### **4. Estimated costs and effects on budget**

The reform is financed from the regular budget expenditures of the Ministry of Finance. Funds were provided in the amount of EUR 161,626 in 2018 through the non-budgetary financing of the reform, and it will be used for the establishment of the Integrated Capital Funds Database (an information system established at the ministry in charge of finance and serves as a support to the capital projects management in the territory of the Republic of Serbia).

### **5. Expected impact on employment and gender**

<sup>37</sup> Tax revenues collected on the basis of audits by tax inspectors.

<sup>38</sup> Shows the ratio of the key budget revenues collection in a given year (personal and corporate income tax, VAT and excise duties) relative to the budgeted amounts.

Improved capital investment management has a direct impact on increasing investment, which results in raising employment in the short, medium and long term, both during capital project implementation and in service. In addition, the measure has an equally positive impact on the employment of both sexes.

#### 6. Potential risks in structural reform implementation

Insufficient human resources for project cost-benefit analyses, assessment and prioritisation of proposed projects and investment project management. It is necessary to improve the human resources management system and provide continuous training to employees.

#### 7. Structural reform implementation monitoring indicators

	2015 (BV)	2016	2017
Implementation rate of planned investment within programmes – TV: 80% (2020)	40%	65%	76%

### 3.2 Area ENERGY AND TRANSPORT MARKET REFORM

#### a) Analysis of main obstacles

*Marked progress has been achieved in priority infrastructural project implementation; however, there is a shortage of human and financial resources necessary for the implementation of efficient energy and transport market reform. Key weaknesses are manifested in insufficient linkages between these markets of Serbia and the markets of the countries in the region, insufficient diversification of energy sources and import dependence, underdeveloped infrastructure as a result of long-standing lack of investment in new capacities, high transport costs owing to the unharmonised regulatory framework.*

**The legal and regulatory framework in Serbia is aligned with the Third EU Energy Package,** which is a prerequisite for the interoperability of CEE and EU energy systems. Progress has been achieved in the implementation of a liberalisation programme to restrict regulation to the key networks which are natural monopolies and enable competition in energy services delivered via networks. The existing state-owned vertically integrated enterprises are unbundled and new market participants are encouraged to enter the energy sector. It is necessary to continue the restructuring of public enterprises in the energy and mining sector and create conditions to attract strategic partners.

**Faster energy market development and regional integration are limited by inefficient generation capacities (average age over 35 years) and underdevelopment of the electric power system,** as a consequence of long-term lack of investments in new generation capacities and insufficient investment in preventive system protection and system development. The demand for electric power and gas is on the increase, especially in the industry. The Energy Sector Development Strategy until 2025 projects electricity consumption growth at the average rate of about 1% per year, underpinned by increasing the capacity of the existing infrastructure and building new power plants. The construction of a new 350 MW coal-fired unit in Kostolac Thermal Power Plant (TPP), a new 140 MW gas-fired unit in Pančevo and wind farms with a total capacity of 500 MW, compliant with all the environmental criteria, will serve the purpose of meeting the increased demand for electricity.

**Serbia is a net electricity importer only in the winter, with up to 10% of the demand met by imports at the monthly level.** The energy supply level of Serbia is above the average in the region. In 2016, the total primary energy generation amounted to 10.917 m Tonnes of Oil Equivalent (hereinafter: TOE) – which is about twice the average for the countries in the region, while energy import of 5.961 m TOE was somewhat below the regional average. The energy intensity of Serbia (total electricity generation relative to the GDP level) is, along with Bulgaria, the highest in the region, while the final energy consumption (excluding non-energy consumption) of 8.307 m TOE in 2016 was

about 50% above the regional average. The construction of **Trans-Balkan Corridor**, a 400 kV power transmission system that will link eastern and western European markets, will contribute to improving energy stability and regional integration of the Serbian electric power industry and further development of the electricity market.

**The implementation of energy efficiency measures should be a higher priority, given the extremely high energy intensity (high electricity consumption in the public sector and households, primarily due to heating) and development opportunities at the local level.** It is necessary to provide more resources and human capacities for the operation of the Budget Fund for Energy Efficiency Improvement and/or consider the modalities of changing its legal status to facilitate the application of more energy efficiency funding mechanisms. It is necessary to introduce an energy management system in the private and public sectors, which should encompass about 70% of the primary energy consumption. In the coming period, it is necessary to further align the legislation with the requirements of directives in the area of energy efficiency. In a situation of insufficient sustainable energy sources utilisation, energy facilities with high GHG emissions have an adverse impact on the environment and human health. The construction of wind farms with a total capacity of 500 MW (deadline – end 2019) and other RES facilities will contribute to raising the share of RES in the gross final energy consumption to 27% in 2020.

**The electricity price needs to be set at a level that reflects the costs of regulated activities (network charges), as well as market prices for electricity.** For households, the electricity price in Serbia is at least 30% below the price in any other South-East European country. An adequate long-term policy on regulated prices, predictable for both customers and investors, is essential for the sustainable development of energy systems. The electricity price increase in 2017 was a step towards raising the wholesale price to the market level and distribution and transmission prices to a justified level. Reaching a cost-reflective electricity price is another element that can contribute to raising energy efficiency in the Republic of Serbia (*2016 EC Progress Report on Serbia, pp. 54 and 55*).

**The gas infrastructure is characterised by the linear natural gas transport system with only one inlet into the country** (Hungary), which is unfavourable from the aspect of energy security and market development. It is necessary to provide gas interconnection with adjacent countries, which would open up the possibility of supplying natural gas from other supply routes as well, first of all from the direction of Bulgaria. **The Bulgaria-Serbia gas interconnection project** facilitates the diversification of Serbia's gas supply and also contributes to gas supply security for all of Europe. The Bulgaria-Serbia gas interconnector is expected to become operational towards the end of 2022.

**The domestic natural gas market is small in size and has been fully open since 2015.** All natural gas end buyers are entitled to freely choose their supplier in the market; however, for the purpose of ensuring security of supply, all facilities of end consumers from the household and small buyers category which are connected to the natural gas distribution system are entitled to public supply at regulated prices, unless they choose another supplier.

**For an efficient energy market reform, it is essential to build institutional capacities,** which are characterised by a shortage of human and financial resources, and the need for these resources will probably be intensified owing to the EU's dynamic energy policy and the consequential expansion of the relevant administrative institutions' competences.

**Serbia's road network is not fully constructed in terms of technical and operational performance, and a large portion of road sections is in a poor condition owing to insufficient allocations for road maintenance.** The *construction of large infrastructure projects is under way, in line with national and regional priorities* (Corridor 10, Šumadija Corridor and Route 4: Belgrade – South Adriatic), as is the *implementation of the national road network rehabilitation programme* and

safety improvement on about 5,000 km of national roads. The road toll rate increase from 2017 (the rate had not been changed since 2008) will secure more funding for adequate road maintenance.

**The existing non-physical, regulatory barriers and procedural limitations at border crossing points and along transport corridors increase transport costs and reduce reliability in doing business with partners in the region.** The progress achieved by Serbia can be monitored through the implementation of computerised customs systems (NCTS), systematic electronic exchange of data (SEED) and simplification of a number of procedures for border crossing points. Nevertheless, a range of problems persist: lengthy and costly inspections, inefficiency in customs officers' coordination, and insufficient railway interoperability at railway border crossing points.

**The obsolete railway network enables quite modest passenger and freight traffic** and most of its sections are in need of modernisation. Serbia has 3,739 km of railway network, out of which 1,546 km have been electrified (not including side tracks). Over 55% of the railway network is over 100 years old (in 2017, by Government decision, public passenger and freight transport was suspended on part of the railway infrastructure totalling 1,099.7 km in length), and train speeds exceed 100 km/h on only 3.6% of the network. However, the passenger transport volume of 438 million passenger kilometres and the freight transport volume of 3.08 billion freight kilometres are trailing behind the region (data for 2016). Railway infrastructure projects concerning Corridor 10 are especially important for railway network modernisation.

**Access to railway infrastructure has been enabled for all railway carriers** if registered in Serbia, and the first contract between the infrastructure manager and a private operator was signed in June 2016. Two state-owned and two private railway carriers currently operate on the public railway network. Beside projects to improve infrastructure capacities, public enterprise reform is also important for the improvement of the railway network and the overall railway transport service (*2016 EC Progress Report on Serbia, p. 51*).

**Serbia has launched a unified database in the field of road safety**, containing data on traffic accidents (collected by the MoI from 2016 in accordance with CADAS – Common Accident Data Set – requirements), traffic safety indicators etc. All data from the unified database are publicly available through the Road Traffic Safety Agency's web applications, except the data whose publication is prohibited by law. Non-modernised and dilapidated road infrastructure and increase in road traffic volume have an impact on traffic safety decline (a relatively high number of fatalities – 607 in 2016). Serbia needs to further improve road traffic safety by taking measures to reduce fatalities and to adopt regulations on intelligent transport systems (*2016 EC Progress Report on Serbia, p. 51*).

**Intelligent transport systems (ITS) are not developed in Serbia**, with the exception of the River Information System (RIS) implemented on the Danube and the Sava. A framework for introducing an ITS for road and railway transport has been defined as part of the process of designing the Transport Strategy 2016-2025, supported by the WBIF (EUR 1.9 m) with a view to preparing a national strategy for ITS development and use, accompanied by an action plan.

The underdevelopment of port infrastructure and outdated port superstructure have a negative impact on the efficiency and speed of transshipment in Serbian ports, which causes a significant loss of time for the owners of goods (especially exporters of agricultural products) and ship-owners, as well as a negative effect on the competitiveness of Serbian goods on the foreign market. The share of water transport in regard to road and rail transport has been increasing in the last few years. In this regard, in 2014, the traffic volume on inland waterways of the Republic of Serbia (import, export and transit) amounted to about 7.5 million tonnes of cargo, in 2016, to about 9.8 million tons, while about 10.2 million tons were transported in 2017. These amounts of cargo put the Republic of Serbia in the third place among the European countries in relation to volume of goods

transport on Danube, immediately behind Romania and Austria. In the period from 2018 to 2022, the implementation of several projects in the field of inland waterway transport is expected (construction of ports, arrangement of critical sectors on Danube and Sava waterways, reconstruction of Djerdap 1 and Djerdap 2 shipping vessels, removal of the sunken fleet from the Second World War near Prahova, as well as several ITS projects in this branch of traffic) totalling about EUR 200 m, which will be financed partly by the Framework Loan for the Development of River Transport Infrastructure, whose conclusion with the EIB is expected in 2018, and partly from grant funds from available European funds (IPA, WBIF, CEF, etc.).

**Underdevelopment and insufficient safety of inland waterway transport** reduces the utilisation of the economically advantageous potential of this mode of transport in Serbia. **In the past few years, the share of waterway transport has recorded a decline relative to road transport.** The overall traffic volume on inland waterways in Serbia varies from one year to another, depending on hydrometeorological and other conditions for navigation (it amounted to 10 m tonnes in 2016, which corresponds to the average for other countries in the region).

**Serbia currently has no modern terminals for transloading containers from one mode of transport to another.** The problem of suboptimal use of various modes of transport is pronounced; it will be partly resolved through the project for the construction of the first modern intermodal terminal in Batajnica, as part of the logistic centre in Belgrade.

#### **b) Report on policy guidance implementation since May 2017**

The realisation of *SR 3 – Energy market development coupled with energy infrastructure construction* implements part of ECOFIN recommendation 4 (*gradually adjust electricity tariffs to reflect actual costs; further improve payment collection and avoid future accumulation of arrears in the energy sector*). In 2015, 2016 and 2017, the Energy Agency approved electricity price adjustments for public supply (4.5% in August 2015, 3.8% in October 2016, and 2% in October 2017). An increase in electricity prices in 2017 was carried out on the basis of the EPS analysis for determining the level of the necessary increase in the price for guaranteed supplies made in cooperation with the World Bank and the approval of the Energy Agency of the Republic of Serbia. Increase in prices for the period 2018-2020 will be determined after the new analyzes have been carried out. Continuous activities are carried out in order to increase the collection rate in PE EPS (in the period January - November 2017, the collection rate stood at 98.7%, compared to 93.7% in the corresponding period of 2016).

### **Structural reform 3. ENERGY MARKET DEVELOPMENT COUPLED WITH ENERGY INFRASTRUCTURE CONSTRUCTION**

#### **1. Structural reform outline**

The reform entails the harmonisation of technical rules and codes governing the operation of the electric power and gas networks and construction of missing interconnectors to achieve reliability and facilitate trade in energy products in the national and cross-border markets. The construction of the Niš-Dimitrovgrad trunk gas pipeline, 108 km in length, will provide the diversification of supply routes and sources, as well as improved security of supply for Serbia, Bulgaria and the entire region. The introduction of new gas pipelines in Serbia is planned by the Energy Sector Development Strategy of the Republic of Serbia until 2025 with projections until 2030 and the Law on the Spatial Plan of the Republic of Serbia from 2010 to 2020. The construction of the long-distance power transmission lines and extension of the substations (SS) within the Trans-Balkan Corridor will increase the cross-border transmission capacities and raise the security of electricity supply to end customers in Serbia. The strategic and legal framework that supports the construction of the corridor includes the Law Establishing Public Interest and Special Procedures for Expropriation and Obtaining of Documentation for the Purpose of Implementation of Construction of the Trans-Balkan Corridor 400 kV Power

Transmission System – the first phase; the Energy Sector Development Strategy of the Republic of Serbia until 2025 with projections until 2030; and the 2017-2023 Programme for the Implementation of the Energy Sector Development Strategy of the Republic of Serbia until 2025 with projections until 2030.

## 2. Activities conducted with a view to structural reform implementation

A **Memorandum of Understanding** has been signed, expanding the **Central and South-Eastern European Gas Connectivity** (CESEC) initiative to include the following areas: electricity market, energy efficiency and renewable energy sources. The Memorandum identifies several projects in which the Republic of Serbia is involved: Italy-Montenegro-Serbia electricity market coupling; coupling of Serbia's electricity market with those of the Czech Republic, Slovakia, Hungary and Romania (4MMC); Romania-Serbia interconnection; Trans-Balkan Corridor – new double-circuit 400 kV interconnector between Bulgaria and Serbia, including stepping up the network voltage level in central Serbia.

**A functioning spot market for electricity, i.e. the day-ahead market was established in 2016** as a joint venture of the Serbian transmission system operator AD EMS and the European electricity exchange EPEX SPOT. In the long run, this approach enables the integration of the national organised market into the existing European coupling initiatives such as 4MMC and PCR (Price Coupling of Regions), which cover about 85% of European energy consumption. In this respect, to date, SEEPEX and AD EMS have:

- analysed the prerequisites for launching the project on coupling the day-ahead electricity markets of the Republic of Serbia and 4MMC;
- joined the AIMS working group and prepared the terms of reference for the provision of prerequisites for coupling the day-ahead electricity markets of Albania, Italy, Montenegro and Serbia;
- launched the initiative with Bulgarian stakeholders, IBEX and ESO EAD, for a feasibility analysis of coupling the day-ahead electricity markets of Bulgaria and Serbia.

**Niš-Dimitrovgrad trunk gas pipeline:** The Special Purpose Area Spatial Plan for the infrastructure corridor, with detailed regulation elements, has been adopted and public interest has been declared. The resolution of property-related legal affairs is under way, as is the public procurement process for exploratory works.

**Trans-Balkan Corridor – first phase:** *Section 1:* All works on the construction of the Pančevo 2 - Romanian border double-circuit 400 kV transmission line have been completed. Pančevo 2 - Romanian border double-circuit 400 kV has been put into operation (standing idle) from SS Pančevo 2 to Romanian border on 21 December 2017. *Section 2:* The technical inspection of the designs for construction permit for the transmission line is in progress. The building permit application (referring only to the transmission line) was submitted on November 20, 2017. It is expected that the license will be issued in early 2018. The building permit was obtained for the upgrade of SS Kraljevo 3. The decision approving the performance of works to equip one bay in SS Kragujevac 2. The procedure for the selection of a bank consultant to participate in project implementation is in progress. *Sections 3:* Adapting of the existing technical documentation to the requirements of the national legislation (conceptual solution, feasibility study with the conceptual project, Environmental Impact Study) was completed in December 2017. As for the second phase (a project for a building permit and a project to run), the funds have been approved by the WBIF donation, but are not yet available. After the adoption for the Spatial Plan for the Spatial Purpose Area, the designer will deliver the updated technical documentation and the preliminary design will then be submitted to the expert control of the audit committee. *Section 4:* The Government of the Republic of Serbia has adopted the Spatial Plan for the Spatial Purpose Area in November 2017. Funds for missing technical documentation have been

approved by the WBIF donation but are not yet available. *Section 4:* The Government of the RS adopted the Special Purpose Area Spatial Plan in November 2017. The application to WBIF for a loan and a grant for construction has been renewed, but still not available.

*The following activities are planned to be implemented in the forthcoming three-year period:*

**Niš-Dimitrovgrad trunk gas pipeline:** Performance of exploratory works, development of the outline design, preliminary design, design for construction permit, environmental impact assessment study. The following is also expected: obtaining the location requirements, energy permit, approval of the revision commission, resolution of property-related legal affairs, development of the detailed design, development of the tender documentation, obtaining the construction permit, tender procedure and launch of the construction.

**Trans-Balkan Corridor – first phase:** Launch of the works on Section 2 (Kragujevac 2 – Kraljevo 3 400 kV transmission line), development of the urban/spatial plan for the Bajina Bašta – Obrenovac transmission line, preparation of technical documentation for the Bajina Bašta – Višegrad – Pljevlja transmission line. Launch of the reconstruction of the Kraljevo 3 SS, required to install the new Kragujevac-Kraljevo transmission line.

### 3. Expected impact on competitiveness

Energy infrastructure development is a prerequisite for energy market development, both within the Republic of Serbia and at the regional level, and therefore also for competition development in the area of energy and freedom of choice for customers with regard to energy supply. By building the Niš-Dimitrovgrad trunk gas pipeline, the number of interconnections with neighbouring countries will increase from 2 to 3, the number of incoming interconnections – from 1 to 2, and the technical capacity of incoming interconnections – from 5.238 bcm to 7.038 bcm. The Trans-Balkan Corridor project – first phase will enable coupling the markets of North-East Europe (where the electricity price is relatively low) with the markets of Southern and Western Europe (where the electricity price is relatively high), which will directly strengthen economic competitiveness and attract investments.

### 4. Estimated expenditures and impact on budget

**Niš – Dimitrovgrad trunk gas pipeline:** The Budget Law for 2018 provided funds in the amount of up to EUR 7,355,600 for the settlement of property relations on the trunk gas pipeline route. For drafting project technical documentation, licensing and investigation, it is planned that Public Enterprise Srbijagas allocates its own funds, namely: EUR 4.7 million in 2018 and EUR 450,000 in 2019. The project will be financed also through IPA support 2017, in the amount of EUR 49.6 m, with national co-financing supported by credit funds of EUR 25.6 m.

**Trans-Balkan Corridor, first phase:** financing of all sections does not have an impact on the RS budget. The total estimated value of all sections is EUR 163 million, and the total length of the planned 400 kV transmission line is 323 km. Section 1 (double transmission line 2x400 kV between Serbia and Romania) is fully funded by Joint Stock Company Elektromreža Srbije (EMS). The total investment value of Section 2 is 29.6 mil. EUR (EUR 16 million for the construction of the transmission line and EUR 13.6 million for works in the Kragujevac Substation 2 and on the increase of the voltage level in Kraljevo Substation 3). Out of which, EUR 15 million is financed from KfW bank loan, EUR 6.5 m is a WBIF donation, and the rest of EUR 8.1 million will be financed from EMS own funds. Estimated value for Sections 3 and 4 is around EUR 107.5 million. A loan application (63.9%) and a donation (25%) were submitted, and the rest are EMS own funds.

### 5. Expected impact on employment and gender

Direct impact on employment is reflected in additional hiring in jobs related to the management and maintenance of the built trunk gas pipeline. According to estimates, it will be necessary to hire about 350 workers temporarily during the construction itself, and after commissioning, about 20 people will be needed for the maintenance of 323 km of the transmission line. The reform has no impact on

gender.

## 6. Potential risks in structural reform implementation

Complexity of investment procedures; possible problems in resolving property-related legal issues; high-voltage power lines and gas pipelines being unacceptable to the local population; ensuring the necessary funds. A mitigation measure is the application for financial support from donor funds.

## 7. Structural reform implementation monitoring indicators

	2015 (BV)	2016	2017
% of construction of the trunk gas pipeline – TV 100% (2020)	0	0	0
No of kilometres of constructed power lines at the annual level (km) – TV 323 km (2023)	/	0	68
Increase in the capacity of the regional transmission grid (MW) – TV 1,000 MW (2023)	/	0	0

## **Structural reform 4. IMPROVING THE CAPACITY AND QUALITY OF INFRASTRUCTURE AND SERVICES IN THE AREA OF TRANSPORT**

### 1. Structural reform outline

The reform entails the development of new regulations to contribute to enhancing road infrastructure safety by introducing new standards that are required to be met by transport routes within the TENT network. The Draft Law on Roads has been prepared; it will, inter alia, impose new requirements on the road operator with regard to EU legislation on tunnels over 500 m in length, audits, road infrastructure safety checks and other tools for improving road safety (introduction of ITS, e-toll collection). The introduction of a new arrangement – performance-based road maintenance improves the road maintenance system.

In 2017 a reform of the road sector in the Republic of Serbia was initiated in cooperation of the Ministry of Construction, Transport and Infrastructure with the World Bank. The project is being implemented under the Loan Agreement (Corridor 10 Highway Project) with the WB, through which the Republic of Serbia undertook the obligation to carry out the reform of the road sector and the public enterprise "Roads of Serbia". Through the Component 4 of the Loan "Assistance in Implementation and Institutional Support", funds for technical assistance in implementing the reform of the road sector have been provided.

### 2. Activities conducted and planned with a view to structural reform implementation

The introduction of an electronic toll collection system, based on the short-range microwave technology (DSRC – *Dedicated Short Range Communication*), on the motorways of the Republic of Serbia has been in progress since 2006 continuously. The introduction of the option of toll payment by means of TAG devices has considerably reduced the waiting time at toll stations and enabled users to pass through toll gates without stopping. Toll is charged per kilometre travelled (with the exception of 2 sections – Niš-Preševo and Ljig-Preljina). The introduction and development of a performance-based road maintenance system in Serbia (PBMC – *Performance Based Maintenance Contract*) was launched by conducting a public procurement procedure for roadside weather stations (18 new and 6 existing ones). New tunnels over 500 m in length are built in accordance with terms that the tunnel must fulfil from the aspect of traffic safety, according to the EU regulations.

On Corridor 10: the tunnels Bancarevo, Progon, Pržojna, Padina, Sopot and Sarlah have been completed, and the public procurement procedure for tunnel fittings for Bancarevo, Sopot and Sarlah is in progress; 56 km from a total of 87km have been commissioned on the eastern leg towards Bulgaria; the Prosek-Bancarevo section, 9.4 km in length, has been completed; 40 km from a total of 74km have

been completed on the southern leg towards Macedonia. The implementation of the overall road sector reform is in progress, in particular the institutional strengthening of the public enterprise "Roads of Serbia", strengthening of the capacity of the competent ministry (Ministry of Construction, Transport and Infrastructure) and assessment of the role and capacities of other relevant government institutions and organizations within the sector, as well as the assessment of the current status of methods and quality of road management in the Republic of Serbia and development of solutions and proposals for their improvement.

*The following has been planned for the next three-year period:* Passage of the new Law on Roads; Completion of the construction of 62 km of motorway on Corridor 11, 34 km on the southern leg of Corridor 10 and 31 km on the eastern leg of Corridor 10; The completion of works and the opening of the Žeželj bridge to traffic; Shift to the new contracting modality with road maintenance enterprises for 3,000 km of state roads; Defining the strategic framework for road transport development and implementing road infrastructure safety improvement tools; Defining a Service Level Agreement (SLA) between the Ministry of Construction, Transport and Infrastructure and the Public Enterprise "Roads of Serbia".

### **3. Expected impact on competitiveness**

Well developed, efficient and safe transport infrastructure is conducive to increasing the productivity of the economy, attracting international transit flows, developing tourism, construction industry and international trade; it also facilitates and stimulates the mobility of people and goods and creates prerequisites for balanced regional development.

### **4. Estimated expenditures and impact on budget**

The Budget Law for 2018 provided funds in the amount of EUR 11,800 for the preparation of regulations necessary for the implementation of the reform. For the implementation of infrastructure projects, financial resources are provided from banks' loans, with the participation of the Republic of Serbia of up to 15%. Some projects are partly funded by donations (grants). For the reform of the road sector funds were provided by the Loan Agreement (Corridor 10 Highway Project), which was signed by the Republic of Serbia and the IBRD, signed in July 2009 ("Official Gazette of the Republic of Serbia - International Agreements" No. 90/2009). Also, for the realization of certain infrastructure projects, there is a guarantee in the budget of Republic of Serbia.

### **5. Expected impact on employment and gender**

Further investment in infrastructure will contribute to a rise in employment in connection with construction works, along with increased engagement of domestic enterprises and higher employment of the local population. The introduction of new tools in the area of transport infrastructure safety will lead to the engagement of new licensed professionals for their implementation. The shift to a closed toll collection system will increase the number of people employed in toll collection jobs.

The transition to a new road maintenance methods will strengthen the construction sector and increase competition among the companies providing services or carrying out works.

### **6. Potential risks in structural reform implementation**

Failure to find ways to fund sections for which projects are ready; Delays in project completion, which increases construction costs and project implementation time; Technical and similar errors; Financial omissions by contractors; Increased prices and shortage of raw materials; Technical obsolescence of equipment; Poor management.

## 7. Structural reform implementation monitoring indicators

Indicators	2016 (BV)	2017
No of kilometres of motorway built – TV 161 km (2018)	48	96
Annual average of daily traffic on Corridor 10, year-on-year growth in %	9.33%	

### **Structural reform 5. REFORM OF RAILWAYS**

#### **1. Structural reform outline**

The essence of railway sector reform is the establishment of sustainable railway enterprises with clearly set aims and tasks, which will operate in accordance with market principles; improving and streamlining the railway network and costs, and market opening and service improvement in accordance with the EU legislation, European standards and practices. The priorities in terms of development, construction and reconstruction and plans for railway infrastructure maintenance are set by the National Programme for Public Railway Infrastructure 2017-2021, adopted in May 2017 (OG 53/17).

#### **2. Activities conducted and planned with a view to structural reform implementation**

Under the reform implemented so far, three new railway enterprises have been established (Infrastructure of Serbian Railways, Serbia Cargo and Srbija Voz Serbia Train); they operate on an unbundled and commercial basis. The contractual relationships for public railway infrastructure management and public service obligation were established; the railway market has been opened for domestic operators (two private operators, in addition to two state-owned ones, operate on the Serbian railway network); workforce optimisation plans have been adopted and the first step of staff rightsizing has been taken (3,146 employees have left all four enterprises); traffic has been suspended on about 1,100 km of unprofitable railway lines. The resolution of historic debts and the sale of surplus assets are under way. Since 2015, 215.4 km of main railway lines have been reconstructed and EUR 755.8 m have been invested in this. Works are in progress on 46.2 km.

*The following has been planned for the next three-year period:* Implementation of new laws: Law on Railways; Law on Railway Traffic Safety; Law on Railway System Interoperability; Harmonisation of the laws in the area of railways with the EU Fourth Railway Package; Analysis of the process conducted to date and continuation of workforce rightsizing and restructuring in railway enterprises; Analysis and monitoring of the key contracts (audit); Adopting the Decision Cancelling the Status of Public-Use Asset; Developing and implementing a new pricing methodology for access to railway infrastructure.

#### **3. Expected impact on competitiveness**

The effects of reconstruction of main railway lines are manifested primarily in raising train speeds from 40-50 km/h to 100-120 km/h, increasing the throughput of railway lines and improving railway traffic safety. Further effects include a rise in the number of passengers on specific lines, as well as in the volume of international freight transport. Investments in capital railway infrastructure projects have an impact on industrial output growth, employment in the domestic economy, reduction in unemployment and, finally, GDP growth.

#### **4. Estimated expenditures and impact on budget**

The Budget Law for 2018 provided funds in the amount of EUR 84.8 m. The same amount was projected for the reform costs in 2019 and 2020 from the budget of the Republic of Serbia. For the implementation of certain infrastructure projects, there is a budget guarantee that is financed by credit or co-financing.

## 5. Expected impact on employment and gender

The number of employees in the railway sector has been reduced significantly by the workforce rightsizing process and will continue to decrease in the coming period, along with adequate recruitment of new staff. This will lead to increased productivity of the railway enterprises which are in the process of restructuring. In workforce restructuring, gender equality is taken into account to a great extent.

## 6. Potential risks in structural reform implementation

Reform risks are external, linked to the general conditions for doing business, as well as internal, linked to the capacity of railway companies' management to achieve a prominent position in the transport market and a positive business performance, relying on the comparative advantages of railway transport.

## 7. Structural reform implementation monitoring indicators

	2014 (BV)	2015	2016	2017*
Volume of freight carried (tonnes)	10,826,372	11,882,000	11,745,000	11.299.200*
No of passengers carried	6,442,455	6,258,190	6,086,078	5.168.998*
No of railway carriers on the railway network	/	2	3	4
No of kilometres of railway lines reconstructed, km	0	36.3	43.3	135.8*

\* The data pertain to the period until November 2017.

### 3.3 Area **SECTORAL DEVELOPMENT**

#### Development of the agricultural sector

##### a) Analysis of main obstacles

*Agriculture is one of the key branches in the economic structure of our country and conditions for its development in Serbia are extremely favourable. However, the unfavourable structure of agricultural holdings, technical and technological underdevelopment of one part of the sector, primarily medium and small holdings, their poor organisation in cooperatives, and other forms of stakeholder associations (associations of manufacturers, manufacturing groups and organisations, etc.), pressures due to rising standards and regulations in the process of alignment with the common agricultural policy of the EU, as well as the insufficiently high level of processing in agricultural holdings and in the existing food industry are just some of the limitations facing this sector.*

The relatively **high share of GVA of the sector of agriculture and food industry in the total GDP** of Serbia (7.1% and 4.2% respectively in 2016) is partly a reflection of favourable natural conditions and resources for agricultural production (geographic position, natural resources, climate), since the used agricultural land accounts for around 40% of the territory, but to a great extent it is also the consequence of the low technological level of the remainder of the industry. Around 20% of the total number of employees are those working in the agriculture-food sector, but a high informal employment is also present.

The great **potential of Serbian agriculture** is also reflected in the latest **World Bank report on agriculture**<sup>39</sup>, which represents the ranking list of the business environment (*Enabling the Business of Agriculture 2017*) for agriculture and enterprises operating in the sector. For the first time, Serbia has been included on the list (of 62 countries) with the following rankings: seed – 19, fertiliser – 4,

<sup>39</sup> In the report, the World Bank measured and pointed out legal obstacles for businesses operating in this area in 62 countries in over 12 covered areas, of which eight were rated: mechanisation, seed, fertiliser, financing, market, transport, information and communication technology and water, with two types of indicators, legal indicators and efficiency indicators.

mechanisation – 2, financing – 40, market – 8, transport – 13, water – 14, and information and communication technologies – 12.

Although Serbia is highly ranked by the mechanisation index (measures regulatory and procedural barriers to the import of tractors and registration), **technical and technological equipment in the agricultural sector is not at a satisfactory level**, and further investments in new tractors, specialised agricultural machinery, irrigation systems, and facility construction and equipment are needed. The share of irrigated areas is low (around 3% of the total surface area of the used agricultural land), so investments in capital irrigation systems are necessary. The producers' lack of skills and knowledge is reflected in low average yields, especially in smaller holdings. Serbia is found among low-yield European countries (4.8 t/ha), with almost half the yield of those most successful (Belgium 9.2 t/ha).

**The Agrarian Budget for 2017 has been increased by 8%** compared to 2016, and within it the budget for supporting investment in agriculture has increased more than four times. A pre-accession EU Rural Development Fund **IPARD is also available to align with the common agricultural policy of the European Union and meet EU standards**, which will increase the safety of consumers of agricultural products and processed products.

**Most of the holdings are small or medium ones in size**, practicing extensive production. The holdings of up to 5 ha account for 77.7% of the total number and use 25.2% of the land. Such farms are too small to be competitive, both for direct sales to the European markets, as well as for the sale of raw products to agricultural processing plants. The organised market appearance of agricultural producers, as well as a better, more efficient and more profitable work of the cooperatives is enabled by the Law on Cooperatives (OG 112/2015), which resolves the issues of property-rights relations of the founders, the ownership of cooperative assets, as well as the method of management. However, according to the Law on Associations (OG 51/2009 and 99/2011 – other laws), agricultural associations are defined as non-governmental, non-profit organisations, which a priori prevents strengthening the competitiveness of farmers through association. In order to increase the competitiveness of agricultural products in foreign markets, of particular significance is the possibility of long-term leasing the land for investments in processing capacities. The result achieved is the lease of 50,000 ha more agricultural land in 2016 compared to the previous year. The digitisation of the land cadastre solves the part of the problem related to the impossibility of leasing land due to vague ownership relations.

**Market-oriented processing of agricultural products in agricultural holdings is under-represented**<sup>40</sup> and is the result of an inadequately regulated issue of selling the products, especially for small and medium-sized agricultural holdings, which significantly affects their competitiveness. The potential of food industry has not been sufficiently exploited taking into account the strong raw products base, which is provided by the agricultural production, although certain foodstuff sectors are highly developed (confectionery industry, production of juices) and their export to the EU market has been approved.

The total **export of agricultural and food products** amounted to EUR 2.9 bn (growth of 12.2% y-o-y) in 2016, representing a share of **21.8% in total commodity exports**. The surplus in the foreign trade of agrarian products is growing (an increase of 39.7% y-o-y), and the rate of import coverage by export is 214.5%. **The export structure is dominated by primary agricultural products**, mainly fruit and vegetables (21.1%) and cereals (16.5% – Serbia is among the top three producers of raspberries and 15 largest world producers of corn), although exports of processed products have recorded faster growth than the export of primary agricultural products. Investments are needed to support the development of

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<sup>40</sup> According to 2012 Agricultural Census, only 12.4% of agricultural holdings generate income from other profitable activities related to the holding (processing of agricultural products, tourism, folk crafts, woodworking, forestry activities, fish farming, renewable energy production, contract work, etc.).

agricultural production in sectors where Serbia has comparative advantages, such as vegetables, fruit and livestock sectors, and especially through systems where these products obtain added value, such as organic production, production of traditional products, and products with geographical origin.

## **Structural reform 6 IMPROVEMENT OF THE COMPETITIVENESS AND STATUS OF AGRICULTURAL HOLDINGS**

### **1. Structural reform outline**

The improvement of the competitiveness of agricultural production and status of agricultural holdings will be facilitated through the implementation of the measures envisaged in the IPARD Programme, 2014-2020, the National Programme for Agriculture for the period 2018-2020, and the National Programme of Rural Development, 2018-2020. The IPARD Programme defines the priority sectors where the highest level of competitiveness can be achieved on the local and foreign markets (sectors: milk, meat, fruits and vegetables, farm crops). The National Programme of Rural Development and the IPARD Programme are complementary, whereby the IPARD measures are intended for economically more powerful holdings, while national measures are focusing on small agricultural producers, which has not been the case so far (national measures were used by all the registered agricultural holdings). The reform implementation is defined by the Law on Incentives in Agriculture and Rural Development through rural development measures, while the plan of their harmonisation with the Common Agricultural Policy is contained in the Action Plan for harmonisation with the EU *acquis communautaire*, the adoption of which is expected, as well as with the Agriculture and Rural Development Strategy of the Republic of Serbia for the period 2014-2024. The drafting of the Law on the Regulation of the Agricultural Products Market is under way, which, *inter alia*, defines producer groups and organisations as forms of organising agricultural producers.

### **2. Activities conducted and planned with a view to structural reform implementation**

The appropriate administrative structure has been established in its full capacity (Managing Authority and IPARD Agency). The First Public Calls for support under the IPARD to investments in physical assets of agricultural holdings - purchase of new equipment and mechanization was announced in December 2017 upon the audit mission of the Directorate-General for Agriculture of the European Commission in November 2017 and their preliminary report. The accreditation of the operational and management structure in Serbia by the EC is expected to end at the beginning of 2018, when the implementation of the agricultural reform set out in the Agriculture and Rural Development Strategy will begin.

*The following has been planned for the next three-year period:* draft, adopt and carry out annual competitions for the distribution of national and EU funds; draft and adopt rules for the implementation of IPARD measures; draft, adopt and announce competitions for the implementation of national programmes for agriculture and rural development, including the investment support programmes; draft rural development programmes for the new programming period (2021-2027).

### **3. Expected impact on competitiveness**

The implementation of rural development measures from the national budget should strengthen small holdings, raise their economic viability and improve their position on the market so that they meet the conditions for using the pre-accession assistance funds (IPARD). Another set of measures from the national budget will support the diversification of agricultural and non-agricultural activities in rural areas including the option of supporting the development of other alternative activities (beyond agricultural sector) that would impact the sustainability of such small holdings.

#### 4. Estimated costs and impacts on budget

The Budget Law for 2018 provided funds in the amount of EUR 61.5 m, out of which the funds for IPARD co-financing amount to EUR 4.9 million, and funds allocated for rural development measures of EUR 42 million. The planned budget funds for financing the reforms in 2019 and 2020 amount to EUR 79.2 million per year. In the form of potential non-budget financing of the reform, the following funds are envisaged: 2018 - EUR 14.6 million (all funds from IPA funds), for 2019 and 2020 - EUR 36.4 million per year.

#### 5. Expected impact on employment and gender

All the measures planned from the national budget, as well as from the pre-accession assistance, within specific ranking criteria, incorporate special points-systems for the beneficiaries who belong to the category of young farmers (up to 40 old), as well as if the holders of agricultural holdings are women. Such a system of support should increase economic activities of such population categories in rural areas of Serbia.

#### 6. Potential risks in structural reform implementation

Unfavourable conditions for pre-financing of IPARD investments; insufficient use of funds; a large number of irregularities in the implementation.

#### 7. Structural reform implementation monitoring indicators

	2016 (BV)		2017
Rate of utilisation of funds from the IPARD Programme (%) – TV: 100% (2020)	0		0
No. of supported projects in the area of processing – TV: 463 (2020)	0		0
No. of newly created jobs in the area of processing – TV: 160 (2020)	0		0
No. of holdings that have modernised production in the primary production – TV: 600 (2020)	0		0
No. of holdings that are making progress towards meeting standards – TV: 843 (2020)	0		0

### Industry sector development

#### a) Analysis of main obstacles

*The growth of the industrial sector in Serbia in recent years has been achieved in an economically sound way, through the increase in processing industry production and strengthening of investment and export activities. However, it has been noticed that the production structure of the processing industry is dominated by products with a low level of added value and finalisation rate, due to insufficient investment in knowledge and innovation. There has also been insufficient correlation between industrial, educational, and research and development policies, and industrial policy measures have not contributed to targeted industrial development.*

**The share of industry in the generation of the total GDV has been growing lately**, inter alia, thanks to the recovery of the domestic processing industry, and, in 2016, it amounted to 25.9% (0.8 pp more than in 2015). **FDIs in this sector have contributed to the recovery of industry** (34.2% of total FDI in 2016), with diversification into different export-oriented areas of the processing industries (growth of 5.3% y-o-y of the physical volume of production in the processing industry in 2016 was achieved). Productivity growth in the industry sector is 1.28%, which is the result of both the growth of GVA of this sector and the minimal increase in employment. However, the productivity of the processing industry of Serbia (EUR 13,024 in 2016) has been five times lower compared to EU-28 (EUR 66,407 in 2016).

**Due to insufficient correlation between the industrial, education policy and the policy in the area of research and development**, the share of high-tech industries in the GVA of the processing industry has dropped by 2.8 pp during 2009-2016 (from 7.2% to 4.4%). According to the product process sophistication indicator, Serbia is ranked 110 out of 137 countries (2017 Report on Global Competitiveness of the World Economic Forum). The challenge in this area is the digitisation of the process and the greater use of modern technologies that will enable the shift of domestic production towards processing with a higher level of added value.

As in the previous period, **industrial policy measures were not focused enough on the key comparative advantages**, the new industrial policy of Serbia will focus on the selected sectors of the processing industry: food industry, timber and furniture, rubber and plastics processing and production of machines and equipment. Environmental protection will be included in all proposed sectors, including the IT sector (horizontal component).

What poses a challenge **in the software industry is the development of own products** which increase the strength of the entire economy. Currently, the largest number of developers in Serbia are developing a software for foreign countries according to the “outsourcing“ model, which means that we export knowledge as a raw material, not as a product. Regarding this domain, it is worth mentioning the importance of further development of new technologies, such as robotics, virtual reality, biotechnology and artificial intelligence.

**Creative industries, like film or audio-visual industry, are a very active segment of the Serbian economy.** The creative sector had a share of 3.1% of the GVA generation and employed about 58,000 people (a share of 2.6% of total employment, and an annual increase of 0.3% on average) in 2016 (source: Serbian Chamber of Commerce).

## **Structural reform 7 RAISING THE COMPETITIVENESS OF THE PROCESSING INDUSTRY**

### **1. Structural reform outline**

The reform comprises a mix of legislative and administrative measures and activities designed to help create a focused and better coordinated policy for the development of the industry sector, as well as to contribute to improving the efficiency of the instruments for its implementation. The reform includes: prioritisation of industrial branches with the greatest potential for growth and development, drafting of a new industrial development strategy, development and implementation of action plans of priority industrial branches, as well as development of the monitoring and evaluation system.

### **2. Activities conducted and planned with a view to structural reform implementation**

In line with the recommendations contained in the closing benchmark for Negotiating Chapter 20 - Entrepreneurship and Industrial Policy, a fundamental review of industrial policy will be carried out in the coming period, with special attention being paid to elaborating measures for its implementation through an appropriate action plan as well as mechanisms for monitoring and evaluation of implementation. Following the principle of industrial restructuring will continue, in order to move towards technologically-intensive and away from labour-intensive sectors. Special attention will be paid to activities aimed at increasing the competitiveness of manufacturing industry and small and medium-sized enterprises sector, in line with the principles of smart growth and increasing integration into international value chains. An analysis of industrial sectors<sup>41</sup> (within the “Competitiveness and Employment” project) was undertaken with the aim of identifying and selecting priority industry sectors with the greatest growth potential. The in-depth analysis of the four selected sectors (food industry, timber industry, rubber and plastics processing, production of machines and equipment) and

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<sup>41</sup> The analysis is based on the methodology established by the composite Development Potential Index.

their value chains, with recommendations for strengthening the value chains was undertaken. An analysis of the value chains is under way with recommendations for the remaining sectors of the processing industry. Evaluation of the impacts of the implemented investment and export support programmes has been performed in order to further focus the industrial and entrepreneurial policy measures for improving competitiveness and attracting investments on human resources development and production of technologically intensive products, and not on labour intensive sectors and cheap labour – which have been the central point until now.

*The following has been planned for the next three-year period:* develop and implement action plans for the four selected sectors of the processing industry; develop and adopt a new strategy for industrial development; develop, implement and monitor action plans for pursuing the new strategy for industrial development.

### 3. Expected impact on competitiveness

The implementation of industrial policy measures will support the creation of innovative products with greater added value, using the benefits of digital technologies in business, as well as economic cooperation of domestic enterprises with European and international partners.

### 4. Estimated costs and impacts on budget

2018 Budget Law envisages funds in the amount of EUR 6.4 million for professional and administrative support in the field of economic and regional development, with an expectation of a direct impact on the budget revenues in the amount of around EUR 15 million. The planned budget funds for financing the reforms in 2019 and 2020 are EUR 6.4 million per year, and in the same period, a positive effect on the budget and growth of budget revenues of about EUR 15 million per year is expected.

### 5. Expected impact on employment and gender

Positive effects on the increase in the number of employees are expected, and the gender aspect will be taken into account when creating industrial policy instruments.

### 6. Potential risks in structural reform implementation

Macroeconomic and fiscal instability, lack of financial resources, deterioration of the global economy.

### 7. Structural reform implementation monitoring indicators

	2014 (BV)	2015	2016
Annual rate of export growth of the processing industry, in % - TV: 5% of annual average in the period of 2015-2018 (export of the processing industry in 2014, amounted to EUR 10,057.2 m)	2.2	8.1	11.6
Share of the GVA of the processing industry in the GDP of Serbia – TV: 20% (2020)	15.7%	15.6%	15.6%
No. of new investment initiatives generated through reformed agencies for export and investment promotion - TV: 30 (2018)	/	20	22
No. of participants in export promotion programmes who are involved in new export activities -TV: 100 (2018)	/	85	90
No. of documented interest of investors - TV: 82 (2018)	/	61	67

## Development of the services sector

### a) Analysis of main obstacles

*In the past few years, Serbia has experienced a strong growth in the export of services and a significant surplus in that area. However, a challenge to further economic growth is the development*

*of the service sector with a special emphasis on raising the level of knowledge and skills in this area, development of tourism (which increases foreign exchange inflows and employment rate, and improves the quality of life of the population).*

Despite **the rising trend of surplus (net exports) of services** from 92% in 2016 (EUR 895 m) compared to 2014 (EUR 465 m), **the share of services surplus in GDP remains at a relatively modest level** of 2.6% in 2016 (an increase of 1.2 pp compared to 2014). **The structure of exports** by a type of service **has not changed for a longer period of time**, and three groups of services dominate: tourism, transport and other business services (with a share of 22.7% in 2016). Significant **growth in export share** in previous years was recorded in **telecommunications, computer and information services** – by 5.5 pp (from 10.6% in 2014 to 16.1% in 2016), i.e. in the same period, the value of exports doubled (from EUR 200 m to EUR 407 m respectively).

**A lack of skills and knowledge** has been identified as **one of the main obstacles to the development of more complex services, i.e. services with a higher added value**. The services sector accounted for almost 50% of the GDP of Serbia in 2016, where knowledge-intensive services participated with only 23% of the GDP (36.5% in the EU-28 in 2015), while less knowledge-intensive services created 25.9% of the GDP (29.5% in the EU-28). Most horizontal measures and reforms implemented in other areas will also affect the better functioning of the service sector, since services make up a large part of the economy.

**E-commerce is still under-represented**, which is, among other things, due to the insufficient increase in the number of domestic ICT users, but also due to relatively high fees for the services of payment via the Internet that are the result of insufficient competition in the area of service provision. In Serbia, in 2016, only 26.3% of Internet users made orders/purchases via the Internet (53% in the EU-28). The lack of sufficient confidence in this type of trade is explained by the impossibility to gain physical insight into the characteristics of the product. By adopting The Law on Electronic Document, Electronic Identification and Trust Services in E-Commerce in the end of 2017 (Official Gazette of the RS, no. 94/17), the necessary prerequisites for the faster development of e-commerce were achieved.

**The tourism sector** has become **one of the largest and fastest growing economic sectors in the world** (according to UNWTO 2016) due to diversification into different areas. Europe was absolutely the fastest growing region in 2015, with 27 million more tourists than in the previous year. Serbia has been recording a **steady increase in the number of tourists** for years. The increase in the number of tourists by 13% compared to 2015 led to an increase in foreign exchange inflows of 10% in 2016 (EUR 1.04 bn). The difference in the occupancy rate between Serbia (20.05%) and the EU-28 (24.6%) is decreasing, and in 2016 it was 4.5 pp. It is necessary to improve the accessibility by air and land in order to attract more international and domestic tourists. The problem is also the lack of categorisation of tourist infrastructure in line with the internationally recognised quality standards.

**There is potential for the development of health tourism** (Europeans take 203 million trips for health tourism annually, spending over EUR 115 bn). **Systemic guidance and improvement of health tourism is the basis for development and modernisation of spa health resorts in Serbia**, so that spas can become not only modern sports and recreation, but also profitable centres.

### 3.4 Area BUSINESS ENVIRONMENT AND REDUCTION OF THE INFORMAL ECONOMY

#### a) Analysis of main obstacles

*By implementing regulatory reforms that reduce the complexity and cost of doing business, Serbia has recorded a significant progress and improved its ranking according to the international competitiveness rating. To improve the business environment, the following challenges should be taken*

*on: improve the legal framework in the field of financial services (increase the availability of the existing and new sources of financing for small, medium size enterprises and entrepreneurship - SMEs), enhance the efficiency of public enterprises and introduce corporate governance, establish a legal framework that regulates the administrative and parafiscal burden of business entities, further develop public-private partnership models, as well as reduce the still high level of the informal economy (controlling the operations of unregistered entities and engaged workforce).*

Serbia has significantly improved its ranking on the World Bank's international Doing Business 2018 – it ranked 43<sup>rd</sup> out of 190 countries in 2017. **Serbia is among the 10 countries that have implemented the most regulatory reforms for reducing the complexity and cost of business since 2015** (and climbed up the ranking list by 16 positions in the last two years): it takes less time to register a company since the administrative fee for signatures has been reduced, postregistration procedures (tax return, social security, licensing) have been simplified and the register is now more efficient. In addition, the system of electronic issuance of building permits (e-licenses) has been introduced, property registration process has been improved as the cadastre system is now more reliable thanks to the geographic information system, and effective deadlines for registering ownership rights in the real estate cadastre have been established. **Serbia has also recorded progress according to the Global Competitiveness Index (GCI)** – it ranked 78<sup>th</sup> out of 137 countries in 2017 (score 4.1 has been the maximum so far), which is a leap of 12 positions up the ladder. High tax rates and inefficient administration were quoted as major factors that weaken Serbia's competitiveness.

**There is a need for a financial product that will reduce the risk for banks and is more tailored to the needs of the SMEs at an early stage in their development.** The SME sector plays a significant role in the economic activities in Serbia, since in 2016 it accounted for 99.9% of total active enterprises (at the EU-28 average), employed 2/3 employees in the non-financial sector (EU-28: 66.8% ) and contributed 56% to the generation of GVA (EU-28: 57.4%), or participated with 35% in the generation of GDP. However, **the limited access to funding sources** (since banks demand good credit history, relatively high turnover, low levels of debt and sufficient capital) **and incentives to run their own businesses, reduces the ability of the SME sector to contribute to a significant improvement in the competitiveness and economic development of the country.** The dominant source of funding for SMEs is currently bank loans (**loans to companies in October 2017 achieved a nominal increase of 7.8% y-o-y** after excluding the effect of write-offs of NPLs), with a slight increase in investment loans in the last two years (1.7 pp since 2014 and in September 2017, the share of investment loans amounted to 31.7%). In recent years, funding tools have been used in the form of grants (mostly direct grants and interest rate subsidies). The Government of the Republic of Serbia declared **2016 as the Year of Entrepreneurship, and taking into account the achieved results called this decade the Decade of Entrepreneurship** with 33 programs for long-term development of entrepreneurs (financial and non-financial support).

**Drafting proposals for improving the legal framework in the area of financial services is a prerequisite for establishing an institutional framework** that would allow for alternative sources of financing (e.g. alternative investment funds, non-deposit financial institutions). A gap in financing the debt of micro enterprises is estimated at about EUR 1 bn per year<sup>42</sup>, which implies many missed opportunities for financing sustainable SME projects. On the other hand, **the lack of managerial skills as well as the lack awareness of financial opportunities on the part of entrepreneurs** weakens the capacity of SMEs to access finance (the so-called investment readiness). There is also a need for technical assistance among start-up companies, as well as among the already established small and

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<sup>42</sup> Ex-ante study to assess the potential future use of Financial Instruments to deploy IPA resources in support of Small and Medium Sized Enterprises (SMEs) in Serbia, EIB.

medium enterprises, especially in the field of managerial skills and business plans.

**The privatisation of 152 business entities with 51,630 employees** was continued (including subsidiaries).<sup>43</sup> A positive impact on public finances is expected through lower amounts of budget support that will be paid to enterprises with high losses and increased productivity of privatised enterprises.

**There is no single law that prescribes types of charges for the use of public goods.** The administrative burden borne by business entities in Serbia is 3.26% of GDP, (according to the research done for 2016 USAID BEP project), which is 19.8% less than in 2010.

**Establishing an up-to-date cadastre of real estate in real time** is a presumption of improving the efficiency of doing business and decreasing the duration of procedures required for the registration of real estate rights in the Real Estate Cadastre. It is of public interest to register real estate rights quickly and electronically, which increases legal security.

**Public-private partnership (PPP) is becoming the most realistic option for the implementation of local/regional/national infrastructure** projects since an increasing number of ideas and projects are moving in that direction. So far, 56 PPP project proposals have been approved with or without elements of a concession. These are mainly local projects in the field of urban and suburban transport of passengers, public lighting, municipal waste collection, generation of heat and electricity using renewable energy sources.

**Efforts to combat informal operation** through an efficient and organised action of inspection bodies and the Tax Administration in 2016, give results that are reflected in the **growth of total tax revenues in real terms by 7.2%**, in all of the most important categories: VAT (7.8 %), excise (11.4%), contributions (3.2%) and personal income tax (4.5%). A significant impact on the growth of total tax revenues, in absolute terms, was achieved on the basis of an increase in revenues from contributions for compulsory social insurance, by about EUR 179 m (all organisations of compulsory social insurance have collected a higher amount of contributions, and above all, the Pension and Disability Insurance Fund). Acting under the procedure of inspection supervision (53,069) in 2016, the Labour Inspectorate found 19,472 unregistered workers (an increase of 19% compared to 2015), after which 17,589 persons were registered for social insurance (44% more than in 2015). As the RS government proclaimed **2017 and 2018 for the Year of Combating Informal Economy**, it is necessary to strengthen and improve the capacities of inspection bodies and the Tax Administration, which have so far failed.

#### **b) Report on policy guidance implementation since May 2017**

The implementation of *SR 8: Package of measures to improve access to finance for SMEs* means the implementation of a part of the ECOFIN recommendation 5 (*develop the regulatory framework for new financial instruments, and improve the access to finance*). The National Bank of Serbia has been considering the possibilities and coverage of a regulatory framework for the operation of non-depository financial institutions which will create additional potential for financing SMEs, particularly in the micro-segment of the newly established start-up enterprises.

The implementation of *SR 9: The introduction of Corporate Governance in Public Enterprises*, means the implementation of a part of the ECOFIN recommendation 2 (*support the fiscal scenario by reinvigorating reforms of the state owned enterprises*) and part of ECOFIN recommendation 4 (*advance the announced restructuring of Srbijagas debt and the implementation of EPS's optimisation plan*). The Ministry of Mining and Energy, EPS and the Trade Union agreed to solve the

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<sup>43</sup> Source: Ministry of Economy – as at August 7, 2017: for 3 companies the process is in progress, 24 companies can announce a public call in 2017, while even 125 companies cannot announce a public call.

problem of redundant employees in the period 2016-2019 through the programme of voluntary stimulated termination of employment. In 2016, a consensual termination agreement with the payment of incentive compensation was signed by 1,519 employees. An additional reduction in the number of employees in 2016 was achieved through the natural outflow of employees. In accordance with the Optimisation Plan, the Supervisory Board of JP EPS on September 18, 2017 issued the Decision on incentive compensation for the consensual termination of employment, after which a public call for employees to apply was announced. For consensual termination of employment applied 1,570 employees. With natural outflow of employees and voluntary termination of employment with severance payments, the Plan for Optimization reduced the number of employees in EPS Group for 2,987 persons by the end of 2017.

The implementation of *SR 10: Simplification of procedures and other conditions for doing business* means the implementation of a part of ECOFIN recommendation 5 (*regulate the amount and number of para-fiscal charges at state level*). The Law on Charges for the Use of Public Goods is being drafted, which regulates the payer of the charge, the basis for payment, the amount of charge, the manner of determining and paying the charge, revenue from charges, as well as other issues relevant to determining and paying charges. Public discussion on the draft of the Law is in progress.

The implementation of *SR 11: Improving the effectiveness of inspection oversight*, means the implementation of a part of ECOFIN recommendation 5 (*ensure better targeting and efficiency of inspections*). The harmonisation of sectoral laws with the Law on Inspection Oversight has been made (out of 147 specific laws analysed, which regulate inspection oversight in certain areas, it has been found that 88 special laws need to be changed and/or amended). The database of inspections and workgroups on the portal [www.inspektor.gov.rs](http://www.inspektor.gov.rs) is constantly updated. An initiative has been launched to improve the ongoing dialogue between economy and inspection by supporting the setting up of a consultant/expert for continuous dialogue and assistance to the economy. The newly-formed Office for Information Technology and Electronic Administration (Official Gazette 73/17) has been assigned the competence in the field of E-inspections.

## **Structural reform 8 PACKAGE OF MEASURES TO IMPROVE ACCESS TO FINANCE FOR SMEs**

### **1. Structural reform outline**

Improved access to finance for SMEs means better quality of the banking sector offer for SMEs, development of new financial instruments, as well as improved ability of SMEs to access different sources of funding. The proposed reform is the implementation of the priority activities within the second pillar of the Strategy to support the development of small and medium enterprises, entrepreneurship and competitiveness for the period 2015-2020. Improving the predictability of the business environment and a support programme for SMEs, with an emphasis on the reduction of costs in access to financing is the recommendation from the *EC Progress Report for Republic of Serbia for 2016* (p. 61).

### **2. Activities conducted and planned with a view to structural reform implementation**

The implementation of Apex Loan for SMEs and other priorities III/B of the European Investment Bank (EIB) of EUR 150 m started in August 2017 upon receiving new requests. By the end of 2017 the European Investment Bank approved 23 projects in the amount of EUR 11.6 million, and at the end of November the first tranche of EUR 5 million was withdrawn.

The access to information about available funding sources has been improved for SMEs through the establishing and regularly updating of the portal (<http://poslovanje.rs/>), as well as through the network of 15 regional development agencies.

Through the initiative of the Government of the RS – “Decade of Entrepreneurship”, in 2017 businessmen were offered over 30 programmes and more than EUR 144 m from public funds. Three

programmes<sup>44</sup> (a combination of loans and grants) have been implemented to support investments worth EUR 11.6 m of grants. The Development Fund and the Export Credit and Insurance Agency, as public financial institutions, continued to implement all regular funding programmes, i.e. guarantees, factoring and purchase of receivables.

An *ex ante* SME study on the introduction of financial instruments by the EIB, conducted with the EU financial support from IPA funds, showed a lack of financial support for innovative companies, lack of guarantee instruments that would enable commercial banks to give loans to risky SMEs and start-up companies, as well as a lack of microfinance instruments.

Funds from IPA 2016 in the amount of EUR 20 m were asked for implementing the guarantee scheme and strengthening the capacity of SMEs to access various funding sources. It is expected that the scheme will be operational in 2018. Commercial banks are encouraged to increase their interest in guarantee schemes through the EU programmes (COSME, Horizon 2020, EaSI).

The National Bank of Serbia carries out activities on the development of a legal framework for the establishment, regulation of operations and supervision of non-deposit financial institutions. The framework and the market of non-deposit financial institutions should be developed by 2019. The establishment of a regulatory framework for funds investing in entrepreneurial (drafting the Law on alternative investment funds is underway) will enable SMEs to attract investment, funding and expertise, achieve and improve market penetration, and enhance their management and corporate governance. Support to the national measures presented is also provided through programmes within the World Bank EDIF platform.

*The following has been planned for the next three-year period:* hold negotiations regarding the withdrawal of APEX loan for additional EUR 200 m; prepare and withdraw APEX loan; implement the project for the establishment of financial instruments financed from IPA 2016; hold annual cycle of the implementation of three programs for small enterprises along with monitoring and evaluating the effects of the implemented programmes; create a legislative framework for the introduction of microfinance institutions; create a legislative framework for the introduction of venture capital funds; encourage financial institutions to join COSME.

### **3. Expected impact on competitiveness**

Better quality of the offer that the banking sector provides to SMEs, new financial instruments and improved ability of SMEs to access various funding sources, would lead to a rise in private sector investments, growth of companies, and enhanced innovation in the SME sector. The introduction of modern technologies and greater automation of the production process would ultimately result in reduced production costs and improved competitive position on the domestic and foreign markets.

### **4. Estimated costs and impacts on the budget**

The Budget Law for 2018 provided funds in the amount of EUR 164.3 m for the implementation of structural reform (out of which EUR 824,000 for the COSME membership fee), with an estimated direct impact on budget revenues in the amount of approximately EUR 12 mil. Positive effect on the budget and growth of budget revenues of approximately EUR 12 m per year is also expected in 2019 and 2020, through tax revenues, taxes and contributions and lesser burden on the National Employment Service. The planned budget funds for financing the reforms in 2019 and 2020 amount to EUR 11.2 m per year. As potential non-budget funding of the reform, the envisaged funds in 2018 amount to EUR 20 million (all from IPA funds).

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<sup>44</sup> 1. The programme of support for small enterprises for procuring equipment within which micro and small legal entities can procure production equipment without mortgage as collateral, and the primary collateral is the pledge on the equipment purchased; 2. The programme for encouraging the development of entrepreneurship through financial support to start-up companies for procuring equipment, equipping business premises and permanent working capital; 3. The programme for encouraging entrepreneurship through development projects, aimed at fast-growing economic entities.

## 5. Expected impact on employment and gender

The introduction of new financial instruments which are currently accessible to start-up entrepreneurs and the SME sector will enable them to start their businesses using more favourable sources of finance, to achieve growth and development, but also create new jobs. In addition, by creating the financial instruments, due attention is paid to the promotion of female entrepreneurship, young and old entrepreneurs. The economic empowerment of women increases their involvement and number in business.

## 6. Potential risks in structural reform implementation

Macroeconomic and fiscal instability; possible lack of cooperation and coordination between competent state bodies, organisations, and bodies; possible lack of financial resources (if the funds from the IPA funds are not granted); lack of interest and inactivity on the part of the banking sector.

## 7. Structural reform implementation monitoring indicators

	2013 (BV)	2014	2015	2016
Share of SME loans in total loans to business entities, in % (source NBS) – TV 30% (2020)	18.9%	22.7%	28.5%	30.1%
Development of the financial market, ranking* (source: GCI) – TV: ranking <60 (2020)	115/148	109/144	120/140	110/138
The total number of SMEs (source: SORS) – TV: 350,000 (2020)	315,412	324,272	324,600	340,112

## **Structural reform 9** *THE INTRODUCTION OF CORPORATE GOVERNANCE IN PUBLIC ENTERPRISES (PE)*

### 1. Structural reform outline

The introduction of corporate governance in public enterprises is based on two key pillars: professionalisation of management bodies and operations control system, which include activities pertaining to the development of legislative enactments and bylaws, introduction of certification system for management bodies, improvements in the oversight and accountability system for state-owned companies.

### 2. Activities conducted and planned with a view to structural reform implementation

Research was conducted into the level of corporate governance in 25 public enterprises and a study was prepared for the purpose of drafting bylaws. In order to regulate the system of professional development of members of the managing authorities, a draft model of certification was developed. A working group has been set up to propose a model of certification and draft bylaws (programme for further professional development in the field of corporate governance, guidelines for the development of corporate governance codes, code of ethics, etc.).

*The following has been planned for the next three-year period:* define the certification system of the management authorities in public enterprises and prepare by-laws for the introduction of the certification system; analyse the need for training members of supervisory boards in public enterprises; conduct training in corporate governance, develop procedures for monitoring and evaluating the effects of corporate governance in PE and start the implementation of these procedures; analyse the impact of the corporate governance system introduction in PE and correction of activities based on the conducted analysis.

### 3. Expected impact on competitiveness

The introduction of the certification system will enhance management and organisational skills of the managing authorities in public enterprises.

#### 4. Estimated costs and impacts on the budget

The reform is financed from the regular budget expenditures of the Ministry of Economy in the amount of EUR 141,256, and the financing of this reform in 2019 and 2020 is presented in the same way.

#### 5. Expected impact on employment and gender

A positive impact on gender is expected.

#### 6. Potential risks in structural reform implementation

Potential risk is reflected in the lack of professional support in introducing corporate governance, as well as the prolongation of this structural reform.

#### 7. Structural reform implementation monitoring indicators

	2014 (BV)	2015	2016	2017*
% of women directors and members of managing boards of public enterprises out of the total number of directors and members of managing boards of PE; TV – 30% (2020)	-	13	22	27
Number of public enterprises established by the Republic of Serbia, which incurred losses; TV – 0 (2020)	9	8	7	9
The total net loss of public enterprises which incurred losses, in million EUR; TV – 0 (2020)	640.1	146.9	148.2	27.4

\* Data for the period from January to September 2017

### **Structural reform 10** *SIMPLIFICATION OF PROCEDURES AND OTHER CONDITIONS FOR DOING BUSINESS*

#### 1. Structural reform outline

The basic goal of simplifying procedures and other conditions for doing business is to improve the business environment and regulatory reform through the guillotine of procedures and regulations that unnecessarily burden the business in the Republic of Serbia, as well as provide all the necessary information for performing economic or other commercial activities in one place (point of single contact and information system). The simplification of the procedures and other conditions for doing business, reduction of their costs using the standard cost model, as well as the abolition of unnecessary regulations, will result in the establishment of a single public register of administrative procedures and other conditions for doing business (hereinafter: the Register). The establishment of the Register will provide business entities and citizens with a transparent overview of all administrative procedures and other conditions for doing business that need to be fulfilled and implemented to ensure the provision of a particular service or business, including all costs in the form of charges, fees, etc., as well as electronic communication with the public administration. This also fulfils the requirement for establishing a point of single contact (PSC), which is a requirement in accordance with the Services Directive 2006/123/EC, the transposition of which is provided for in Article 59 of the SAA. The reform is defined in the Strategy for the Support of the Development of Small and Medium Enterprises, Entrepreneurship and Competitiveness for the period 2015-2020 with the Action Plan, the Strategy of Regulatory Reform and the Improvement of the Public Policy Management System for the period 2016-2020 (Official Gazette of the Republic of Serbia No. 8/16) and the National Programme for the Reduction of the Informal Economy (Official Gazette of the Republic of Serbia, No. 110/15).

#### 2. Activities conducted and planned with a view to structural reform implementation

The Operational Action Plan for setting up the Register and the form for listing administrative procedures related to doing business with the Instruction for completing the form was adopted in December 2016. An online Form for the List of Administrative Procedures relating to the economy was prepared. An electronic site on the website of the Republic Secretariat for Public Policy

([www.epopis.rs.jp.gov.rs](http://www.epopis.rs.jp.gov.rs)) has been functionally established containing all necessary information and documents related to the Register. Programmes and materials were prepared and training held for trainers and civil servants for listing administrative procedures (35 trainings were organised and 16 trainers and 479 civil servants from 107 bodies and organisations were trained). The listing included 80 bodies and organisations and is at the final stage. It is expected that 2,459 procedures will be listed and ready for analysis. The *Draft Law on Services* has been prepared, which provides for the establishment of an Electronic Point of Single Contact (ePSC) as part of the Register. A working group was formed for preparing the *Draft Law on the Unified Public Register of Administrative Procedures and other Business Conditions*. Instruction for implementing an analysis for the simplification of administrative procedures, methodology for calculating administrative costs of the analysis of administrative procedures and the Instructions for calculating administrative costs have been prepared. The portal and software i.e. calculator for calculating the cost of administrative procedures with the accompanying Instruction for using the calculator have been set up.

*The Draft Law on Charges for the Use of Public Goods* is being prepared, which will include and regulate all charges that are now stipulated in several separate laws, which will make the costs of operations of business entities more predictable and the use of public goods more rational. The law will define the payer of the charge, the basis for payment, the amount of charges, the manner of determining and paying charges, revenue from charges, as well as other issues relevant to defining and paying charges. Public discussion on the Draft Law is being conducted in the period from 3rd January to 28th February 2018.

*The following has been planned for the next three-year period:* check the accuracy of the listed administrative procedures; analyse the listed administrative procedures; draft a law that will regulate the legal framework for the establishment of the Register; simplify administrative procedures and adopt the Action Plan for amending regulations; list administrative requirements, or other conditions for doing business; revise the operational plan of activities; collect initiatives of companies for changing ineffective procedures; adopt and implement the Law on Charges; adopt by-laws on the basis of the law that will regulate the legal framework for the establishment of the register; establish the Register; adopt annual reports on the simplification and prepare a new Action Plan for amending regulations.

### **3. Expected impact on competitiveness**

It is expected that administrative costs will be reduced from 3.26% of GDP in 2016 to 3% of GDP in 2020 (reduction of 15-20%), and on the basis of the analyses and proposals for simplification and optimisation at least 30% of the most common and most expensive administrative procedures will be cut.

It is expected that the impact on competitiveness will be positive – by enacting the Law on Charges, all the charges that are now regulated by several special laws will be regulated by a single law, which will contribute to the predictability of the operating costs of business entities, and improve the rational use of public goods and their transparency.

### **4. Estimated costs and impacts on the budget**

The Law on the Budget for 2018 provided funds in the amount of EUR 88.589 (contribution of the Republic of Serbia for IPA 2013). As a potential non-budgetary funding of the reform, the envisaged funds amount to: 2018 - EUR 1.7 m (out of which EUR 724,815 from IPA), 2019 - EUR 1.4 m (out of which EUR 517,725 from IPA), 2020 - EUR 1.2 m (out of which EUR 414,180 from IPA).

### **5. Expected impact on employment and gender**

An indirect impact on increasing employment is expected, since costs for the economy in terms of administrative barriers will be reduced and savings achieved, which can result in job creation. A direct

impact on the gender aspect cannot be expected, because the reform is gender neutral.

## 6. Potential risks in structural reform implementation

There is a risk of postponing the deadlines envisaged in the Operational Plan for Establishing the Register, which can be overcome if the authorities and institutions that first complete the first phase (the list of administrative procedures) are the first to enter the next phase of the analysis (procedure simplification/optimisation phase). A potential delay of the project for software solution for the Registry and ePSC also presents a risk.

## 7. Structural reform implementation monitoring indicators

	2012 (BV)	2014	2016
The administrative burden on businesses, in % GDP – TV: 3 (2020)	3.7	3.46	3.26

## **Structural reform 11** *IMPROVING THE EFFECTIVENESS OF INSPECTION OVERSIGHT*

### 1. Structural reform outline

The reform will result in better coordination of inspectorates, legal regulation and establishment of an information system in order to efficiently exchange data and electronic documents during planning and implementation of inspection oversight, which is a goal of the Strategy of Public Administration Reform in the RS and the Law on Inspection Oversight. The establishment of a common information system for inspections – e-Inspector is related to the activity contained in the Action Plan for the Implementation of the e-Government Strategy 2017-2018.

One of the key novelties of the Law on Inspection Oversight is its application to unregistered entities – by introducing clear powers in their control, which leads to reducing of the informal economy. Apart from emphasising the preventive impact of inspections, significant innovations were introduced into the process of inspection supervision: improved planning of inspection supervision based on risk analysis; better co-ordination between inspections; improved supervision due to the introduction of checklists, which significantly simplify the supervision, both for inspectors and supervised entities; risk analysis introduced.

The transparency of inspection supervision has been enhanced, since inspections are obliged to publish annual oversight plans and checklists on the website, which allows supervised entities to get information in advance about their obligations, perform self-check, and possibly eliminate certain irregularities in their operation.

### 2. Activities conducted and planned with a view to structural reform implementation

The project for the establishment of a common system e-Inspector has not been implemented in accordance with the established schedule due to the duration of the procedure before the Commission for Protection of Bidders' Rights. An agreement with the contractor was signed in November 2017. The sectoral laws have been harmonised with the Law on Inspection Oversight. There are 147 special laws that regulate inspection oversight in certain areas, and it has been found that 88 special laws need to be changed and/or amended in order to comply with the provisions of the Law on Inspection Oversight as a system law in the field of inspection oversight. The two-year project “Improving the Capacity of Inspections, Misdemeanour Courts and Economy” has started, which will enhance cooperation and coordination of joint activities of inspections and misdemeanour courts in dealing with violations in the field of inspection oversight. The database of inspections and working groups on [www.inspektor.gov.rs](http://www.inspektor.gov.rs) has been completed and updated. The 2018 Programme of Professional Development of Inspectors was adopted. An initiative has been launched to improve the ongoing dialogue between businesses and inspection by supporting the establishment of a consultant/expert for continuous dialogue and assistance to businesses.

*The following has been planned for the next three-year period:* develop the e-Inspector system; train trainers and implement training programs for inspectors; establish business adviser; improve the website of the Coordination Commission and promote an online survey on the satisfaction of business entities with the work of inspections; adopt amendments based on the analysis of the implementation of the Law on Inspection Oversight; continuously set exams for inspectors; produce the e-Inspector system by the Office for IT and Electronic Administration, followed by handover and training; review the elements of risk control in the Inspection Checklists.

### **3. Expected impact on competitiveness**

It is expected that the enhanced inspection oversight will improve the quality of services and goods, as well as increase tax collection, while the introduction of clear powers for controlling unregistered entities will additionally reduce the informal economy.

### **4. Estimated costs and impacts on the budget**

The Budget Law for 2018 provided funds in the amount of EUR 1.2 m. Total value of the project Establishing a unique e-Inspector system is EUR 1,599,600.

### **5. Expected impact on employment and gender**

Reducing the number of employees in the grey economy, better monitoring of compliance with the labour contracts and workers' rights.

### **6. Potential risks in structural reform implementation**

Lack of appropriate staff and technical equipment of inspections.

### **7. Structural reform implementation monitoring indicators**

	2015 (BV)	2016	2017
All inspection services at the republic level will be using the e-Inspector system, in % - TV: 100% (2018)	0	0	

## ***Structural reform 12 IMPROVEMENT OF THE GEOSPATIAL SECTOR AS SUPPORT TO INVESTMENT DECISION-MAKING PROCESS***

### **1. Structural reform outline**

By establishing the National Spatial Data Infrastructure (NSDI), and improving the address register and the mass real estate appraisal system, a strategic Digital Geosector Platform is created and the cadastre will play an important role in most systems. The combined datasets available through web services, their efficient, fast and high-quality exchange will enable citizens, business entities and educational institutions to easily identify and comfortably access the desired data, thus obtaining information that is crucial for quality investment decision-making at all strategic levels. The development of mass real estate appraisal system implies the registration of all real estate movements, development of a model for mass real estate appraisal and the collection of basic data (registration into records) of all real estates in the territory of the Republic of Serbia. The Law on State Survey and Cadastre from 2009 created the legal basis for the establishment of the NSDI, whereby certain provisions of the INSPIRE Directive were transposed. A complete transposition of the directive will be carried out by the adoption of the Law on the National Infrastructure of Geospatial Data. Republic Geodetic Authority (RGA) has established Road Map through the Strategy of measures and activities for increasing the quality of services in the field of geospatial data and real estate title registration in the official state records – RGA Reform Path until 2020.

### **2. Activities conducted and planned with a view to structural reform implementation**

The address register, which is a part of the NSDI, represents a public register of house numbers and street and square names in residential areas, including the identification of house numbers for

residential and commercial buildings, as well as for cadastral parcels for which the town-planning scheme provides construction. The data from the Address Register are also kept in the Real Estate Cadastre Database. The Register of real estate prices was put into operation by RGA in 2012, and since January 2014 an organisational structure for data collection on the entire territory of the Republic of Serbia has been built. The implementation of this system is necessary for getting the right idea of the real estate market and its movements.

The aim of the NSDI is to create a common national framework for the purpose of exchanging spatial data on the environment among public institutions, and enabling public access to spatial data. A successfully established NSDI makes the corner stone of the development of e-Government. The NSDI also supplements the international network of spatial services, where the European-level cooperation in the field of geoinformation is very important.

*The following has been planned for the next three-year period:* prepare and adopt laws and bylaws on NSDI, mass real estate appraisal, Address Register and Register of Spatial Units; harmonise spatial data of RGA and create the National Geoportal; develop mass real estate appraisal system; update the data of the Address Register and the Register of Spatial Units in the territory of the Republic of Serbia; establish a framework for accessing and exchanging geospatial data; implement the mass appraisal system in the property taxation system.

### **3. Expected impact on competitiveness**

As a direct impact of the reform, an increase in the share of property tax in GDP is expected (estimated at 0.9% after the completion of the activity in 2020). NSDI results in the increase in GDP and indirectly, through stimulating more efficient investment decision-making, the availability of information and high-tech solutions to the scientific sector and economy (in particular, the SME sector).

### **4. Estimated costs and impacts on the budget**

The Budget Law for 2018 provided funds for financing the reform in the amount of EUR 2.8 m. The budget funds for the financing of the reform are foreseen as follows: EUR 3.7 m in 2019 and EUR 3.1 m in 2020. As a potential non-budgetary financing of the reform, the funds are foreseen as follows: 2018 – EUR 750,000 (out of which EUR 250,000 from the IPA) and 2019 - EUR 250,000 (all from IPA funds).

For the remaining activities on the development of the system of mass valuation, within the Project Improvement of Land Administration are planned funds of approximately EUR 5 m which are financed from the loan. Estimated costs of activities on the Project Data Update of the Address Register of EUR 6 m are financed from donations.

### **5. Expected impact on employment and gender**

No impact is expected on the gender aspect. The impact on employment is very indirect through the support of the SME development, and thus cannot be predicted with certainty.

### **6. Potential risks in structural reform implementation**

Activities within the NSDI and the Address Register are carried out through the cooperation of a large number of institutions and organisations with a very different level of technical equipment and employees' competencies, which is a great challenge for the implementation of the system; non-adoption of laws and bylaws in the specified deadline; uncompleted financial package.

### **7. Structural reform implementation monitoring indicators**

	2017 (BV)	2018	2019
The share of property tax in GDP – TV: 0.9% (2020)	0.60	0.60	0.75
Loan-to-value ratio – TV: 75% (2020)	60	65	69

Number of settlements where the Address Register has been updated – TV: 100% (2019)	60	80	100
Number of harmonised data sets within the NSDI – TV: 20 (2020)	2	5	13
Number of available NSDI services – TV: 45 (2020)	9	23	34

### 3.5 Area RESEARCH, DEVELOPMENT AND INNOVATION, AND DIGITAL ECONOMY

#### a) Analysis of main obstacles

*Serbia has scientific and research potential, which should be further developed and more adequately used, if we want a “knowledge-based economy”. The key issues in this field are: insufficiently efficient model of financing support to science, lack of support for business innovations, inadequate connection between business and academic community, “brain drain”, availability and introduction of digital technologies, products and services, standardisation of communication infrastructure.*

According to the **Global Innovation Index (GII)**, Serbia ranked 62<sup>nd</sup> (out of 127 countries) in 2017, and its worst ranking is in the pillar of market sophistication (99<sup>th</sup>), which includes access to loans, protection of investors and the number of projects funded by venture capital.

**The academic and research network of Serbia is not integrated into European and global networks due to insufficient investments and a small number of financial instruments to support research and innovation.** The total expenditures for science in Serbia in 2016 amounted to 0.9% of the GDP, which was twice lower than the EU-28 average (2.03% of the GDP). Only 9.2% of total investment in science in 2016 came from the business sector, which was less than in 2015 (12.8%) and well below the EU-28 average (55%). One of the reasons for such a low investment of the business sector is the lack of tax incentives for companies that carry out research and innovation activities, as well as the lack of favourable loans to innovative projects of companies.

**The orientation of scientific research to the economy is relatively low**, which is also reflected in the position Serbia holds in the *2017 Global Competitiveness Report (GCI)* – in terms of the quality of the cooperation between university and business, it is ranked 95<sup>th</sup> of 137 countries. Out of the total number of results achieved in scientific-research projects financed from the budget in the period 2011-2015, patents and technical solutions accounted for only 3.3%, while the share of scientific papers was 88%<sup>45</sup>. What also poses a problem is the fact that scientists rarely move from academia to business and vice versa, and for raising the level of innovation in Serbia, this type of mobility is also needed.

**The lack of professional staff in the field of information and communication technologies (ICT) significantly limits economic growth and innovation.** According to the country’s capacity to “hold” and “attract” talents, Serbia ranked 132 out of 138 in 2017 (source: GCI). In Serbia, there are 3,335 employees in research and development sector per million inhabitants, which is insufficient compared to the 5,000 in the EU-28. Out of 16,592 researchers (62% or 10,286 with PhD degree) only 3% is employed in non-financial sector. The lack of “research visa” and unregulated reintegration of researchers – returnees, are some of the reasons for the low competitiveness of Serbia in the area of science.

**The communication infrastructure in Serbia needs to be systematically improved**, both in the regulatory framework and in the area of investments. **Broadband Internet access** in 2016 was provided to **57.8%** (an increase of 1.8% compared to 2015) of **Serbian households** (83% - the EU-28

<sup>45</sup> Research “Analysis of the Regulatory Framework for Entrepreneurs Focusing on the Three Most Potential Sectors, Proposing Simplified Procedures for Young Entrepreneurs”, Economics Institute

average). However, Serbia's competitiveness decreased in the pillar of technological readiness (a drop of 21 positions in 2017 compared to 2015), since the increased number of users resulted in a slower bandwidth per user (from 112.4 to 26.3 kb/s). **Access to computers and the Internet in companies is widespread**, since all companies use computers and are connected to the Internet.

According to the **Network Readiness Index**<sup>46</sup>, which is an indicator of the country's digital economy development or the **readiness of the country to join the IT sector**, in 2016 Serbia ranked 75<sup>th</sup> out of a total of 139 countries. Although Serbia has improved its position over the past few years, it is still worse ranked than most Central and Eastern European countries: the Czech Republic (36), Poland (42), Slovakia (57), Hungary (50), Romania (66), and Bulgaria (69).

**Administrative costs and complexity of procedures for obtaining the necessary permits for construction of optical networks are some of the identified deterrents to the development of the communications infrastructure.** The network of optical cables with 80 nodes, which has been constructed on a network of long-distance power transmission lines of the total length of 6,500 km, is unutilised, and it can be the backbone for the formation of the national broadband network. The problem of a standardised communications infrastructure that would provide fast, reliable and secure connection to Internet of all the users within institutions can be resolved by using the national telecommunication network. Significant progress has been made in connecting educational institutions, and the connection to the Academic Network of the Republic of Serbia (AMRES) was contracted for 1,750 primary and secondary schools. (Around 1.650 primary schools are connected by the end of 2017, out of which majority of the remaining primary schools are located on the territory of Kosovo and Metohija).

### **Structural reform 13 PROGRAMME SUPPORTING INNOVATIONS AND TECHNOLOGICAL DEVELOPMENT IN THE PUBLIC AND PRIVATE SECTORS**

#### **1. Structural reform outline**

The reform implies support for innovation and technological development projects in scientific and research organisations and the private sector, the establishment of a technology transfer system, implementation of joint projects by public scientific and research organisations and private companies, and financing innovation projects in the private sector through the Innovation Fund. Independent international evaluation of Serbian public research and development institutes will be conducted to enhance their efficiency and capacities for collaboration with the private sector through technological projects. The Strategy of Scientific and Technological Development of the Republic of Serbia for the period 2016-2020 – Research for Innovations is implemented through the reform.

#### **2. Activities conducted and planned with a view to structural reform implementation**

Implementation of the IPA 2013 Direct Grant Agreement – Programme of Cooperation between Science and the Economy, under the Innovation Fund, is underway. Fourteen best-rated projects were selected and are now being implemented.

Within the framework of the “Competitiveness and Employment” project, documents were prepared for the Early Development Programme and the Programme for Co-Financing Innovations in May 2017 and in December, 25 innovative projects of enterprises from Serbia were selected and presented, supported with a total of EUR 2.45 m in the form of grants.

The Innovation Fund announced in December 2017 a public call for awarding innovative vouchers – a financial support mechanism for micro, small and medium-sized enterprises aiming to raise the level of product innovation and increase their competitiveness on the market. Enterprises which are interested can compete for innovation vouchers worth up to EUR 6.400 (RSD 800,000) for public scientific and

<sup>46</sup> Source: The Global Information Technology Report, World Economic Forum

research organisations services in order to solve technical or technological issues in their operations. The innovation voucher covers up to 80% of the total cost of the service. The public call is open until May 2018, i.e. until the allocated funds in the amount of EUR 192.000 are spent.

The Green Innovation Vouchers Programme in Serbia (grants of up to EUR 20,000 for small and medium enterprises to cover up to 90% of the cost of external research and development services) in order to improve the process of introducing innovations in small and medium enterprises, primarily in the field of resource efficiency. Vouchers cover most of the costs of research and development services that businesses need for developing innovative products, services or processes while reducing resource consumption (energy, water and raw materials).

It was decided to extend the funding of national projects by the end of 2018.

The technology transfer service lines have been established at the Central Office for Technology Transfer within the Innovation Fund (8 in total) – IPA 2013, and a handbook for the Technology Transfer Facility Programme has been prepared. At this moment there are 10 active service lines. Since the launch of the TTF programme, a total of 21 inventions were applied, 11 of which were evaluated positively by the TTF Expert Commission. Total amount granted for these 11 approved projects amounts to EUR 176,000.

Memorandum of Understanding was signed between the EUPIC Centre for Innovation Projects and the Technology Transfer Centre of the University of Belgrade, which provides support to Serbian researchers in establishing cooperation with scientific and research institutions and companies in China. The office of the Technology Transfer Centre of the University of Belgrade was opened in the industrial zone of Qingdao, China.

*The following has been planned for the next three-year period:* IPA 2013 – implementation of projects by beneficiaries that were awarded funding and monitoring by the Fund within the programme of cooperation between science and the economy, as well as the implementation of the Technology Transfer Facility Program in the Central Office for Technology Transfer; pilot innovation vouchers programme results analysis; IPA 2014 – signing of a direct grant agreement between the Innovation Fund and the Ministry of Finance, preparation of documentation for grant programmes and implementation of projects by beneficiaries who were awarded funding and monitoring by the Fund; “Competitiveness and Employment” – implementation of projects 1 and 2 PE by users and monitoring by the Innovation Fund; conducting analysis of the institutions in the scientific and research sector.

### **3. Expected impact on competitiveness**

An analysis was conducted of the results achieved by the companies which are funded through the Innovation Support Project in Serbia (IPA 2011) in the period from 2012 to 2016. The results show a significant increase in revenues, from EUR 7.67 m in 2012 to EUR 16.64 m in 2016. When it comes to the emerging innovative companies, where 34 out of 38 which are financed are still operating on the market, the operating income increased in the same period from EUR 1.03 to 5.35 m, which is an average increase of approximately EUR 113,000 per company. A significant positive result was also observed in the analysed number of employees – more than 450 new jobs were created in the funded companies in the period 2012-2016.

An independent analysis of the impact of financing on the Serbian economy was carried out, which showed the positive impact of these programmes. The analysis recommends that the Government of the Republic of Serbia should support the continued financing of the Fund public calls and it is estimated that an annual budget of EUR 30 m should be provided in order to respond to demand and achieve positive impact on the innovative ecosystem and the economy as a whole.

### **4. Estimated costs and impact on budget**

Funds for financing the reform in the amount of EUR 49.3 million are provided by the 2018 Budget Law. The allocation for financing the reform in 2019 is EUR 47.5 million and EUR 46.6 million in

2020. Additional non-budget funds are provided: in 2018 EUR 2.8 million (out of which EUR 2.5 million from IPA funds); in 2019 EUR 1.6 million (out of which EUR 1.3 million from IPA funds); and in 2020 EUR 250,000 (the whole amount provided from IPA funds).

### 5. Expected impact on employment and gender

The positive impact on employment is reflected in the creation of long-term sustainable and well-paid jobs for high-qualified employees. The Fund provides funding through its instruments thus supporting the jobs during the project, and the analysis of the companies financed in the previous calls shows a very positive effect on the creation of new jobs, once funding has been completed. There is a potential that developed innovations will have a positive impact on a wide range of aspects of the society.

### 6. Potential risks in structural reform implementation

Untimely provision of funds and stagnation in cash flows, insufficient coordination of participating institutions and inadequate capacities of institutions with regard to employment restrictions, inadequate implementation of other envisaged reforms in the sector of science and innovation, relatively low interest on the part of the economy and science for cooperation, lack of potential technologies for commercialisation in scientific and research organisations, low interest on the part of researchers to participate in the commercialisation process, as well as low interest of the researchers employed in scientific institutes.

### 7. Structural reform implementation monitoring indicators

Indicators	2015 (BV)	2016	2017
Number of conducted self-evaluations of institutes – TV: 50 (2018)	0	0	0
Number of newly established project partnerships between the private and academic sectors – TV: 42 (2018);	22	36	36
Number of newly established innovative companies – TV: 296 (2018);	156	156	200
Number of registered patents – TV: 103 (2018);	58	58	65
Number of highly qualified staff employed through the supported projects - TV: 584 (2018).	324	459	500

Note: Projects funded under *Mini and Matching Grants* have not been implemented in 2016.

## **Structural reform 14 DEVELOPMENT AND IMPROVEMENT OF THE NATIONAL BROADBAND COMMUNICATIONS INFRASTRUCTURE**

### 1. Structural reform outline

The implementation of this structural reform, in addition to enabling fast, reliable and safe Internet connection, also includes consolidation of the broadband network owned by the public sector, as well as connection of public institutions to the national network. It has also been planned to adopt the Law on Broadband Communications Infrastructure, which will provide conditions for and regulate the manner of development of the broadband Internet access. It is necessary to formulate and implement programmes encouraging and supporting investments in the development of broadband communications infrastructure with access networks in settlements, particularly in poorly populated areas. By 2020, Serbia should reach and become level with the EU level with respect to the access to broadband Internet as defined in the Digital Agenda for the Republic of Serbia, which consists of the Strategy for Information Society Development in the Republic of Serbia up to 2020 and the Electronic Communications Development Strategy of the Republic of Serbia, 2010-2020.

## **2. Activities conducted and planned with a view to structural reform implementation<sup>47</sup>**

The Law on Broadband Communications Infrastructure is being drafted and it will enable harmonisation with 2014/61/EU Directive on measures for reducing costs of setting up high-speed electronic communications networks. The Conclusion on the adoption of the Action Plan for Efficient Use of Telecommunication Infrastructure (OG 36/2017) was adopted, defining activities related to the utilisation of the state telecommunication infrastructure resources in order to establish a single national broadband network. In November 2016, the “National Broadband Network Implementation Plan” project, which includes analyses of, plans and cost estimates for the further development of the broadband access, was started. Detailed analysis of the existing capacity and availability of broadband Internet access is made in the 8 selected municipalities. Development of Web GIS applications is completed and will provide to the citizens, interested institutions and local self-government representatives the insight into the current state of the network and potential developments.

*The following has been planned for the next three-year period:* adopt the Law on Broadband Communications Infrastructure; connect education and culture institutions to AMRES; prepare and plan the establishment of a unique national telecommunication network; analyse, prepare and design pilot projects; operationally establish a single national telecommunication network; construct access broadband networks in municipalities across the country.

### **3. Expected impact on competitiveness**

Broadband access to the Internet and ICT will lead to faster, more secure and more efficient doing business, which will increase the productivity of companies and reduce operating costs. In such a way, small and medium-sized enterprises will increase their competitiveness in the local and international markets (particularly through access to e-business). This reform has a particularly positive impact on the development of rural areas, interconnection of economic regions, as well as on the development of industrial zones and increased use of new technologies and innovations in doing business. The reform also has a positive impact on the decisions of consumers. By enabling access to the Internet, a better access to products is ensured, as well as access to information on price or quality, and the consumer can make a decision more easily.

### **4. Estimated costs and impact on the budget**

Funds for financing the reform in the amount of EUR 910,408 are provided by the 2018 Budget Law. The allocation for financing the reform in 2019 and 2020 amount to EUR 646,408 per each year. Potential non-budget funds are provided for 2018, 2019 and 2020 in the amount of EUR 58 million per each year.

### **5. Expected impact on employment and gender**

The construction of broadband communications networks will provide employment, as well as work via the Internet and increase the number of jobs in practically all the sectors, including the ICT sector. Increasing the level of knowledge, competences and skills in the area of IT technologies will open up job opportunities in the IT area, but also in other areas in which new technologies are being introduced or increasingly used. Implementation of the reform will enable Internet access to citizens, indiscriminately and with equal opportunities.

### **6. Potential risks in structural reform implementation**

Untimely identification of sources of financing, in order to comply with the defined deadlines, poor cooperation between institutions, as well as between institutions/companies that manage unutilised

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<sup>47</sup> Priority Structural Reform 4, ERP 2017 - 2019

optical fibres.

## 7. Structural reform implementation monitoring indicators

	2016 (BV)	2017	2018
Fixed broadband network coverage, % of households	89.2	90.8	92.5
Utilisation of fixed broadband access, % of households	57.5	58.2	60.0
Fast-speed broadband networks subscribers, % subscribers >=30Mb/s	17.2	18.8	21.5

Data source: DESI index

### 3.6 Area TRADE-RELATED REFORMS

#### a) Analysis of main obstacles

*The full realisation of investments from the previous period, economic recovery of the main foreign trade partners of Serbia, more favourable relations of exchange and improvement of the business environment contributed to a significant improvement of the balance-of-payment position of Serbia. In addition to the fact that Serbia is not fully integrated into the international economic system, the challenges in this area are also related to the use of modern technologies in production that should enable shifting towards processing with a higher level of value added, increased share of high-tech products in overall exports, greater orientation of domestic producers to consumers' demands, as well as requirements of technical regulations and standards, i.e. implementation of conformity assessment of products with these requirements, with further harmonisation of the standardisation, metrology and accreditation systems with EU acquis and practice.*

**The share of exports of goods and services in GDP is growing**, and in the third quarter of 2017 it was **51.3% (2.1 pp more y-o-y)**, which was mainly due to the strengthening of external demand in the Eurozone countries. In the first nine months of 2017, foreign trade of goods grew by 13.3% (EUR 25.4 bn), with exports growing at a rate of 13.4% (EUR 11.3 bn), slightly more than imports that grew by 13.1% (EUR 14.2 bn). In the same period, the foreign trade deficit increased by 11.8% y-o-y (EUR 2.9 bn), while the coverage of imports by exports was 79.6% (compared to 79.1% in the same period last year). The exchange ratio (indicator of export purchase power per import unit) was improved to 3.1% in 2016 (2.2% in 2015).

**External trade of Serbia is the largest with EU member states, as much as 64.9% of total trade.** In line with the trade part of the Stabilisation and Association Agreement further liberalisation in the trade between Serbia and the EU is expected in 2017, in tariff positions where some restrictions were retained (in the form of higher customs rates or quantitative restrictions). **The second important partner is CEFTA signatories**, with which we have a trade surplus mainly as a result of exports of agricultural products, iron and steel, road vehicles, as well as the export of and miscellaneous final products.

Serbian economy materialises its **comparative advantages** mainly in **primary and products of lower stages of processing**, which are predominant in the Serbian exports structure (67% of Serbia's exports compared to 31% exports in the EU-28). **The share of high-tech products** of barely 6% in overall Serbia's exports in 2016 is far **below an average level in the EU-28** (26%). The ICT sector achieved exports of EUR 740 m in 2016, while in the first quarter of 2017, the export in this area grew by 21.7% y-o-y.

On the *Doing Business List*, **according to the external trade volume indicator, Serbia ranked 23<sup>rd</sup>** out of 190 countries on the list, which is also the most important ranking within the composite indicator of Business Environment. The most important activity for the good ranking in this pillar is **an**

**efficient implementation of the New Computerised Transit System (NCTS) by the Customs Administration, as well as introduction of an electronic customs clearance system.**

**In the area of goods market efficiency** (in the scope of the Global Competitiveness Index) **Serbia ranks poorly** (ranks 110<sup>th</sup> out of 137 countries) in spite of the competitive ranking in the segment of the number of procedures for the commencement of business operations (36<sup>th</sup> on the ranking list) and import coefficient of 61.6% of the GDP (rank: 30<sup>th</sup>). Inter alia, the reason for such a low position is in the **pillar of customers' sophistication**, where **Serbia has kept a very low ranking** (rank: 128<sup>th</sup>). Buyers' decisions on purchase of goods are commonly guided solely by low price, because manufacturers pay little attention to demands of their customers who, either for cultural or historical reasons, differ from one country to another. Companies are neither innovative enough nor customer-oriented, which limits increase in the efficiency on goods market.

**The wide dispersiveness of exports is ensured by the diversification of FDI into a large number of sectors producing interchangeable goods.** FDI showed a growth by 12.2% (EUR 992 m in the first half of 2017), and almost one third was directed towards export-oriented activities. **Total investments rose** by 1.3 % y-o-y in the first quarter of 2017 (according to SORS estimates), and in the first six months of 2017, a positive contribution to public investment is expected due to the intensification of capital expenditures (3 times higher compared to the same period last year).

**Serbia is not fully integrated into the international economic system, because it is not a member of the World Trade Organization (WTO).** The WTO has 164 members, and Serbia, Bosnia and Herzegovina and Belarus are the only European countries that are not part of this organisation. The accession to the WTO is becoming increasingly complex, the average accession time is from 6 to 10 years, and the delay in the accession process brings new and more difficult conditions. Membership in the WTO is a prerequisite for the EU membership. Although Serbia fulfilled most of its obligations in terms of the accession to the WTO in 2010, within the framework of multilateral cooperation (systemic issues), the only open issue is the ban on the foreign trade of GMO products in Serbian regulations. The WTO rule stipulates that there can be no explicit import/export bans (except in exceptional situations specifically defined in WTO agreements), but WTO members are allowed to independently prescribe the way in which the foreign trade of GMO products can be carried out. This enables Serbia to introduce very restrictive conditions in accordance with domestic needs. When it comes to bilateral WTO negotiations, it is necessary to intensify activities on a bilateral level with Brazil, Ukraine and the Russian Federation, as well as to consult with the US and EU delegations at the WTO in Geneva in order to provide support for the continuation of negotiations.

**Harmonisation of national with the technical regulations of the European Union and their efficient application through the developed system of quality infrastructure are a prerequisite for Serbia's inclusion in international and European integration flows and ensuring the free movement of goods and services.** Serbia has largely aligned its horizontal technical legislation, standards and technical regulations with the EU acquis (to date 97% of standards and about 75% of technical regulations have been taken). In the process of taking over the harmonised EU legislation, 6 (out of 38) of the areas covered by Negotiating Chapter 1 – Freedom of movement of goods stagnate, and these are: motor vehicles, construction products, toys, civil explosives and pyrotechnic articles, cultural goods and eco design, and energy efficiency. In the non-harmonised area, in accordance with the requirements of the European Commission for the removal of unnecessary barriers to trade, activities of revising regulations for the purpose of their harmonisation with Articles 34-36 of the Treaty on the Functioning of the EU have been initiated. It is necessary to intensify these activities by adopting and implementing the Action Plan for the regulation of the non-harmonised area. Serbian standards are adopted in accordance with the Law on Standardisation (Official Gazette of the Republic of Serbia No. 36/09 and 46/15) and the rules of the Institute for Standardisation of Serbia, which are in

line with the rules of international and European organisations for standardisation, as well as the Code of Good Practice for Development, Adoption and Application of the standards set out in the Agreement on Technical Barriers to Trade in the WTO. On 1 January 2017, the Institute for Standardisation of Serbia became a full member of the European Committee for Standardisation (CEN) and the European Committee for Electro-technical Standardisation (CENELEC), which significantly facilitated access for Serbian businessmen to the European and other markets, thus improving their competitive position. Serbia should further harmonise sectoral legislation and ensure better implementation of the technical requirements and standards (EC 2016 Progress Report for the Republic of Serbia, page 37).

## **Structural reform 15 IMPROVING THE CONDITIONS FOR PRODUCT SAFETY AND REMOVING BARRIERS TO TRADE**

### **1. Structural reform outline**

An efficient and internationally recognised quality infrastructure (QI) system is aimed at providing safe and good-quality products on the market, which is among the key prerequisites for improving the competitiveness of the Serbian economy, exports and economic growth. An efficient QI system provides the Serbian enterprises and industry with a framework for the implementation of technical regulations and standards for products and management control systems (safety, quality, environmental protection, etc.). This reform is focused on attaining a uniform high development level of metrology, standardisation, accreditation and conformity assessment (CA), as well as the full and efficient implementation of the legislation applicable to free movement of goods, without unnecessary technical barriers to trade.

The medium-term objective of the reform, in the period from 2018 to 2020, refers to the improvement of the conditions for product safety and removal of technical barriers to trade in the following areas: construction products, motor vehicles, chemical products, pyrotechnic articles/civil explosives, personal protective equipment, medical devices and toys. These areas are part of the area covered by the Negotiating Chapter 1 - Free movement of goods, which is the responsibility of several ministries. This reform is in line with the National Programme for the Adoption of the *Acquis* (NPAA) and goals of the Strategy for Improvement of the QI System in RS for the period 2015-2020 and includes: (1) harmonising the legislation with the EU *acquis*; (2) regulating the non-harmonised area; (3) an internationally recognised institutional QI framework.

### **2. Activities conducted and planned with a view to structural reform implementation**

The reform has a wide range of different industrial products. Serbian Standardization Institute (SSI) took over 98% of European standards into Serbian standardisation. By October 2017, the Accreditation Body of Serbia (ATS) accredited 547 bodies for Conformity Assessment (CAB) in different areas. Capacities for assessing product conformity have been strengthened by implementing the project of procurement of laboratory equipment worth EUR 4.6 m within the IPA 2013 programme. The CA area is partially harmonised with the EU and regulated by the Law on Technical Requirements and Conformity Assessment (Official Gazette of the Republic of Serbia No. 36/2009) preparation of the new law is underway. The fully harmonised areas are: machine safety, equipment and protective systems intended for use in potentially explosive atmospheres, noise, safety of lifts, electromagnetic compatibility, recreational crafts, gas appliances, crystal glass, fertilisers. By the end of 2017, a total of 74 CABs were appointed in line with technical regulations. Market surveillance is regulated by the Law on General Product Safety and the Law on Market Surveillance, both aligned with the EU *acquis* to the greatest extent

*The following has been planned for the next three-year period:* harmonise regulations in accordance with the NPAA and AP for the harmonised area; arrange the non-harmonised area by implementing AP; strengthen the capacities of line ministries; strengthen the capacity of authorised bodies (AB) and

Quality Insurance institutions and maintain their status in European and international organisations, as well as strengthen market surveillance. The reform in the next programming period focuses on the following areas: construction products, motor vehicles, chemical products, pyrotechnic articles/civil explosives, personal protective equipment, medical devices and toys. The Market Inspection Sector, which has 100 market inspectors, carried out 5,009 controls of product compliance and safety in 2016, issued 589 decisions on taking corrective and restrictive measures, and filed 573 requests to the competent judicial authorities for breach of technical and safety requirements for products.

### 3. Expected impact on competitiveness

Implementation of the planned activities under this reform will directly contribute to the creation of new, favourable conditions for placing products on the market, since the new regulations and standards will reduce production costs, increase product quality, reduce testing and certification costs, which will together increase the competitiveness of local companies. In addition, this reform provides for more efficient market surveillance that ensures the application of technical regulations, and therefore the placement of safe products on the market. The new harmonised legislative framework will lead to the abolition of unnecessary barriers to trade with CEFTA signatories.

### 4. Estimated costs and impact on the budget

Funds for financing the reform in the amount of EUR 4.4 million are provided by the 2018 Budget Law. The allocation for financing the reform in 2019 and 2020 is EUR 2.7 million per each year. Potential non-budget funds are provided for 2018 in the amount of EUR 3.2 million (the whole amount derives from IPA funds); and EUR 1.7 million for 2019 and 2020 per each year.

### 5. Expected impact on employment and gender

Strengthening the competitiveness of the national economy has an impact on the growth of employment.

### 6. Potential risks in structural reform implementation

Reduced capacities of the competent institutions for the harmonisation of regulations in accordance with NPAA and Action Plan for the harmonised area poses a risk that can be avoided by adequate training and staffing. The lack of cooperation between the competent institutions, as a potential risk, can be avoided by enhancing cooperation through Negotiating Group 1, establishing a co-ordination body, improving exchange of information etc. Inadequate implementation of technical legislation, as a potential risk, can be avoided by cooperating with the non-governmental sector, Serbian Chamber of Commerce, supervisory bodies, reporting to the national and European institutions, etc. The potential loss of membership and termination of agreements with relevant European and international organisations by the national QI institutions can be prevented by increased oversight of their work, enhanced cooperation, and exchange of information. One of the possible instruments for reducing and avoiding these risks is the provision of expert and other forms of support through EU projects and programmes.

### 7. Structural reform implementation monitoring indicators

	2014 (BV)	2015	2016	2017	2018	2019
The index of the implementation of the rules and principles of the single EU market and the WTO/TBT agreement – TV: 56 (2020)	/	48	50	51	52	54
Share of exporters in the total number of SMEs – TV: 6.5% (2020)	4.3%	4.3%	4.5%	5%	5.5%	6%
Share of exports in total turnover of the SME sector – TV: 11.5% (2020)	9.1%	9.1%	9.5%	10%	10.5%	11%

### 3.7 Area EDUCATION AND SKILLS

#### a) Analysis of main obstacles

*Investment in education is a necessary prerequisite for the development of human capital because a well-educated and competent workforce is vitally important for the competitiveness of the economy – it stimulates domestic and foreign investments and enables the development of products and services of high value added. However, there are many challenges related to education and skills in Serbia: a low coverage of preschool education, inadequate capacities of the preschool education system and education in terms of the number of children and the network of institutions, lower quality of primary education reflected in the students' ability to apply the acquired key knowledge and skills, unregulated system of qualifications acquired by education, low share of population with university degree, labour market mismatches, "brain drain" ..*

**The coverage of non-compulsory preschool education is relatively low** in Serbia – **below 50%** (children aged up to 3 years – 22.2%, from 3 to 5.5 years - 39.5%), while the EU standard is 85%. On the other hand, **the coverage of compulsory pre-school education** (from 5.5 to 6.5 years of age) is relatively **satisfactory** and amounts to **96.6%**, although there are significant differences depending on the region observed. In 2016/2017, **the network of institutions or facilities for preschool education** comprised 334 preschool institutions with 2,682 facilities, which are **inadequate system capacities** from the aspect of the number of children and the network of institutions (especially in rural and urban areas).

The educational system in Serbia is **not sufficiently inclusive** as its capacity to respond to the educational needs of various vulnerable social groups has not been adequately developed, nor are there appropriate affirmative measures in place for the enrolment of children from lower socioeconomic background.

About **35%** of people over the age of 15 **have not completed eight-year primary education or have only completed eight-year primary education** (2011 Census). **The quality of primary education in Serbia is lower than the average in the OECD countries**, measured by the PISA<sup>48</sup> test in 2012 – 15-year-olds from Serbia scored on average 60 points less than the OECD average of 500. However, according to the results of the 2015 TIMSS<sup>49</sup> study, students from Serbia scored **above-average results** – the average score for Serbia is 518 points, 18 points higher than the international average. **Modernisation of instruction** for students from 5<sup>th</sup> to 8<sup>th</sup> grade is implemented by introducing **cross-curricular** activities as support to underrepresented **entrepreneurial education**, aiming to stimulate children towards creative, process-based and project-based thinking.

Although Serbia is one of the few countries where secondary education is not yet mandatory, **about 95% of students who have completed primary education enrolled** in general and vocational secondary schools in 2016. Due to the labour market mismatches since September 2016, the introduction of the concept of the National Model of Dual and Entrepreneurial Education has been prepared. The model should provide high school students with intensive apprenticeship in companies where they would later get a job. In the territory of Serbia, 13.8% of secondary vocational schools have dual educational profiles. The total number of students enrolled in 2017/2018 school year was 4,559

<sup>48</sup>The Programme for International Student Assessment (<http://www.oecd.org/pisa>) – the greatest triennial international survey that tests the skills and knowledge of 15-year-old students. It measures student performance in reading, mathematical and scientific literacy, and as of 2018 financial literacy. Serbia did not participate in 2015 PISA testing.

<sup>49</sup>Trends in International Mathematics and Science Study, [http://www.ipisr.org.rs/timss/o\\_istrazivanju\\_timss](http://www.ipisr.org.rs/timss/o_istrazivanju_timss) – the project of the International Association for the Evaluation of Educational Achievement is carried out once in 4 years, with fourth-grade and eighth-grade students. It is an achievement test in mathematics and science.

(1,482 in schools with dual profiles and 3,077 in schools with dual education elements), while 1,832 companies were willing to become part of the dual education process. Out of this number, 205 companies were licensed in this school year for providing work-based learning (67 companies for dual educational profiles and 138 companies for educational profiles with dual education elements). In terms of the local economic development it is especially important that a number of companies involved be in the category of small and medium-sized enterprises.

The share of the population with higher education in Serbia is low and amounts to only 10.6% (2011 Census). The situation is somewhat better when it comes to the share of the active population with a university degree – 24.4% (LFS, 2016). In **the field of university education**, some of the key challenges have been identified: **enrolment quotas that do not correspond to market needs** (faculties do not operate under performance-based funding system, but are funded according to the number of departments and teachers), **duration of study** (approximately twice as long as the duration of the study program), **limited opportunities for acquiring practical knowledge** (the economy does not participate in formulating the curriculum, and students are not encouraged to work on their professional development outside the faculty), the quality of research papers is questionable. On the other hand, there is a **lack of teaching space** (especially in university centres outside Belgrade), with relatively **outdated research equipment**, etc.

Current **investments in education, due to inadequate education systems**, are not sustainable, as they do not create **university educated young people that are competitive in the labour market**. **Unemployment among young people** aged 15-29 is **high**, and the unemployment rate of 29.7% (LFS, 2016) is one of the indicators of the inadequacy of our education system. On the other hand, the **lack of adequate staff**<sup>50</sup> is one of the biggest obstacles in business development, which is a clear indicator that companies find it harder to find good quality employees. In order to ensure better matching between supply and demand, systemic monitoring of labour market needs should be established.

## **b) Report on policy guidance implementation since May 2017**

The implementation of SR 16 *Qualifications oriented to the labour market requirements* means the implementation of a part of ECOFIN recommendation 6 (*develop dual learning in vocational education and training in close cooperation with social partners and the business community*). The concept of the National Model of Dual and Entrepreneurial Education in Serbia has been implemented since September 2016, and currently 13.8% of secondary vocational schools in the territory of the RS have dual educational profiles. The total number of enrolled students in 2017/2018 school year is 4,559 (1,482 in schools with dual profiles and 3,077 in schools with dual education elements), while 205 companies are licensed to organise work-based learning (67 companies for dual educational profiles and 138 companies for educational profiles with elements of dual education).

## **Structural reform 16 QUALIFICATIONS ORIENTED TO THE LABOUR MARKET REQUIREMENTS**

### **1. Structural reform outline**

The purpose of establishing the National Qualifications Framework (NQF) in Serbia is to organise and improve the system of qualifications in accordance with the requirements of socio-economic development, to support the implementation of lifelong learning concept and facilitate mobility of labour. Once established, the NQF will define what each individual can and knows to do according to the acquired qualifications. Also, the establishment of a dual education system will enable high school students to move from the world of education to the world of work more easily, that is encourage

<sup>50</sup> Source: Annual survey of the Union of Employers of Serbia.

students to be more entrepreneurial and motivate them to start their own business and join the world of work. The above reforms will bring benefit to both individuals and individuals, and the society as a whole.

## **2. Activities conducted and planned with a view to structural reform implementation**

A Draft Law on NQF was prepared and a public discussion was held. The Action Plan for the establishment and implementation of the NQF is under way. A unique qualification database was set up and 113 qualifications were entered, 59 of which have a qualification standard. Activities on the development of three sector profiles and development of studies relevant to the establishment of the NQF system have been initiated.

The Law on Dual Education has been adopted and bylaws are being drafted, which will, among other things, enable the implementation of the licensing process for business entities for dual education. The implementation of an analytical system for monitoring and evaluating dual and entrepreneurial education is under way as well as the development of training for instructors who will facilitate work-based learning in business entities, and creation of new educational profiles for the dual education model. In line with the plan, the activities of promotion of dual and entrepreneurial education were undertaken in 34 cities in Serbia through "The Spirit of Youth". New enrolment plan that has been implemented throughout the school year 2017/2018 took into account the needs of the labour market.

*The following has been planned for the next three-year period:* in order to establish and implement the NQF system, adopt the Law on the National Qualifications Framework of Serbia, establish the Council for NQF, the Agency for Qualifications and Sectoral Councils as the institutional framework of the NQF, establish the NQF registry, develop non-formal and informal learning validation system so that qualifications can be acquired both on the basis of work or life experience through a special procedure, as well as link the NQF with the European Qualifications Framework.

In order to implement the dual education system, it is planned to establish a commission for the development and implementation of dual education with the Government of the RS, adopt bylaws in accordance with the Law on dual education, develop and improve the model of student cooperatives, student internship and career guidance and counselling, modernise and create new educational profiles for the dual model of education, as well as establish an analytical system for monitoring and evaluation of dual and entrepreneurial education.

## **3. Expected impact on competitiveness**

Establishment of the NQF system provides mechanisms for social partnership among all stakeholders on the labour market: the educational system redefines its offer on the labour market when it comes to formal education, while on the other hand, non-formal education service providers can intervene in the market of competences in a fast and efficient manner with an offer of accredited training programs. By establishing a link with the NQF, qualifications acquired in Serbia become visible and comparable with qualifications acquired in other countries, primarily the EU. By implementing dual and entrepreneurial education we expect the improvement of human capital (knowledge, skills and competences), as well as the improvement of the competitiveness of business entities operating in Serbia.

## **4. Expected costs and budgetary implications**

The amount of EUR 224,000 for financing the reform is provided by the 2018 Budget Law. The same amount for financing the reform is envisaged in 2019 and 2020. As for the non-budget funding of the reform, the following funds were provided: 2018 - EUR 74,794; 2019 - EUR 19.680.

Non-budget support provided for the NQF system amounts to EUR 1.5 million. This amount is programmed under the IPA 2014 and it is planned to be contracted in 2018. Furthermore, support for the NQF system will also be implemented through IPA 2016 in accordance with the sector budget support mechanism.

## 5. Expected impact on employment and gender

The implementation of reforms will contribute to reducing the gap between education and labour market needs, ensuring the participation of social partners in the development of market-relevant qualifications, and therefore confidence in the (market) relevance of the education system as a whole. Attending dual and entrepreneurship education programmes will improve the level of competence and employability of students and facilitate their integration into the world of work.

## 6. Potential risks in structural reform implementation

Potential risk can be the low level of participation of business entities and other social partners in the establishment of the NQF system and in the implementation of the dual education model.

## 7. Structural reform implementation monitoring indicators

	2015 (BV)	2016	2017
Number of accredited qualifications in the qualifications register (based on qualifications standard and learning outcomes) – TV: 150 (2020)	0	59	62
Number of established contracts between schools and companies	40	62	128
Number of students attending the dual system	510	1,000	4,559

### 3.8 Area EMPLOYMENT AND LABOUR MARKET

#### a) Analysis of main obstacles

*The Serbian labour market has experienced expansion in the past few years (despite negative demographic trends), featuring the increase of employment and activation, and the decrease of unemployment. However, there are still multiple challenges that reduce the quality of the human capital through the loss of skills, self-confidence and motivation: high youth and long-term unemployment rates (characteristics of structural unemployment), a considerable proportion of workers working outside of the formal sector, the inflow of unemployed persons as a result of the finalisation of the privatisation and restructuring process in state-owned enterprises and the public sector, inadequate capacities of the public employment service to render high-quality services, as well as the limited effects of active labour market policies.*

**Positive labour market trends in Serbia have persisted, although with effects on employment below the EU-28 level.** The employment rate of the population aged 15 and over was 48.2 % in Q3 2017 (EU-28: 53.6 %, Q2 2017, Eurostat), which shows an increase of 1.4 pp year-on-year. The employed population grew to 2.9 million (a 2.4 % y-o-y increase) as a result of the increase in the number of employed persons (2.2 million) in the formal sector by 117 thousand y-o-y (the most in the Processing Industry and the Accommodation and Food Services), while the number of people working in the grey economy decreased by 49 thousand y-o-y, to 628,000 informally employed persons in Q3 (mostly in agriculture).

**The informal employment rate** stood at 21.8% (LFS, Q3 2017), which was a **drop of 2.3 pp y-o-y**. Addressing the high share of informal employment requires a **broad range of measures**, in order to mitigate the detrimental effects on the country's economic development, such as the decline of tax revenues, limited access of workers to social protection, inadequate employment contracts, comparatively low wages and vulnerability upon job loss or retirement. A reform of the labour legislation has been initiated, with special focus on temporary agency work, temporary engagement in seasonal jobs in certain sectors and social entrepreneurship.

**Unemployment in Serbia is at its lowest level in the past few years.** The unemployment rate of the

population aged 15 and over was 12.9 % in Q3 2017 (EU-28: 7.6 %, Q2 2017, Eurostat), which constituted a **year-on-year decline by 0.9 pp**. However, the labour market is facing the **challenges of structural unemployment**, because a large number of unemployed persons have been seeking a job for more than a year (the long-term unemployment rate is 7.7 %). **Long-term unemployment** leads to the obsolescence of knowledge and, since the probability of finding a job decreases proportionately to the increase of the length of unemployment, it can **lead to permanent exclusion from the labour market**.

**Youth aged 15-24 in Serbia, with their unemployment rate of 28.8 % (Q3 2017), are still in a considerably worse position compared to their peers in the EU (EU-28: 16.9 %, Q2 2017, Eurostat).** The decrease of the youth unemployment rate by 0.4 pp year-on-year is not solely the consequence of the reduced number of unemployed people, but also of the negative demographic trend, i.e. the shrinking population aged 15-24. Compared to the general population (15+), the youth employment rate is more than twice lower (23.7 % and 48.2 %, respectively), whereas the unemployment rate is more than twice higher (28.8 % and 12.9%, respectively). A particularly vulnerable group in the labour market are youth who are not in employment, education or training (NEET), whose share in the overall youth population was 17.1 % in Q3 2017 (1.1 pp year-on-year decrease). In Serbia, youth are defined as young persons between age 15 and 30<sup>51</sup>, considering that global social changes have contributed to the phenomenon of “extended youth”, which entails a longer period of education, later transition into the labour market, as well as later marriage and parenthood. Labour market indicators for youth aged 15-30 in Q3 2017 had the following values: activity rate – 49.8 %, employment rate – 35.6 % and unemployment rate – 28.5 %.

**Women’s position in the labour market** is much more unfavourable than men’s, as shown by all indicators, and the disparity was the most pronounced between employment rates, where the difference was 14.7 pp (55.8 % for men and 41.1 % for women, LFS, Q3 2017). Women’s share in the overall employed population in Serbia was 44.2 % (LFS, Q3 2017), although their share in the overall general population was 51 % (2011 Population Census).

**Labour market reintegration of redundant workers** still poses a challenge, considering that there are still 144 enterprises with unresolved status in the Privatisation Agency’s portfolio, with more than 50,000 employees. Severance pay was disbursed to more than 25,000 employees who were made redundant in 2015 and 2016. The total reduction in the number of public sector employees by September 2017, compared to the end of 2014, was about 28,500 persons, mostly through natural employee attrition. After several cycles of comprehensive labour force rightsizing, there are now 6.4 public administration employees per 100 people in Serbia, while the European Union average is 8.5, which ranks Serbia among the European countries with the smallest public administration staff.

**The public employment service in Serbia lacks human resources and infrastructure for rendering high-quality support to unemployed persons**, especially for improving the labour market position of the prioritised categories (youth, redundant workers, long-term unemployed persons, financial social assistance recipients, women etc.). Employment counsellors are facing a heavy workload (the current average workload is 1,180 unemployed persons per one employment counsellor), which decreases the efficiency and implementation of ALMPs and hampers the **targeted inclusion of unemployed persons in those ALMPs that contribute the most to their more competitive participation in the labour market**.

In order to ensure better matching of labour supply and demand, i.e. the pairing of job seekers and employers who offer jobs, the key challenge is to **establish the systemic monitoring of the skills gap**

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<sup>51</sup> Law on Youth (*RS Official Gazette* No 50/11)

**in the labour market.** It is necessary to **improve counselling methods and techniques in dealing with the unemployed and employability assessment on a case-by-case basis** in line with the characteristics of individuals (education level, work experience, additional sets of knowledge and skills, gender etc.) and of the labour market. The process of certification of the NES employment counsellors has begun as part of a World Bank project.

#### **b) Report on policy guidance implementation since May 2017**

The implementation of *SR 17 - Improving the effectiveness of active labour market policies with special emphasis on youth, redundant workers and the long-term unemployed* covers a part of the ECOFIN Recommendation 6 (*target active labour market measures to vulnerable groups, including social assistance beneficiaries*). The National Employment Action Plan for 2017 (RS Official Gazette No 92/2016) specifies hard-to-employ categories of unemployed persons that should be prioritised for inclusion in all active labour market programmes and measures, and they include fit-for-work recipients of financial social assistance. The Action Plan further prescribes that at least 70 % of the unemployed persons included in a public works scheme should come from hard-to-employ groups. Moreover, financial social assistance recipients are specifically recognised as one of the target categories for subsidies aimed at the employment of unemployed persons. In addition, with a view to the provision of integrated services for financial social assistance recipients, i.e. for their adequate and timely labour market integration or reintegration, cooperation protocols were also signed in 2017 between centres for social work and the NES branch offices. As a result of these activities, in 2017, a total of 11,461 financial social assistance recipients were included in active labour market policies.

### **Structural reform 17. IMPROVING THE EFFECTIVENESS OF ACTIVE LABOUR MARKET POLICIES WITH SPECIAL EMPHASIS ON YOUTH, REDUNDANT WORKERS AND THE LONG-TERM UNEMPLOYED**

#### **1. Structural reform outline**

The promotion of efficiency and effectiveness of active labour market policies (ALMPs) based on an analysis of labour market needs and the status of certain categories of unemployed persons, as well as the effects of implemented ALMPs, should contribute to a timely, adequate and proper integration or reintegration of the unemployed in the world of labour. The development of a system of early profiling of the unemployed as an integral part of the NES reform (by improving counselling methods and techniques and employability assessments) and inclusion of youth, redundant workers and the long-term unemployed in ALMPs through service packages contributes to higher employability and employment, i.e., to a more competitive position in the labour market. The ALMPs are implemented in line with the annual National Employment Action Plan (NEAP), as the core instrument for operationalising the strategic goals set out in the National Employment Strategy 2011-2020. This reform is also aligned with the objectives defined in the Employment and Social Reform Programme (ESRP) and National Youth Strategy for the period 2015-2025.

#### **2. Activities conducted and planned with a view to structural reform implementation**

Within the reform of the NES, aimed at improving the quality of the NES services, including through staff capacity building by establishing the system for internal certification and training of employment counsellors, 542 (85.2 %) employment counsellors were included in the certification process (tested) in 2017, and 486 (76.4 %) counsellors received certificates (out of the total of 636 employment counsellors / PWD employment counsellors in the NES). As regards the target groups of this structural reform – youth, redundant workers and the long-term unemployed, the total number included in ALMPs in the period 1 January – 30 September 2017 was: 40,862 young people (20,988 women) or 29.1 % of the total number of persons in this category (140,405 persons, among whom 73,244

women); 9,646 redundant workers (5,585 women), or 20.5 % of the total number of persons in this category (46,982 persons, among whom 25,239 women), and 58,197 long-term unemployed persons (31,921 women), or 13.4 % of the total number of persons in this category (433,909 persons, among whom 233,360 women).

The document titled *National Employment Strategy 2011–2020 Effectiveness Assessment for the First Five Years of Implementation and Identification of the Further Courses of Action until 2020*<sup>52</sup> has been finalised, and the analyses *Assessment of the Scope, Scale and Effects of LEAPs in the Period 2010–2016*<sup>53</sup>, *Appraisal of the National Budget Expenditures in the Period 2013–2015 on Policies Aimed at Increasing Youth Employability and Employment* and *Analysis of Subsidised Employment Measures*<sup>54</sup> have been conducted. Evaluation has been undertaken of the service package for youth and the ALMPs – on-the-job training and apprenticeship training – provided by the NES, as well as of the set of measures supported by the MoYS and implemented by youth offices and civil society organisations, and recommendations have been provided for enhancing the effectiveness of the measures targeting unemployed youth. The findings and recommendations of the analyses were used within the National Employment Action Plan for 2018, which was adopted in December 2017 and which determines objectives and priorities of the labour market policies in 2018.

Support to associations and local government units has continued in 2017 through funds provided for 31 projects that are currently in progress.

Four regional meetings were organised to discuss *The Role of Local Government Units in Achieving Employment Policy Objectives*, with a view to intensifying the dialogue between the national and local levels, exchanging the experiences between local government units and local employment councils about the process of local employment action plan implementation. The meetings were attended by 166 representatives of 70 local government units, NES, MoLEVSA, other institutions and social partners, donors and experts.

*The following has been planned for the next three-year period:* Further improvement of the employment policy in line with the elements specified in the national Action Plan for Chapter 19; Enhancing the employability and stimulating the employment of hard-to-employ categories through the implementation of target-oriented active labour market policies; Capacity building of authorities responsible for employment affairs in order to ensure better targeting and higher efficiency of active labour market policies, especially of the NES, through the reform of this institution; Improvement of the methods and techniques for monitoring and evaluation of active labour market policies; Development and strengthening of cooperation among local-level stakeholders and coordination of their activities in the employment policy system; the adoption of Action Plan for the Implementation of the National Youth Strategy 2018–2020, which will be a basis for Ministry of Youth and Sport to continue with implementation of activities which will enhance conditions for employment, self-employment, entrepreneurship and youth employment.

### **3. Expected impact on competitiveness**

The involvement of youth, redundant workers and the long-term unemployed in ‘targeted’ active labour market policies, according to personal characteristics and preferences and in accordance with gender equality principles, especially if the goal of such policies is the acquisition of knowledge, skills and work experience, employment/engagement or entrepreneurship development, contributes to

<sup>52</sup> In cooperation with the International Labour Organization, the World Bank and the European Commission.

<sup>53</sup> With support of the technical assistance project under the IPA programme.

<sup>54</sup> Within the project “Support to the Implementation of the Employment and Social Reform Programme (ESRP) in Serbia with a Focus on Youth Employment and Employability Policies”. The project is funded by the Government of the Swiss Confederation through the Swiss Agency for Development and Cooperation, and implemented by the Social Inclusion and Poverty Reduction Unit in cooperation with MoESTD, MoLEVSA and MoYS.

enhancing the position of these groups in the labour market and the prevention of unfavourable migration flows in the form of brain drain (especially of youth) and work in the grey economy. Furthermore, the implementation of ALMP programmes and measures decreases the disparities among the development levels of regional and local labour markets and contributes to employment policy decentralisation, i.e. the creation and implementation of policies tailored to the status, trends, needs and possibilities of local labour markets, which leads to the evolution of a stable and sustainable labour market characterised by high-quality human capital as a precondition for the growth of economic and investment activities.

#### 4. Expected costs and budgetary implications

Funds for financing the reform are provided by the 2018 Budget Law and they amount to EUR 5.2 million baring the fact that expected direct effect on budget revenue amounts to EUR 29,2 million. The same amount (EUR 5.2 million) for financing the reform is envisaged in 2019 and 2020 per each year. Note: Transfer of funds to the National Employment Service, for active employment policy measures were cancelled, which relieved the Serbian Budget and did not diminish the funds for the implementation of measures, which are primarily aimed at encouraging employment and improving the position in the labour market of unemployed persons classified to hard-to-employ category. The amount of EUR 29.2 million was planned for the active employment policy measures for 2018. and provided in the National Employment Service Financial Plan for 2018, and will be financed from contributions for compulsory unemployment insurance (which is in accordance with Article 59 of the Law on Employment and Insurance in the Case of Unemployment).

#### 5. Expected impact on employment and gender

Equal inclusion of unemployed men and women in ALMPs is planned in order to increase equal employment opportunities. The improvement of active labour market policies, especially the service package for youth, as well as the implementation of the programmes and measures funded from the national budget, will help young people to acquire knowledge, skills and work experience that is important for their quicker school-to-work transition, social empowerment and career management.

#### 6. Potential risks in structural reform implementation

The inactivity of the unemployed in the labour market; the mismatch between supply and demand, i.e., the mismatch between knowledge, skills, and competences of the unemployed and employers' requirements; lack of interest on the part of employers for employing/engaging hard-to-employ persons; inadequate capacities of the NES.

#### 7. Structural reform implementation monitoring indicators

	2014 (BV)	2015	2016
Long-term unemployment rate (the share of persons who have been unemployed longer than one year in the total active population) – TV 7 % (2018)	12.8 %	11.3 %	9.9 %*
Number of people employed/engaged through active labour market policies – TV 30,000 (2018)	16,800	41,891**	37,212***
Long-term youth (15-29) unemployment rate (the share of unemployed young people who have been unemployed longer than one year in the total active population) – TV 7 % (2018)	21.1 %	18.9 %	14.5 %*

\* LFS, SORS

\*\* National Employment Service Performance Agreement / Implementation Report

\*\*\* 2016 NEAP Implementation Report.

### 3.9 Area SOCIAL INCLUSION, POVERTY REDUCTION AND EQUAL OPPORTUNITIES

#### a) Analysis of main obstacles

*The level of expenditures on social protection is consistent with the current development level in Serbia, so the key challenge in the area of social and child protection is the reallocation of these funds among the existing schemes in order to increase their accessibility. Since poverty is widespread and affects various population groups, often by multiple deprivation factors, the fundamental issues are: lack of links among centres for social work and with other institutions, absence of social cards, insufficient quality of services, as well as poor control and regulatory mechanisms.*

**Poverty in Serbia is widespread**, considering that the absolute consumption poverty rate<sup>55</sup> shows that between 6 % and 7.6 % of the total population of Serbia has not been able to meet even its basic needs in recent years (7.3 % in 2016). According to another indicator, 38.7 % of the population (2.7 million people) were at risk of poverty or social exclusion in 2016<sup>56</sup>, suggesting that the risk in Serbia was greater than in the European Union countries (EU-28: 23.8 %, SILC, 2015). The at-risk-of-poverty threshold (the relative poverty line) was RSD 15,416.00 (EUR 123.5) on average per month for a single-person household.

**The inequality of income distribution is high**, as indicated by the income quintile share ratio (S80/S20) – the most affluent 20 % of the population had 9.7 times higher equivalised income compared to the poorest 20 %, and the Gini coefficient, which stood at 38.6 (which is above its average value in the EU-28 – 31, SILC, 2015).

**Poverty dynamics varies by age groups and employment status.** The most exposed to the risk of poverty are persons in the 18-24 age bracket (32.7 %) and persons under 18 years of age (30.2 %). Considered by employment status, the most exposed group among persons aged 18 and over are the unemployed (48 %). The risk of poverty of children is largely influenced by their parents' labour market status, especially in conjunction with limited access to social services. In Serbia, as in many other countries, **certain groups are particularly disadvantaged**, most notably the Roma, especially those in informal settlements, as well as internally displaced persons, persons with severe disability, the elderly without pensions, individuals with no/low education and the non-urban population. Many poor households are **affected by multiple deprivation factors**, which requires complex interventions of a preventive nature, as well as active inclusion measures that combine cash benefits, employment/activation of beneficiaries and high-quality integrated social services.

**The expenditures on social protection** in Serbia in 2016 amounted to **23.4 % of the GDP** (SORS). However, expressed in purchasing power standards, the expenditures amounted to only 2,397 PPS per capita<sup>57</sup>, i.e. three times lower than in the EU-28 (7,905, 2014, Eurostat). Lower expenditures than Serbia's, expressed in purchasing power standards per capita, were recorded in Turkey and Romania.

The structure of expenditures on social assistance and transfers is **dominated by expenditures on pensions**, whose GDP share decreased from 12.1 % in 2015 to 11.8 % in 2016<sup>58</sup>. **The expenditures on social assistance amount to approx. 3.7 % of GDP**, which is consistent with the current development level and is comparable with the levels of expenditures for this purpose in the Southeast European countries. However, **the reallocation of these funds among the existing schemes is a challenge**, since a large number of socially vulnerable persons do not receive financial social assistance although

<sup>55</sup> Source: Household Budget Survey, 2008–2016, SORS

<sup>56</sup> Source: Survey on Income and Living Conditions (SILC), SORS

<sup>57</sup> PPS – Purchasing Power Standards

<sup>58</sup> Source: Consolidated Government Balance, Ministry of Finance

they should, whereas, on the other hand, social protection rights are also exercised by individuals who are not socially vulnerable (e.g. child allowances are also awarded to more financially secure families).

The solution to this problem requires the **introduction of an integrated system for the creation of social cards** by linking a large number of various institutions (Tax Administration, MoI, Real Estate Cadastre etc.), because **centres for social work** conduct their activities in a **closed environment of local IT systems which are linked neither to each other nor to other institutions** and/or registries. On the one hand, this extremely complicates the procedures for clients / social protection beneficiaries, who are burdened by requirements to submit extensive documentation, whereas on the other hand, it increases the risks of abuse, thus impairing the funds distribution equity.

**Social assistance** (provided by centres for social work) and employment support services and measures (provided by the NES) require **better integration and coordination** in order to resolve the problems of persons in need of social protection. Another challenge in the field of social protection concerns the **continuous improvement of service quality, strengthening of control and regulatory mechanisms, monitoring and evaluation**. The social protection inspection banned the operation of 125 illegal elderly care homes in the period 2014–2017. 24 bans for illegal elderly care homes were issued in 2017 (93 bans since 2013 through 2017).

**Gender equality is still not at a satisfactory level.** Serbia is the first non-EU country to introduce the Gender Equality Index, and the data indicate that it lags behind the EU Member States' average in all gender equality domains (except the domain of power), with a serious gap in the domains of work and money. **The pay gap between women and men** in Serbia stands at **11 %**<sup>59</sup>, which means that employed women earn 11 % less than men<sup>60</sup>. Although women account for 51 % of the general population, there are still **fewer of them among decision-makers**: women hold 35.6 % of the seats in the parliament, and 23 % of offices in the Government. When it comes to managerial positions in public enterprises, the situation has improved, because women accounted for as many as 22 % of general managers and board members in 2016, which was an increase of 9 pp compared to 2015 (one of the indicators for SR 10 – Public Enterprise Reform).

## **Structural reform 18. IMPROVING THE ADEQUACY, QUALITY AND TARGETING OF SOCIAL PROTECTION**

### **1. Structural reform outline**

Includes two measures: *Measure 1.* Increasing the adequacy of cash benefits and improving the accessibility and quality of social services by amending the legislation; and *Measure 2.* Linking different sectors' information systems to ensure that beneficiaries can exercise their social rights without administrative barriers, thus ensuring better targeting of overall social assistance.

The prerequisites for enhancing the adequacy of cash benefits are: higher weights (benefits) for children and youth with disabilities, relaxation of property-related requirements, primarily by increasing the land ownership ceiling depending on soil quality for elderly households, increasing the adequacy of the child allowance scheme for children with disabilities and increasing the coverage of poor children, linking cash benefits to corresponding services, reviewing the rationale for the existence of the attendance allowance under two systems (the pension and disability insurance system and the social protection system) and an analysis of the basic attendance allowance amount.

The activities contributing to the accomplishment of the objectives (consistent and high-quality social services within the mandate of local governments) include: amendment of current and adoption of new

<sup>59</sup> Source: Gender Pay Gap in the Western Balkan Countries: Evidence from Serbia, Montenegro and Macedonia, FREN.

<sup>60</sup> By comparing the earnings of women and men with the same education, work experience and occupations, the authors of this study concluded that women in Serbia would have to work additional 40 days in a year in order to earn as much as men with the same labour market profile do.

regulations in the field of control and regulatory mechanisms, strengthening of control services (in terms of staff number and expertise), a review of the benchmarks and criteria for costing social services, harmonisation of social service standards with the voluntary European Quality Framework for Social Services, the application of the mechanism of earmarked transfers to underdeveloped municipalities for funding social services in compliance with the Budget System Law, as well as the further involvement of as many different actors as possible, including civil society organisations, in the system of social service providers, while paying attention to the quality of the services, through strengthening the social protection inspection and the establishment of the oversight of social service providers' professional work.

The linking of information systems of different MoLEVSA departments, as well as between relevant institutions, will reduce administrative barriers for social protection beneficiaries, accelerate the exercise of social protection rights and enhance analytical capacities; enable centres for social work to access the records of other public authorities when deciding on clients' applications and enable them to obtain certain types of evidence relevant for the procedure by themselves, which shortens the process and thereby improves access, while at the same time functioning as a control mechanism. This will also shorten the procedures and decrease administrative obstacles, while reducing the scope for potential abuse.

## **2. Activities conducted and planned with a view to structural reform implementation**

The Law on Financial Support to Families with Children was passed (December 2017). The Decree on Earmarked Transfers was adopted in March 2016 and is implemented through the allocation of earmarked funds in line with the amount planned in the RS Budget for the current year. The Draft Law Amending the Law on Social Protection is under preparation. Until the end 2017, 326 licenses were issued to social protection organizations for the provision of services.

*The following has been planned for the next three-year period:* Revision of the benchmarks and criteria for costing social services; Increase of the weights (benefits) for children and youth with disabilities, and relaxation of property-related requirements, primarily by raising the land ownership ceiling depending on soil quality for elderly households; Completion of the process of service standardisation and the licensing of social service providers and professionals, introduction and upgrading of training programmes, as well as the preparation of relevant bylaws; Improvement of the quality of social services; Alignment of social protection regulations with a view to linking different sectors' information systems; Linking of cash benefits to relevant services; Review of the rationale for the existence of the attendance allowance under two systems (an insurance-based allowance and a social benefit) and an analysis of the basic attendance allowance amount; Improvement of cash benefits adequacy; Expansion of regional foster care and adoption centres and the design and improvement of their control function; Strengthening of inspection services (increasing the number of staff, introducing a new organisation and modality of operation).

## **3. Expected impact on competitiveness**

A precondition for increasing competitiveness and achieving economic growth is the existence of a system that can ensure the right to adequate and accessible social protection for its citizens.

Improved adequacy of cash benefits, higher quality of social services, increased accessibility of services, established control mechanisms in the social protection system, enhanced work efficiency and time savings of centres for social work, facilitated access to entitlements and services, improved coverage of cash benefits, more equitable funds distribution and enhanced cooperation of various sectors.

## **4. Expected costs and budgetary implications**

The amount of EUR 227.7 million for financing the reform is provided by the 2018 Budget Law. Planned budget funds for financing the reform in 2019 amount to EUR 244 million, i.e. EUR 258.7

million in 2020.

### 5. Expected impact on employment and gender

Job creation in the social protection system as a result of the completed process of standardization of services and licensing of new social protection institutions and professional workers.

### 6. Potential risks in structural reform implementation

Untimely adoption of the amendments to the Law on Social Protection, as well as the reduction of the overall financial envelope for these purposes. In order to establish a single social protection information system, it is necessary to link several institutions, as well as to open their databases, which poses one of the greatest potential risks to the implementation of this measure.

### 7. Structural reform implementation monitoring indicators

	2014 (BV)	2015	2016
Share of FSA recipients' net income in the at-risk-of-poverty threshold for single-person households – TV 80% (2020)	57%	53%	
Share of FSA beneficiaries' net income in the at-risk-of-poverty threshold for households with two adults and two children – TV 80% (2020)	69%	68%	

## V BUDGET IMPLICATIONS OF STRUCTURAL REFORMS

Total amount of costs planned for implementation of structural reforms in 2018 is EUR 566 million, and the estimated positive effects on budget revenues in the same period (based on an increase in production and employment, more efficient administrative processes, better collection of revenues, lower budget allocations due to increased efficiency and liquidity of state enterprises) amount to EUR 56 million. Total net budgetary impact in 2018 is estimated at EUR - 622 million.

Funds for implementation of structural reforms in 2018 are planned in accordance with the 2018 Budget Law ("Official Gazette of the Republic of Serbia", No. 113/2017), budget and loan funds, donations inflows, or from other sources. Given that in the 2018 there was a negative net budgetary impact, it is necessary to bear in mind that a direct impact on the budgetary expenditures is expected from those that are given, since the presented effects are planned for the implementation of structural reforms as well as the regular activities which are the starting point for their implementation. Funds from the budget of the Republic of Serbia for the implementation of structural reforms in 2019 and 2020 must be planned in accordance with the allocated limits for the owners of the reforms during the budget procedure. Due to the implementation of fiscal consolidation measures, the provision of additional financial resources for the implementation of structural reforms in 2018 and 2019 is not possible given the limited balance possibilities and the limits that the Ministry of Finance designates for the owners of the reforms.

The direct effects of each individual reform on budgetary expenditures have been reported in accordance with the 2018 Budget Law. Listed positive effects on the budget are assessed and represent positive risks, rather than an integral part of the scenarios from the Medium-Term Macroeconomic Framework (Chapter 2 of the ERP). Also, for each structural reform, funds from other sources, such as EU IPA funds, loans, donations, international financial institutions, have been allocated.

Detailed information on the effects of the implementation of structural reforms on the budget and potential non-budgetary financing are presented in Table 10 in the Annex section.

## VI INSTITUTIONAL ISSUES AND STAKEHOLDER INVOLVEMENT

The activities on the development of ERP for the period 2018-2020 started immediately after obtaining the EC guidelines in June 2017. The introductory meeting, chaired by the Minister of Finance, was held on 12 September 2017, with the participation of ERP coordinators from line ministries and other relevant institutions of the Republic of Serbia (NBS, NES, SORS), representatives of the OECD and the EU Delegation. The meeting was used to present the results achieved in the previous period, the new EC Guidelines for the preparation of ERP 2018-2020, the recommendations of the ECOFIN Council and the activity plan. In order to ensure more comprehensive involvement of civil society in the process of preparation and subsequent implementation of ERP, on the same occasion, on 12 September 2017, the Platform for monitoring the implementation of the implementation of the ERP 2018-2020 program and the Employment and Social Reform Program (ESRP) in the process of European integration. The platform's subscribers were the Minister of Labor, Employment, Veterans and Social Affairs, the Minister of Finance and the Manager of the Social Inclusion and Poverty Reduction Team, together with representatives of civil society gathered in the National Convention on the European Union (European Movement, Center for European Policies, NALED and Foundation Center for Democracy). The aim of this initiative is to establish an effective dialogue between the Government of the Republic of Serbia and civil society in the Republic of Serbia on the implementation of the most important reform measures for the economic and social development of the Republic of Serbia contained in the relevant fields of the ERP and the ESRP. The implementation of the Platform has resulted in very useful and tangible analytical documents such as: Horizontal Overview of the Economic Reform Program, Transformation of the Tax Administration, Improvement of the National Quality Infrastructure System, Raising the Competitiveness of the Manufacturing Industry, Development and Improvement of National Broadband Communications Infrastructure and Unique Electronic Contact Point. Also, within the Working Groups in the National Convention on the European Union, 10 thematic sessions were held where relevant analytical representations were presented, which was an opportunity for civil society representatives to ask questions, provide comments and suggestions for amending ERP 2018-2020. The results of these meetings in the form of presentations, analytical reviews and infographics were presented to the public on social networks and on the websites of the supporters of the Platform (for details refer to Annex 1 of the document).

The Republic of Serbia has a developed structure for intersectoral coordination of the ERP, and ERP coordinators have been appointed at the highest level, demonstrating high commitment to and ownership of the process of drafting the document. With a view to further enhancing ownership of the process, this year the Working Group for ERP Development and Monitoring has been formalised by Minister's decision (the Decision Establishing the Working Group is given in Annex 2).

In accordance with the established practice, the first part of the document (Chapters 1-3), regarding the macro-fiscal framework, has been developed by the Ministry of Finance and the National Bank of Serbia, relying, for the most part, on the Fiscal Strategy for 2018 with Projections for 2019 and 2020. The work on the preparation of Chapter 4 –Structural Reforms for the Period 2018-2020 and Chapter 5 – Budgetary Implications of Structural Reforms, has been coordinated by the Republic Secretariat for Public Policy and the Ministry of Finance.

By the end of October 2017, an update of the diagnostics in each area was carried out and the information on the implementation of the priority structural reforms for the period 2017-2019 was collected NS carried out. Also, a Preliminary List of Structural Reforms for 2018-2020 was drafted, based on the agreement reached at the meeting of the ERP Coordinator on 17 October 2017, and subsequent bilateral meetings and consultations with the relevant authorities. Comprehensive consultations with representatives of the EC were carried out between 20-22 November 2017.

Comprehensive ERP 2018-2020 draft was completed by mid-December 2017. After completing the consultations with interested parties, and upon completing the internal procedures, the document was adopted by the Government of the RS and submitted to the EC by the end of January 2018.

Special attention in the fourth cycle of ERP drafting process was given to consultations with representatives of the civil sector and the professional public, which was further strengthened and carried out in two cycles this year. The National Convention on the European Union plays an important role in the consultation process, as a permanent body within which a thematically structured debate is held between non-governmental organizations, experts, business, trade unions, professional organizations, political parties and representatives of the state administration on the accession of the Republic of Serbia to the European Union, and it has more than 600 members. The first consultation cycle was held on 17 October 2017 - after the Preliminary List of Structural Reforms was drafted and published on the websites of the Ministry of Finance, the Public Policy Secretariat, the Office for Cooperation with Civil Society and the National Convention on the EU from November 9-24 2017. Subsequently, a meeting with representatives of civil society on the Preliminary List of Structural Reforms was held on 20 October 2017. In addition to the numerous presentations at meetings with representatives of civil society gathered in the National Convention on the EU, representatives of local self-governments were also consulted through the participation of the representatives of the MoF at the Annual Assembly of the Standing Conference of Towns and Municipalities (SCTM) on 12 December 2017. The consultative meeting with the relevant National Assembly of Serbia was held on 15 December 2017, where the Minister of Finance presented the ERP preparation process, as well as a review of structural reforms. The final conference on the Platforms for ERP and ESRP, summarizing the results of the pilot phase of the Platform implementation, was held on 21 December 2017. In the second phase of consultations, the draft ERP 2018-2020 was published on the websites of the Ministry of Finance website, the Republic Secretariat for Public Policy, the Office for Cooperation with Civil Society, and the National Convention on the EU in the period from 29 December 2017 to 19 January 2018, and the final discussion on the draft ERP with representatives of stakeholders with the participation of the Minister of Finance was held on 19 January 2018. Stakeholders' comments are largely integrated into the final ERP 2018-2020, which contains a final list of 18 structural reforms. A detailed overview of stakeholder consultations is provided in Appendix 1.

## VII Annexes

Table 10. Budgetary Implications of Structural Reforms

Policy description	2017	2018	2019	2020
<b>Structural reform 1. TAX ADMINISTRATION TRANSFORMATION</b>				
A. Duration of the reform*				
B. Net direct budgetary impact (if any), in EUR	-4,585,664	-5,638,464	0	0
B.1. Direct impact on budgetary revenue, in EUR				
B.2. Direct impact on budgetary expenditure, in EUR	4,585,664	5,638,464		
C. Possible non-budgetary financing, in EUR				
C.1. Of which committed IPA funding including WBIF funding, in EUR				
<b>Structural reform 2. IMPROVED CAPITAL INVESTMENT MANAGEMENT</b>				
A. Duration of the reform*				
B. Net direct budgetary impact (if any), in EUR	0	0	0	0
B.1. Direct impact on budgetary revenue, in EUR				
B.2. Direct impact on budgetary expenditure, in EUR		0		
C. Possible non-budgetary financing, in EUR		161,626		
C.1. Of which committed IPA funding including WBIF funding, in EUR				
<b>Structural reform 3. ENERGY MARKET DEVELOPMENT COUPLED WITH ENERGY INFRASTRUCTURE CONSTRUCTION</b>				
A. Duration of the reform*				
B. Net direct budgetary impact (if any), in EUR	0	-7,355,600	0	0
B.1. Direct impact on budgetary revenue, in EUR				
B.2. Direct impact on budgetary expenditure, in EUR		7,355,600		
C. Possible non-budgetary financing, in EUR	13,378,055	9,639,341	14,915,476	29,126,587
C.1. Of which committed IPA funding including WBIF funding, in EUR	178,000	1,429,000	4,650,000	1,851,000
<b>Structural reform 4. IMPROVING THE CAPACITY AND QUALITY OF INFRASTRUCTURE AND SERVICES IN THE AREA OF TRANSPORT</b>				
A. Duration of the reform*				
B. Net direct budgetary impact (if any), in EUR	0	-11,800	0	0
B.1. Direct impact on budgetary revenue, in EUR				
B.2. Direct impact on budgetary expenditure, in EUR		11,800		
C. Possible non-budgetary financing, in EUR				
C.1. Of which committed IPA funding including WBIF funding, in EUR				
<b>Structural reform 5. REFORM OF RAILWAYS</b>				
A. Duration of the reform*				
B. Net direct budgetary impact (if any), in EUR	0	-84,811,800	-84,811,800	-84,811,800
B.1. Direct impact on budgetary revenue, in EUR				
B.2. Direct impact on budgetary expenditure, in EUR		84,811,800	84,811,800	84,811,800

C. Possible non-budgetary financing, in EUR				
<i>C.1. Of which committed IPA funding including WBIF funding, in EUR</i>				
<b>Structural reform 6. IMPROVEMENT OF THE COMPETITIVENESS AND STATUS OF AGRICULTURAL HOLDINGS</b>				
A. Duration of the reform*				
B. Net direct budgetary impact (if any), in EUR	-15,072,000	-61,512,304	-79,225,000	-79,225,000
<i>B.1. Direct impact on budgetary revenue, in EUR</i>				
<i>B.2. Direct impact on budgetary expenditure, in EUR</i>	15,072,000	61,512,304	79,225,000	79,225,000
C. Possible non-budgetary financing, in EUR	13,700,000	19,506,080	48,588,000	48,588,000
<i>C.1. Of which committed IPA funding including WBIF funding, in EUR</i>	13,700,000	19,506,080	48,588,000	48,588,000
<b>Structural reform 7. RAISING THE COMPETITIVENESS OF THE PROCESSING INDUSTRY</b>				
A. Duration of the reform*				
B. Net direct budgetary impact (if any), in EUR	5,600,000	8,576,000	8,576,000	8,576,000
<i>B.1. Direct impact on budgetary revenue, in EUR</i>	12,000,000	15,000,000	15,000,000	15,000,000
<i>B.2. Direct impact on budgetary expenditure, in EUR</i>	6,400,000	6,424,000	6,424,000	6,424,000
C. Possible non-budgetary financing, in EUR				
<i>C.1. Of which committed IPA funding including WBIF funding, in EUR</i>				
<b>Structural reform 8. PACKAGE OF MEASURES TO IMPROVE ACCESS TO FINANCE FOR SMEs</b>				
A. Duration of the reform*				
B. Net direct budgetary impact (if any), in EUR	-89,736,320	-152,312,000	776,000	776,000
<i>B.1. Direct impact on budgetary revenue, in EUR</i>	12,000,000	12,000,000	12,000,000	12,000,000
<i>B.2. Direct impact on budgetary expenditure, in EUR</i>	101,736,320	164,312,000	11,224,000	11,224,000
C. Possible non-budgetary financing, in EUR		20,000		
<i>C.1. Of which committed IPA funding including WBIF funding, in EUR</i>		20,000		
<b>Structural reform 9. THE INTRODUCTION OF CORPORATE GOVERNANCE IN PUBLIC ENTERPRISES</b>				
A. Duration of the reform*				
B. Net direct budgetary impact (if any), in EUR	-52,000	0	0	0
<i>B.1. Direct impact on budgetary revenue, in EUR</i>				
<i>B.2. Direct impact on budgetary expenditure, in EUR</i>	52,000	0		
C. Possible non-budgetary financing, in EUR	130,000			
<i>C.1. Of which committed IPA funding including WBIF funding, in EUR</i>				
<b>Structural reform 10. SIMPLIFICATION OF PROCEDURES AND OTHER CONDITIONS FOR DOING BUSINESS</b>				
A. Duration of the reform*				
B. Net direct budgetary impact (if any), in EUR	-249,672	-80,535	0	0
<i>B.1. Direct impact on budgetary revenue, in EUR</i>				
<i>B.2. Direct impact on budgetary expenditure, in EUR</i>	249,672	80,535		
C. Possible non-budgetary financing, in EUR	684,151	1,754,961	1,376,088	1,252,543
<i>C.1. Of which committed IPA funding including WBIF funding, in EUR</i>	414,180	724,815	517,725	414,180

<b>Structural reform 11. IMPROVING THE EFFECTIVENESS OF INSPECTION OVERSIGHT</b>				
A. Duration of the reform*				
B. Net direct budgetary impact (if any), in EUR	-560,000	-1,231,056	0	0
<i>B.1. Direct impact on budgetary revenue, in EUR</i>				
<i>B.2. Direct impact on budgetary expenditure, in EUR</i>	560,000	1,231,056		
C. Possible non-budgetary financing, in EUR				
<i>C.1. Of which committed IPA funding including WBIF funding, in EUR</i>				
<b>Structural reform 12. IMPROVEMENT OF THE GEOSPATIAL SECTOR AS SUPPORT TO INVESTMENT DECISION-MAKING PROCESS</b>				
A. Duration of the reform*				
B. Net direct budgetary impact (if any), in EUR	0	-2,831,774	-3,700,000	-3,100,000
<i>B.1. Direct impact on budgetary revenue, in EUR</i>				
<i>B.2. Direct impact on budgetary expenditure, in EUR</i>		2,831,774	3,700,000	3,100,000
C. Possible non-budgetary financing, in EUR		750,000	250,000	
<i>C.1. Of which committed IPA funding including WBIF funding, in EUR</i>		250,000	250,000	
<b>Structural reform 13. PROGRAMME SUPPORTING INNOVATIONS AND TECHNOLOGICAL DEVELOPMENT IN THE PUBLIC AND PRIVATE SECTORS</b>				
A. Duration of the reform*				
B. Net direct budgetary impact (if any), in EUR	-45,251,064	-49,250,066	-47,492,888	-46,600,000
<i>B.1. Direct impact on budgetary revenue, in EUR</i>				
<i>B.2. Direct impact on budgetary expenditure, in EUR</i>	45,251,064	49,250,066	47,492,888	46,600,000
C. Possible non-budgetary financing, in EUR	1,169,696	2,804,662	1,609,613	250,000
<i>C.1. Of which committed IPA funding including WBIF funding, in EUR</i>	836,336	2,471,329	1,276,280	250,000
<b>Structural reform 14. DEVELOPMENT AND IMPROVEMENT OF THE NATIONAL BROADBAND COMMUNICATIONS INFRASTRUCTURE</b>				
A. Duration of the reform*				
B. Net direct budgetary impact (if any), in EUR	-1,076,368	-910,408	-646,408	-646,408
<i>B.1. Direct impact on budgetary revenue, in EUR</i>				
<i>B.2. Direct impact on budgetary expenditure, in EUR</i>	1,076,368	910,408	646,408	646,408
C. Possible non-budgetary financing, in EUR	50,000,000	58,000,000	58,000,000	58,000,000
<i>C.1. Of which committed IPA funding including WBIF funding, in EUR</i>				
<b>Structural reform 15. IMPROVING THE CONDITIONS FOR PRODUCT SAFETY AND REMOVING BARRIERS TO TRADE</b>				
A. Duration of the reform*				
B. Net direct budgetary impact (if any), in EUR	-9,614,424	-4,433,656	-2,683,760	
<i>B.1. Direct impact on budgetary revenue, in EUR</i>				
<i>B.2. Direct impact on budgetary expenditure, in EUR</i>	9,614,424	4,433,656	2,683,760	2,746,768
C. Possible non-budgetary financing, in EUR	5,300,000	3,161,088	1,713,368	1,713,368
<i>C.1. Of which committed IPA funding including WBIF funding, in EUR</i>	5,300,000	3,161,088	0	0
<b>Structural reform 16. LABOUR MARKET NEEDS ORIENTED QUALIFICATIONS</b>				
A. Duration of the reform*	X			

B. Net direct budgetary impact (if any), in EUR	0	-224,000	-224,000	-224,000
<i>B.1. Direct impact on budgetary revenue, in EUR</i>				
<i>B.2. Direct impact on budgetary expenditure, in EUR</i>		224,000	224,000	224,000
C. Possible non-budgetary financing, in EUR	20,463	74,794	19,680	0
<i>C.1. Of which committed IPA funding including WBIF funding, in EUR (and in 2018 – IPA 2016 – SBS)</i>				
<b>Structural reform 17. IMPROVING THE EFFECTIVENESS OF ACTIVE LABOUR MARKET POLICIES WITH SPECIAL EMPHASIS ON YOUTH, REDUNDANT WORKERS AND THE LONG-TERM UNEMPLOYED</b>				
A. Duration of the reform*				
B. Net direct budgetary impact (if any), in EUR	17,240,000	24,040,000	-5,160,000	-5,160,000
<i>B.1. Direct impact on budgetary revenue, in EUR</i>	22,400,000	29,200,000		
<i>B.2. Direct impact on budgetary expenditure, in EUR</i>	5,160,000	5,160,000	5,160,000	5,160,000
C. Possible non-budgetary financing, in EUR				
<i>C.1. Of which committed IPA funding including WBIF funding, in EUR</i>				
<b>Structural reform 18. IMPROVED ADEQUACY, QUALITY AND TARGETING OF SOCIAL PROTECTION</b>				
A. Duration of the reform*				
B. Net direct budgetary impact (if any), in EUR	-229,613,488	-386,839,760	-428,805,118	-437,165,126
<i>B.1. Direct impact on budgetary revenue, in EUR</i>				
<i>B.2. Direct impact on budgetary expenditure, in EUR</i>	229,613,488	386,839,760	428,805,118	437,165,126
C. Possible non-budgetary financing, in EUR				
<i>C.1. Of which committed IPA funding including WBIF funding, in EUR</i>				
<b>Total net budgetary impact</b>	<b>372,971,000</b>	<b>-724,827,223</b>	<b>-643,396,974</b>	<b>-650,327,102</b>
<b>Total impact on budgetary revenue</b>	<b>46,400,000</b>	<b>56,200,000</b>	<b>27,000,000</b>	<b>27,000,000</b>
<b>Total impact on budgetary expenditure</b>	<b>419,371,000</b>	<b>781,027,223</b>	<b>670,396,974</b>	<b>677,327,102</b>

\* Indicate start (and, if needed, end) with an “X” mark















a) Adopt the Strategy and AP for the harmonized area													
b) Adopt new technical regulations in accordance with the Action Plan on the Harmonised Area and the revised NPAA													
Regulation of the non-harmonized area, through the implementation of the AP for the non-harmonized area and improving the capacities for the implementation of the Decree on the procedure of reporting and method of information regarding technical regulations, assessment of conformity and standards (Decree on Notification)													
a) Strengthen the contact point for the provision of information on technical regulations and implementation of Regulation (EC) No 764/2008													
b) Strengthen the capacity of line ministries to identify/remove barriers to trade in the non-harmonised area and conduct a legal analysis of the regulations from the Action Plan on the Non-Harmonised Area													
c) Conduct a campaign on the need to notify technical regulations in the preparation stage (as required by the revised Decree on Notification)													
d) Repeal and innovate obsolete technical regulations, potential obstacles to trade, in the non-harmonized area													
Open and lead negotiations under NC1 - Freedom of movement of goods													
Strengthen the capacities of line ministries, market supervision, IC institutions and conformity assessment bodies (CAB)													
a) Maintain membership of national institutions in European and international organizations for standardization, accreditation and metrology													
b) Implement equipment procurement for CAB (Project IPA 2018)													
c) Efficient use of procured equipment for assessing conformity (procured from IPA 2013 and IPA 2018)													
d) Implement trainings for the relevant ministries													
e) Implement trainings for more efficient market supervision over the implementation of technical regulations													
f) Implement training for designated and authorised conformity assessment bodies, i.e. potential notified bodies													
g) Prepare informational and promotional materials: guides, publications and brochures													
h) Hold round tables, informational events on the significance of IC for all stakeholders, particularly the industry													
<b>Structural Reform 16</b> <i>QUALIFICATIONS ORIENTED TO THE LABOUR MARKET REQUIREMENTS</i>	<b>2018</b>				<b>2019</b>				<b>2020</b>				
	<i>Q1</i>	<i>Q2</i>	<i>Q3</i>	<i>Q4</i>	<i>Q1</i>	<i>Q2</i>	<i>Q3</i>	<i>Q4</i>	<i>Q1</i>	<i>Q2</i>	<i>Q3</i>	<i>Q4</i>	
Apply a methodology of enrolment in secondary schools that involves the harmonization of the curriculum of the educational system with the needs of the labour market													
Promote dual and entrepreneurial education through the “Spirit of Youth” caravan													
Form and open the inter-regional information centre Valjevo													







Table 12. Report on Implementation of Priority Structural Reforms (PSR) from ERP 2017-2019

	<b>SHORT DESCRIPTION OF ACTIVITIES PLANNED FOR 2017</b> (activities from the Gantt chart)	<b>STATE IF THE ACTIVITIES PLANNED FOR 2017 HAVE BEEN IMPLEMENTED</b>	<b>IF YES OR PARTIALLY, GIVE A SHORT REVIEW</b> (the steps taken, dynamics of implemented activities, difficulties and delays in implementation)	<b>IF NOT, EXPLAIN</b>	<b>OTHER ACTIVITIES</b> (unplanned activities but implemented with the aim of implementing the PSR)
<b>PSR 1. Tax Administration transformation</b>					
1.	Plan for retaining quality personnel, taking into account the gradual change in the age structure	not		The Law on Civil Servants and the Law on Salaries of Civil Servants and State Employees, as well as the conditions for promotion, reward and stimulation related to them, leave no room for favouring employees and making any plan as an independent act whose aim would be to keep quality staff in jobs in Tax Administration.	
2	Activities related to the establishment of a new risk management system	yes	A new risk management system is being applied according to OECD risk management model according to the compliance plan. For this purpose, the Department for Strategic Risks has been formed, which has developed the Tax Compliance Plan for 2017, in accordance with recommendations and best practices. The selection of taxpayers should be based on inputs received from the Strategic Risk Department as well as the Operational Risk Department. The Strategic Risk Department has been formed at the central level (at the Office of the Director of Tax Administration), and operational risks are defined within the basic functions (Control Sector, the Centre for Large Taxpayers and the Tax Police Department).		
3.	A harmonized proposal for the new organizational structure at all levels	yes	In August 2017, the Act on internal organization and job classification was adopted in the MF - Tax Administration, which reduced the number of organizational units from 178 branches and outlets to 78 branches.		

4.	Review and revise LTPTA in relation to the application of indirect calculation methods, as well as the methods of assessment directed to the inspection of the taxpayer's accounting data on the basis of risk/business	partially	Analysis of LTPTA and by-laws was prepared; A reasoned proposal was drafted on the need for the adoption of a by-law introducing an indirect method of taxation of undeclared income into tax practice; The key parameters for comparing are defined; The reference values for the defined parameters are determined.		
5.	Preparation for the implementation of the adopted proposal for a new organizational structure	yes	Preparation for the implementation of a new organizational structure is planned; Adoption of a new organizational structure and its partial implementation and the adoption of the act on systematization have been initiated.		
6.	Activities related to the improvement of the control and collection function, tax-legal affairs and non-tax functions, more efficient management of material resources and IT resources, improvement of electronic services and development of services for taxpayers	yes	Centralization and automatization of financial and material business; Financial and material business software was developed, which, among other business processes, includes the operational system of budgeting and periodic reporting; all major tax forms are covered by electronic services (electronic tax returns); a Sector for providing services to taxpayers has been established and a Strategy for providing services to taxpayers has been adopted. Automatization of regular and forced payments has been conducted by support of the project "Development of payment system in the framework of the integrated IT system of Tax Administration.		
7.	Final preparations for the implementation of the proposed new organizational structure of the TA	yes	Conclusion of the Government of the RS from 5 December 2017, the Action Plan of the Transformation Programme for period 2018-2023 has been adopted and Decision on core and non-core activities of Tax Administration, which identifies non-core activities of TA, which until June 2019 should be transferred to other institutions wherever possible, and separate management from core functions of TA. The Action Plan envisage further consolidation of the network of branch offices in two phases (phase 1: June 2019 and phase 2 in 2013).		

8.	Establish an organizational unit for providing services to taxpayers	yes	A Sector for providing services to taxpayers has been established. A program for the phase introduction of services in the branches was developed .Training for employees have been organized. In 37 branches the counter called "Your Tax Officer" has been established whose basic purpose is to help and provide services to the taxpayer.		
9.	Introduce a more effective penalty regime for late payment	yes	An analysis of the existing penalty regime was prepared and an initiative for changes and amendments to the Law on tax procedure and tax administration was prepared regarding the measure of temporary ban on performing activities during the tax control. The proposal is that this measure of prohibition for a duration of up to 60 days, when the turnover from sale of goods or the provision of services is not registered through the cash register or in another prescribed way, is regulated in a different manner by imposing it as "obligatory measure"		
10.	Activities related to the establishment of a new training system for employees in line with the needs of the organization	yes	A new training system was established. The Rulebook on Vocational Training and Development of Employees in the Ministry of Finance - Tax Administration.		
12.	Effective management of confiscated goods	yes	The redesigned business process of financial and material bookkeeping was improved, through the new software "System for financial material business". One of the components of the project is the effective management of the confiscated goods		
13.	Completion of electronic services of Tax Administration	yes	Electronic tax filing for all the most important tax forms from 2018 is enabled.		

**PSR 2. Improved capital investment management**

1.	The pilot phase of the assessment of capital projects by the budget users and the Ministry of Finance	No		The legal basis for the implementation of these activities is the Decree on the content, method of preparation and evaluation, as well as monitoring the implementation and reporting on realization of capital projects in accordance with Article 54 a. The Budget System Law, which starts to apply from 2018.	
2.	Adoption of the remaining methodologies for managing the capital investment system	partially	The said Decree was adopted and came into force on the eighth day from the date of its publication in the "Official Gazette of the Republic of Serbia" No. 63 of 28 June 2017. The application of the said Decree shall start on 1 January 2018.		
3.	Implementation of training of budget users regarding the application and use of methodology and instructions	No		As a prerequisite for the realization of these activities is drafting of rulebook, methodologies and instructions for the implementation of the Decree. All activities planned for 2017 are postponed for 2018.	
4.	Preparation of terms of reference and procurement of a single information base of capital projects	No			
5.	Analysis and suggestions for improvement of methodologies	No			
6.	Implementation and updating of a single information base of capital projects	No			
7.	Estimation of capital projects by budget users and the Ministry of Finance	No			

**PSR 3. Connection to the regional market**

	<b>Measure 3.1. Construction of the E-75 and E-80 Highway (Corridor 10)</b>				
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1.	Completion of tunnel construction	partially	At Corridor 10, on the Eastern leg towards Bulgaria 56 km of the motorway out of 87 km was completed and opened for traffic. The section Prosek-Bancarevo in length of 9.4 km was completed, but for technical reasons it was not opened for traffic. Tunnels Bancarevo, Progon, Przojna Padina, Sopot and Sarlah were completed. Public procurement for equipping the tunnel Bancarevo, Sopot and Sarlah is in progress. About 40 km of the motorway out of a total of 74 km was completed on the southern leg of Corridor 10 towards Macedonia.		
	<b>Measure 3.2. Construction of the Zezelj bridge near Novi Sad with access roads (Corridor 10)</b>				
1.	Construction of access roads	partially	The construction of the access road to Zezelj Bridge represents a total investment value of 4.1 million EUR and is financed from the IPA 2016. Works began in April 2017. Completion of works and opening of the bridge for traffic is expected in the 2nd quarter of 2018.		
2.	Completion of bridge construction	No		The realization of the project of building the Zezelj bridge was hampered by technical and organizational problems related to the work of the contractor and the deficiencies in the Bridge Preliminary Design. The plan is to start testing the bridge at the beginning of March, followed by the establishment of railway traffic through the new Zezelj Bridge.	
	<b>Measure 3.3. Modernization of the railway Belgrade - Subotica - Kelebija (state border with Hungary) (Corridor 10)</b>				
1.	Contracting in accordance with the defined financing model	partially	Section Belgrade-Stara Pazova - Works on this section started on November 28, 2017. The deadline for the execution of works is 36 months. Section Stara Pazova-Novu Sad - A partial building permit for works on the tunnel outlet and viaduct has been obtained. Works on the		

			tunnel outlet started on September 19, 2017 and are carried out in accordance with the planned dynamics. It is necessary to complete the expropriation procedure. The work on the viaduct and the tunnel is planned to last 52 months. For the section Novi Sad-Subotica-state border, preparation of Preliminary Design with Feasibility Study is ongoing. Negotiations of commercial contract on modernization and reconstruction of Hungarian-Serbian railway for section Novi Sad-Subotica-state border.		
	<b>Measure 3.4. Modernization and rehabilitation of single-track railway Niš – Preševo on the section Niš - Brestovac (Corridor 10)</b>				
1.	Signing contract with the most favourable bidder	No		Funding from IPA 2015. The call for tender for the selection of the most favourable contractor is expected after the adoption of the Preliminary Design at the Republic Audit Committee.	
2.	Beginning of works (lasting for three years, by the end of 2019)	No		The Preliminary Design, Feasibility Study and Environmental Impact Assessment have still not been adopted by the Republic Audit Committee. The original location conditions have expired and new location conditions were obtained in December 2017. After the selection of the bidder and the development of the Design for Building Permit and Construction Project and obtaining a building permit, works will be started.	
	<b>Measure 3.5. Construction of Route 4 Belgrade - South Adriatic</b>				

1.	Construction of the Surcin-Obrenovac section	partially	Works on the bridge over the Sava river began on May 5, 2017. The planned completion date of the project is December 2019.		
2	Construction of the section Preljina - Pozega	partially	On March 10, 2017 the Government adopted the Decision on the establishment of a working group for the implementation of the project "Belgrade - South Adriatic" sections: Preljina - Pozega and Pozega - Boljare, with the task of defining an acceptable form of financing, construction, maintenance and exploitation of these sections.		
3.	Construction of the section Obrenovac - Ub and Lajkovac - Ljig	partially	About 72% of the works were carried out on the section Obrenovac - Ub in the physical extent, while on the section Lajkovac - Ljig about 87% of works were completed on 01.11.2017. The deadline for the completion of works is postponed to March 15, 2018.		
	<b>Measure 3.6. Construction of the trunk gas pipeline Nis - Dimitrovgrad</b>				
1.	Preparation of the elaborate for expropriation	No		Public procurement for investigative works necessary for the preparation of design and technical documentation (development of expropriation elaborate is part of this documentation) is not completed due to the filed complaint of the bidder.	
2.	Investigative works	No		Public procurement for investigative works necessary for the development of design and technical documentation has not been completed due to the filed complaint of the bidder.	
3.	Development of conceptual design				
4.	Determining the public interest	yes			
5.	Development of feasibility study				
6.	Obtaining location requirements				

8.	Development of environmental impact assessment study				
9.	Resolving legal - property affairs	Partially	Completion of activities has been envisaged in 2018.		
10.	Approval of the conceptual design and feasibility study				
11.	Obtaining energy permit				
	<b>Measure 3.7. Trans-Balkan corridor</b>				
1.	Construction of the transmission line Pancevo - Resica	yes	Transmission line is completed from our side and released to empty stretch to the border with Romania on 21 December 2017.		
2.	Reconstruction of TS Pancevo 2, necessary for reception of new double transmission line Pancevo - Resica.	yes	The works were completed in December 2017.		
3.	Construction permit for TL Kragujevac - Kraljevo	no	Application for the building permit has been submitted and it is expected to be obtained at the beginning of 2018.	The project for building permit was submitted to internal and external technical control in August 2017. After that, removing the objections and reviewing the project compliance with the expropriation decision were made until November 2017, when a request for a building permit was submitted, which refers only to the transmission line. For the upgrade of TS Kraljevo 3, a building permit was obtained, while permission was obtained for the reconstruction of the TS Kragujevac 2, which approves the execution of works.	
7.	Development of urban / spatial plan for TL B. Basta - Obrenovac	yes	A procedure was initiated for the development of a spatial plan of a special purpose area.		
8.	Development of technical documentation for TL Obrenovac - B. Basta	partially	Adaptation of the existing technical documentation, developed in 2011 with the support of the WBIF funds, to the requirements of the national legislation, was completed in December 2017. After adoption of Spatial plan of a special purpose area, the updated technical documentation will be delivered and the preliminary design will be submitted to the professional control of the		

			audit committee. The second phase of the documentation preparation (construction permit project and project implementation) will be financed by WBIF funds.		
9.	Development of a spatial plan for TL B. Basta - Visegrad - Pljevlja	yes	The permitting process has not begun yet. The Government of the Republic of Serbia made a decision on the proclamation of the spatial plan of the special purpose area. The plan was developed and approved by the Ministry of Construction, Transport and Infrastructure. The plan underwent the public consultation in May 2017 and was accepted without objections at the public review. The Government of the Republic of Serbia has adopted spatial plan of a special purpose area, and it was published in Official Gazette of the Republic of Serbia, No 104/17		

**PSR 4. Development and improvement of the national broadband communications infrastructure**

1.	Adoption of the Law on Broadband Communication Infrastructure	partially	Drafting of the Law on Broadband Communication Infrastructure is ongoing. The analyses of the regulations of the neighbouring countries which regulate this area and are in line with the provisions of Directive 2014/61/EU on measures to reduce the costs of building high-speed electronic communications networks. Suggestions were also received regarding the model of financing the construction of broadband communication infrastructure from public funds.		A project with the Korea Information Society Development Institute (KISDI) has been completed with the aim of enabling improvement of the fixed broadband access in RS through the consultation program "Development of fixed broadband access to RS".
2.	Connecting educational and culture institutions to the Academic Network of the Republic of Serbia (continuous activity)	yes	By the end of 2017, about 1.650 main school facilities were connected to AMRES (Academic Network of the Republic of Serbia), and the devices for the mobile connection for around 100 main facilities, many of which are in the territory of Kosovo and Metohija.		

3.	Preparation and planning for the establishment of a single national telecommunication network (SNTN)	partially	An Action Plan for the efficient use of telecommunication infrastructure has been adopted. The Draft Strategy for the Development of New Generation Networks until 2023, with the aim of providing the necessary infrastructure for the development of the Single Digital Market in the RS, in line with the EU strategic framework. In the first quarter of 2018, adoption of the Law on Electronic Communications as an umbrella document is expected, followed by drafting of the Law on Broadband Infrastructure.		
4.	Construction of access broadband networks in municipalities across the country	partially	In order to achieve greater accuracy, i.e. a higher level of quality of data on the availability of the Internet, an analysis of the availability and presence of Internet access was carried out 8 municipalities were selected, those which have the greatest potential for broadband Internet access, and a detailed analysis of the existing capacities and the availability of broadband access to the Internet was performed.		
5.	Operational establishment of SNTN	No		Following the Government's decision to continue with the operational establishment of SNTN, it will take 12-18 months for the operational establishment of SNTN from the moment of providing the necessary financial resources.	
6.	Analysis, preparation and design of pilot projects	yes	The public procurement of the GIS information system has been completed in order to collect and publish the data on the availability of broadband internet access in RS. The development of the WEB GIS application has also been completed, which will provide insight to citizens, interested institutions and representatives of local self-government about the current state of the network and the importance and potentials in the course of development and the possibility of improving the network.		

**PSR 5. Improvement of the competitiveness and status of agricultural holdings**

1.	Preparation of rules and	yes			
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	competition				
2.	Adoption of Rulebook and Call for Applications	yes			
3.	Announcement of invitation and conducting the competition	yes	An amendment was made to the rulebook on IPARD incentives for investments in the physical assets of agricultural holdings. After the audit mission of the Directorate-General for Agriculture of the European Commission in November 2017 and the preliminary report, the announcement was made in December for the First Public Call for IPARD incentives for investments in physical assets of agricultural holdings - purchase of new equipment and mechanization.		Although the audit mission passed without blocking findings, due to duration of the procedure the signing of the Financing Agreement has not taken place and accreditation of the IPARD operational structure has not been performed.
4.	Implementation of the structural reform (in accordance with the Plan for Publication of Calls to the IPARD Structural Reforms issued at the beginning of the year for that year and with the by-laws)	yes	The Invitation for IPARD Incentives Plan has been published until June 2018, as well as the First Public Call for Measure M1: Investments in the Physical Property of Agricultural Holdings (purchase of new equipment and machinery), December 25, 2017 The deadline for filing applications under the First Public Call is February 26, 2018 The planned funds are provided in the budget for 2018.		

#### PSR 6. Raising the competitiveness of the processing industry

1.	Development of strategy and action plan for priority industrial branches - establishment and work of the working group	partially	The realization of activities in the preparation of four priority industrial strategies (manufacturing industry) with action plans at the very beginning began with a delay due to process of public procurement procedure. In April 2017, the findings of the studies that were done in accordance with the contractual obligations were presented. After these presentations, the revised reviews of the current status with SWOT analysis for all four sectors of the manufacturing industry, which were formally accepted by the Ministry of Economy, were submitted.		
2.	4 Strategies and Action Plan for priority industrial branches	No		Due to delays in the analysis of the situation in the four selected priority	

	completed			sectors, an extension of previously planned deadlines was proposed.	
3.	Industrial policy review	No		Activities in the realization of the adoption of the new Industrial Policy will be harmonized in the following period.	
4.	Implementation of new investment and export support programs	yes	The implementation of the new Strategic Framework and Action Plan for the Development Agency of Serbia (2017-2019) started in 2017, which envisages a new organization of the Agency and implementation of development programs aimed at accelerating the realization of investment projects and the competitiveness of small and medium enterprises.		
8.	The Government was presented with the Bill on Amendments to the Law on Companies	partially	Draft Law on Amendments to the Law on Companies was prepared in December 2017.		

**PSR 7. Package of measures to improve access to finance for SMEs**

1.	Withdrawing loan from APEX loan for an additional 150 million Euros.	yes	The realization of APEX III/B loan began in August 2017 through intermediary banks. By the end of 2017, 23 projects were approved in the amount of 11.6 million Euros, and at the end of November 2017, the first tranche of 5 million euros was withdrawn.		
2.	Negotiations regarding withdrawal of loan APEX loan for additional 200 million euros.	No		The negotiations are expected to be completed in 2018.	
5.	Preparation of a study of analysis of needs for the establishment of alternative financial instruments with the proposal of the investment strategy - EIB	yes	The European Investment Bank completed the study in late July 2017.		
6.	Preparation of the Public Financial Institutions Reform Plan - work of the working group	partially	The selected consulting house is in the process of drafting Due Diligence in cooperation with the Development Fund and the Export Credit and Insurance Agency. The Ministry of Finance is the coordinator of the entire process.		

7.	Implementation of the project of establishing financial instruments financed from IPA 2016	yes	A draft agreement is being drafted and will be signed in October 2017 between the European Delegation and the European Investment Fund, after which the planned funds of 20 million Euros will be available for the implementation of the guarantee scheme through the EDIF platform.		
8.	Adoption of the public financial institutions reform plan	No		The selected consulting house is in the process of drafting Due Diligence in cooperation with the Development Fund and the Export Credit and Insurance Agency. The Ministry of Finance is the coordinator of the entire process.	
9.	Drafting of laws and by-laws related to the reform of public financial institutions	No		The selected consulting house is in the process of drafting Due Diligence in cooperation with the Development Fund and the Export Credit and Insurance Agency. The Ministry of Finance is the coordinator of the entire process.	
10.	New annual cycle of implementation of support program for procurement of equipment for small enterprises	yes	A new cycle of implementation of support programs for the procurement of equipment for small enterprises began in April 2017. So far, 90% of the funds have been spent.		
16.	Drafting a legislative framework for the introduction of microfinance institutions	partially	The National Bank of Serbia has established a Working Group for drafting proposals for improving the legal framework in the field of financial services, which would enable the setting up and operation of non-deposit financial institutions in the Republic of Serbia. Activities in the analysis of the need for introduction of this type of institutions were also supported by the USAID - BEP (Business Enabling Project) project.		

#### PSR 8. Reform of public enterprises

	<b>Measure 8.1. Introduction of corporate governance in PE</b>				
1.	Analysis of the capacities of potential educational institutions to provide training services in the field of corporate governance	yes	A working version of the Certification Program has been developed (in which the model, process and bodies for certification of governance bodies in the public companies is proposed).		

2.	Establishment of a working group for defining the system of licensing of directors and members of supervisory boards in PE	yes			
3.	Work of the working group for defining the system of licensing of directors and members of supervisory boards in PE	yes			In the plan (the last quarter of 2017 and the first quarter of 2018)
4.	Drafting laws and by-laws for the introduction of the system of licensing of directors and members of supervisory boards in PE	partially			Planned (Last Quarter 2018)
5.	Analysis of training needs (TNA) of directors and members of supervisory boards in public companies	yes	Envisaged in the Certification Program		
	<b>Measure 8.2. Reform of the railway</b>				
1.	Review of key contracts (revision)	yes	Consultants were engaged as part of the project "Comprehensive Rail Reforms" funded by the IPA funds of the EU in the drafting of a contract management plan. As part of this project, an analysis of existing contracts was carried out, where key points to be improved have been identified.		
2.	Monitoring the implementation of workforce restructuring	yes	In August 2017, all companies adopted new systematizations. It is planned to reduce the number of employees for 2,394 in total. Railway companies have taken all necessary steps to continue the process of restructuring the workforce according to the planned dynamics, and in accordance with that, a total of 2,556 workers left (leavings on December 28, 2017), which is more than planned.		
4.	Development of capacity development plan	partially	In February 2017, the project started through IPA 2014 "Technical Assistance to the Ministry of Construction, Transport and Infrastructure and State-Owned Railways companies in Serbia - Comprehensive Rail Reform". In accordance with this project, specific resources (personnel and competencies) that are necessary for the		

			MCTI will be identified, defined structured programs of training and development of personnel and determination of the specific competencies necessary for each activity within the scope of railway operations and defined structured programs for training and development of staff. According to the plan of the consultant, the determination of development plans is planned for 2018.		
	<b>Measure 8.3. Reform of PE EPS</b>				
1.	Adaptation to the market conditions with the implementation of the Financial Consolidation Plan	partially	In line with the Financial Consolidation Plan, to reach the price level of electricity that would justify the cost, the target for 2017 is 7.7% price increase for guaranteed supply. Based on the conducted analysis of EPS for determining the level of required price increase for guaranteed supply and approval of the World Bank, the Energy Agency approved an increase of 2% from October 2017. Increase in prices for the period 2018-2020. It will be determined after the new analyzes have been carried out. Continuous activities are carried out in order to increase the collection rate in PE EPS (in the period January-November 2017 the rate of collection was realized at 98.7%, while the realization in the same period in 2016 amounted to 93%). For 2017, the target value of reducing electricity losses is 12.8%, and in the period 1.1.-30.9.2017. year loss rate was 12.61%.	An increase in electricity prices in 2017 was carried out on the basis of the EPS analysis for determining the level of the necessary increase in the price for guaranteed supplies made in cooperation with the SB and the approval of the Energy Agency of RS. Price increases for the period 2018.-2020. will be determined after a new analysis has been carried out. Continuous activities are carried out to increase the collection rate in PE EPS (in the period January-November 2017, the rate of collection was 98.7%, while the realization in the same period in 2016 was 93.7%).	
2.	Improvement of management within the existing organizational structure and more efficient corporate governance	partially	Harmonized Decision on the establishment of PE EPS with the new Law on Public Enterprises. Centralized management of subsidiary enterprises has been implemented. A new PE EPS Statute has been adopted in order to comply with the provisions of the law on Public Enterprises and the Decision on the Establishment of the PE EPS and sent to the Government for obtaining consent. The process of obtaining the Government's approval of the Decision on amendments to the Decision on the Establishment of EPS Distribucija d.o.o. Belgrade for the purpose of harmonizing this act with the new Law on Public Enterprises.	In the forthcoming period, the competent state authorities are expected to decide on the approval of the PE EPS Statute and the Decision on amendments to the Founding Act of EPS Distribucija, d.o.o. Belgrade.	

3.	Transformation of the legal form of PE EPS into the Joint Stock Company	No		It is necessary to resolve disputable issues related to the determination of ownership or other types of PE EPS rights in relation to the remaining immovable property of high value.	
4.	Improving operational and organizational efficiency	yes	A unified planning process has been introduced for the main activities in the entire PE EPS (planning of funds, planning of production, planning of procurement). The process of implementation of procurement procedures in accordance with the LPP with 14 individual processes for the implementation of procurement procedures was reduced to two processes-for PE EPS and for EPS Distribution.		
5.	Implementation of the Plan for the optimization of the number of employees, decision on simulative severance pay	yes	The Supervisory Board of PE EPS on 5.8.2016 adopted the Plan for optimizing the number of employees in EPS Group for 2016-2019, and 31.8.2016 passed the Decision on conditions and method of stimulating compensation. In order to implement the adopted Plan for optimizing the number of employees in EPS Group in 2017.		
6.	Implementation of the Program for solving the surplus of employees	yes	In accordance with the adopted Plan for optimizing the reduction of the number of employees, it is implemented by natural outflow and by consensual termination of employment with the payment of compensation. The above Plan does not provide for the elaboration of the redundancy program. In 2017, the Public Invitation to interested employees in the EPS Group was held until 16.10.2017. In the same year they apply for a consensual termination of employment with the payment of stimulative compensation. 1,570 employees applied for a consensual termination of their employment. In accordance with the Optimization Plan, ending 31.12.2017. The number of employees in EPS Group decreased by 2,987.		

7.	Activities regarding the establishment of ownership rights on the immovable property of PE EPS and EPS Distribution	partially	Because of the complexity, for a certain number of immovable property upon which is possible to establish the ownership right (production facilities and facilities connected with their function), the procedure of inventory of immovable property is ongoing.	In the following period, the competent state authorities are expected to decide on the request of the PE EPS for the establishment of ownership in the production facilities.	
8.	Customer Relationship Strategy	yes	Communication plan on the topic of energy efficiency and the value of electricity is being implemented; The PE EPS's website upgrade is in process; call centre for small commercial customers has been established.		

**PSR 9. Simplification of procedures for business entities**

1.	Preparation of a digitized form with instructions for making inventory of administrative procedures	yes	The process of drafting and establishing a fully functional digital form for the inventory of administrative procedures has been completed. The form has been prepared and improved on the basis of numerous suggestions from the authorities and organizations that participate in the inventory of administrative procedures and the inventory of administrative procedures conducted through the portal and a fully functional form.		
2.	Organizing trainings for trainers and trainings of civil servants who will participate in the inventory of administrative procedures	yes	In the period from February to May 2017, a total of 35 one-day training was held for 479 employees in 107 bodies, organizations, public enterprises and other holders of public authorizations who participated in the inventory of administrative procedures.		Additional trainings, held outside the envisaged time limit, were held for subsequently appointed and involved officials who will conduct the inventory of administrative procedures.

3.	Inventory of administrative procedures and other business conditions	partially	The inventory of administrative procedures started on June 5, 2017 .It has 80 bodies and organizations and is in the final stage, with 2,459 procedures being recorded and ready for analysis.		The inventory of Customs Administration procedures related to imports is listed in a unified procedure. Due to their enormity and complexity, new deadlines will be set for creating a solution of this process which will be displayed. During the inventory, it was established that there are procedures that bodies and organizations did not register for the inventory but should be included in the inventory.
4.	Analysis of the results of the inventory of administrative procedures and other business conditions	No		The analysis of the inventory of administrative procedures started in October 2017 and will be done in phases. A methodology is being developed that will be used throughout the entire analysis process and a form for calculating administrative burden through a standard cost model (developed and software solution).	
5.	Simplification and optimization of the inventoried administrative procedures	No		Simplification and optimization of the inventoried administrative procedures begins in the first quarter of 2018, because this activity cannot be started until the completion of the inventory of administrative procedures and their analysis.	Prepared methodology for simplifying and optimizing administrative procedures.

6.	Drafting and adoption of the legal framework for the Register (Law on Unified Public Register of Administrative Procedures and Other Operating Conditions and Bylaws)	partially	A working group was formed for the drafting of the Law on the Unified Public Register of Administrative Procedures and Other Operating Conditions. The first draft of the law is being prepared.	The establishment of the Registry is planned by the end of 2018, but due to the identified risk, a new deadline for the establishment of this register is envisaged in the second half of 2019. The deadline was shifted primarily due to delay in project support from the Good Governance Fund (GGF) of the Government of the United Kingdom.	
8.	Promotional activities related to the establishment of the Registry (continuous process)	partially	Within the project "Business Environment Improvement" financed by the Good Governance Fund of Great Britain, a communication strategy was prepared covering the entire project of establishing a unified public register of administrative procedures and other conditions for doing business.		The communication strategy will set the basics, but also set goals and promotional activities during the entire process of establishing the Unified Public Register of Administrative Procedures and other conditions for doing business.
10.	Adoption of the Electronic Document Act, electronic identification and confidentiality services in electronic commerce	partially	The draft law was adopted by the Government on August 17, 2017 and the Law was adopted by the National Assembly of the Republic of Serbia on October 17, 2017.		
11.	Adoption of the Law on Services	partially	The draft law was adopted by the Government of the Republic of Serbia		
12.	Adoption of the Decree on the work of the Electronic Points of Single Contact and the establishment of the ePSC (Phase I)	No		The legal basis for the adoption of the Decree is prescribed by the Draft Law on Services.	
14.	Preparation and adoption of the Law on Fees for the Use of Public Resources	partially	The Draft Law on Fees for the Use of Public Resources was drawn up in the framework of the work of the Working Group established by the Minister's decision. Public hearing is under way from January 3 to February 28, 2018.		

**PSR 10. Establishing a common information platform for all inspectorates at the level of the Republic (E-Inspection)**

	Phase II				
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1.	b) Contracting the Contractor for Phase II	yes	The contract was signed on November 2, 2017 for the software solution of uniform information system for inspection - e-inspector.		
2.	v) GAP analysis	yes			
3.	g) Design of e-Inspector system	no		Not implemented, it is expected that the planned activities will be started after functional analysis.	
4.	d) Functional analysis of the system	partially		Activities started in December 2017.	
5.	d) Development of the e-Inspector system for the first 4 inspection services	No		No implemented, it is expected that the planned activities will be commenced after the signing of the contract.	

**PSR 11. Programme supporting innovation and technological development in the public and private sectors**

1.	Implementation of projects by beneficiaries to whom the financing is assigned, monitoring by the Fund - IPA 2013	yes	A total of 14 financing agreements were signed in the first quarter of 2017 with beneficiaries in the total amount of EUR 3 million. At the moment, implementation of the fourth quarter is in progress for beneficiaries (13 in total), while one project, in accordance with the implementation plan, is completed after three quarters. With the technical assistance of the World Bank, the Fund has developed quarterly monitoring manuals with a set of monitoring documentation.		
2.	Signing a direct grant agreement between the Innovation Fund and the Ministry of Finance - IPA 14	No		Due to the long-term harmonization of the tender dossier.	
3.	Preparation of documentation for grant programs (Early Development Program and Innovation Co-financing Program, Mini Grants and Matching Grants) - IPA 2014, promotional activities - info days for the first public call	No		See point 2 - IPA 2014 application has not been approved and a direct grant agreement has not been signed. This activity can be implemented after signing a direct grant agreement.	

4.	Open doors and workshops, preparation of applicants for registration - IPA 2014; At the end of the quarter announcement of the public call for the Early Development Program and the Innovation co-financing program - IPA 2014 - the first public call	No		See point 2 - IPA 2014 application has not been approved and a direct grant agreement has not been signed. This activity can be implemented after signing a direct grant contract.	
9.	Promotional activities and presentation of the program and announcement of the public call for MG during the first quarter - "Competitiveness & jobs"	yes	The public call was announced on June 1, 2017, when a ceremonial event was organized in STP Zvezdara on the occasion of announcing a public call. The promotional activities and presentation of the MG was launched during June and July 2017 - Belgrade, Zrenjanin, Nis, Vrsac, Kragujevac, Cacak, Krusevac, Novi Sad.		
10.	Consultations and open doors at the end of the second quarter, the deadline for submission of applications - "Competitiveness & jobs"	yes	Consultations and open doors were conducted during July and August 2017.		
11.	Evaluation of incoming projects and decision-making on financing - "Competitiveness & jobs"	yes	On December 7, 2017, the Independent Expert Commission of the Fund decided to fund a total of 25 projects (20 in the framework of the Early Development Program and 5 projects within the co-financing of innovation program), after the process of selecting projects for financing within the early development program and the co-financing of innovation programs in accordance with the approved program manuals.		
17.	Commencement of implementation of technological development program - MESTD (Ministry of Education, Science and Technological Development)	yes	The realization of the technological development program takes place according to the current cycle of financing. The new project cycle has not been announced.	Decision to amend the Decision on the annulment of the Act on the evaluation, selection, financing and monitoring of projects from the Basic Research Program and Basic Oriented Research for the period from 2016 to 2020 and the Research Program for the Technological Development for the period from 2016 to 2019 (Off. Gazette 3/2018)	

18.	Establishing technology transfer service lines at the Central Office for Technology Transfer: 1. Collection of inventions of Applicants, 2. Technological and commercial readiness assessment (triage), 3. Financing of additional development in order to increase commercial readiness, 4. Defining the strategy and tactics of commercialization, 5. Implementation of the commercialization strategy, 6. Identification of potential commercial partners, 7. Negotiation and conclusion of transactions, 8. Supervision and monitoring of further development of commercialization - IPA 13 and "Competitiveness & jobs "; A detailed self-assessment report and pilot analysis of international experts - "Competitiveness & Jobs"	yes	Service lines (11 in total) for transfer of technology within the Central Office for Transfer of Technology have been established and activated. A Manual for the Technology Transfer Program has been delivered to applicants.		
19.	Realization of the activities: 1. Collecting project proposals by TTF and TTO, 2. Evaluation of submitted project proposals and 3. Defining the commercial exploitation strategy - IPA 13 and "Competitiveness & Jobs" + development of new service lines	yes	1. The number of project proposals submitted is 26; 2. A total of 22 project proposals were evaluated; 3. Commercial exploitation strategy is defined for 3 projects. The Central Technology Transfer Office has initiated a public call for funding within innovative vouchers, which is an additional service line within the TTF Program.		Within the TTF program, the first license agreement was signed, which represents the first transaction within the established service lines.
20.	Implementation of the analysis of the institutions in the scientific and research sector, based on the methodology stemming from the analysis of the pilot institutions from 2016. A Sector Reform Plan, including the introduction of a performance-based management system both at the institution's and individual levels - "Competitiveness & Jobs"	No		Within the project "Competitiveness & Jobs" a call was announced for the engagement of a consultant responsible for design and supervision of the method of self-assessment of scientific research organizations, the selection of the appropriate candidate is ongoing. The selection of consultant is expected in the first quarter of 2018, after which the process of implementation of this activity would begin.	

1.	Adoption and implementation of annual action plans for the implementation of the Strategy for Improvement of Quality Infrastructure (2015-2020)	partially	Realized activities in the field of quality infrastructure during 2017 are fully in line with the objectives of the Strategy.		
2.	Adoption of the new Law on Technical Requirements for Products and Conformity Assessment (LOTR)	partially	Prepared text of the draft LOTR. In September, a public debate was held.		
4.	Further harmonization of the regulations encompassing Ch. 1 - Freedom of movement of goods, in accordance with the NPAA and AP for the harmonized area	partially	The competent ministries, responsible for the adoption of technical regulations within the framework of the PG1, have made a plan for the adoption of new technical regulations, with the aim of full harmonization with European legislation in this field. The deadline for full harmonization is the fourth quarter of 2021.		
4.1.	Adoption of the Strategy and AP for a harmonized area	No		Within the Negotiation Chapter 1, the Strategy and AP for the harmonized area have been corrected in line with the comments of the European Commission and resubmitted to the European Commission on 15 December 2017.	
4.2.	Revision of NPAA for Negotiation Chapter 1 - Freedom of movement of goods	yes	In October 2017, the third revision of the NPAA at the level of Negotiation Chapter 1 - Free movement of goods was completed.		
4.3.	Adopting new technical regulations in accordance with the AP for the harmonized area and the revised NPAA	yes	4 new technical regulations have been published: Rulebook on equipment and protective systems intended for use in potentially explosive atmospheres (ATEX); Rulebook on safety of lifts; Rulebook on Inspection of Lifts in Use and Rulebook on aerosol dispensers.		
5.	The regulation of the non-harmonized area by implementation of the AP for the non-harmonized area and strengthening of the capacity to apply the Regulation on the application procedure and method of information related to technical regulations, conformity assessment and standards (Regulation on	partially	Work on the preparation of the final version of the Draft Action Plan for the harmonization of the legislation of the Republic of Serbia with Articles 34-36 of the Treaty on the Functioning of the European Union (AP for the non-harmonized area) is under way. The European Commission (EC) submitted its comments to the Ministry of Economy on the proposal of the AP for the non-harmonized area for Criterion 1. In accordance with the comments, the text of the AP Proposal was		

	notification)		<p>corrected and submitted to the European Commission on December 15, 2017.</p> <p>Consultative meetings with Czech experts were held as part of the support provided through the TWINNING project - Support to the development of the industry by strengthening the capacity of the bodies responsible for quality infrastructure and the providers of conformity assessment services, regarding the processing of these EC comments and preparation of the final text of the AP Proposal for the non-harmonized area. Awareness-raising and capacity-building campaign was conducted on the necessity of notifying technical regulations. Three trainings in cooperation with the Serbian Chamber of Commerce were performed in March, April and September 2017. One was intended for representatives of the state administration, and the second and third for representatives of the economy, in order to strengthen the capacity to apply the Regulation on the application procedure and the manner of information related to technical regulations, conformity assessment and standards (Regulation on Notification). In order to further strengthen the capacity and awareness of the obligation to notify technical regulations, a promotional brochure "Technical regulations at hand" has been produced, and the plan is to continue to strengthen the mentioned campaign.</p>		
5.1.	Strengthening the contact point for providing information on technical regulations and applying Regulation 764/2008/EC	partially	<p>The contact point operation procedures for providing information on the products are prepared. In September 2017, a seminar was held in the Serbian Chamber of Commerce on the topic Establishment and work of the contact point for products where the work plan was presented and the cooperation between the relevant institutions was put in place in order to establish a network of contact points that will be a support in the work of the Ministry of Economy as a central contact point for products.</p>		
5.2.	Strengthening capacities of competent ministries for identifying/removing barriers to trade, in non-harmonized areas and	partially	<p>Over 8 trainings were organized for the representatives of the relevant institutions in order to prepare a legal analysis of the regulations from the AP for the non-</p>		

	conducting legal analysis of regulations from the AP for non-harmonized area		harmonized area and deadlines for implementation were determined.		
5.3.	Campaigning about the need to report technical regulations at the stage of preparation (according to the requirements of the revised Regulation on Notification)	partially	In cooperation with the Serbian Chamber of Commerce in March and April 2017, two seminars were held: one for the representatives of the state administration and the other for the representatives of the economy in order to strengthen the capacity for implementation of the Regulation on the application procedure and the manner of information related to technical regulations, conformity assessment and the Standards (Notification Regulation), in order to further strengthen the capacity and awareness of the obligation to notify technical regulations, a promotional brochure "Technical regulations at hand" has been produced, and the plan is to continue to strengthen the mentioned campaign		
5.4.	Putting out of force and innovating obsolete technical regulations, potential barriers to trade, in a non-harmonized area	yes	All obsolete technical regulations within the jurisdiction of the Ministry of Economy, which are covered by the AP for the non-harmonized area, for which it was determined by legal analysis that they contain potential barriers for trade, have been put into effect by passing the Rulebook on termination of the validity of certain regulations ("Official Gazette of RS" no. 34/2017). Innovation of obsolete regulations is a continuous activity in accordance with the foreseen indicative deadlines in the AP for the non-harmonized area.		
6.	Opening of negotiations within Negotiation Chapter 1 - Freedom of movement of goods	No		Negotiations with the European Union under Negotiation Chapter 1 - Freedom of movement of goods are not open, because Serbia has not yet fulfilled two criteria provided by the European Commission.	
7.	Strengthening the capacities of the QI Institutions and Bodies for Conformity Assessment (BCA)	partially	Implementation of the contract under the IPA 2013 on procurement of conformity assessment equipment in the amount of 4.6 mil. EUR.		

7.1.	Fulfilment of requirements and obtaining the full membership of the ISS in CEN / CENELEC	yes	Realized in 2016. The ISS continued to fulfil its obligations based on the full membership.		
7.2.	Maintaining full membership of national institutions in European and international organizations for standardization, accreditation and metrology	yes	ISS, ABS and DMPM held membership in 2017 in all relevant European and international organizations for standardization, accreditation and metrology.		
7.3.	Realization of procurement of equipment for BCA and DMPM (IPA2013 project)	partially	Delivery and receipt of equipment for 11 parties is in progress. Delivery and installation for 7 parties, worth about EUR 3 million, have been completed. A procedure for receiving equipment and installations for 4 more parties is ongoing.		
7.4.	Efficient use of purchased equipment for the purpose of assessing conformity	partially	In accordance with the Contract with the equipment user, the equipment can be used only after the Certificate of Temporary Reception of Equipment has been signed. A certificate for the temporary acceptance of equipment has been signed for 4 parties and laboratories have started to use the purchased equipment for testing petroleum products, construction products, chemicals and certain types of criteria.		
7.5.	Development of new types of accreditation and development of existing types of accreditation in new areas	partially	This is a continuous activity of the ABS, which can never be completed in its entirety.		
7.6.	Realization of training for designated and authorized bodies for assessment of conformity, i.e. potential notified bodies	yes	The TWINNING project was implemented according to plan and completed at the end of 2017		
7	Preparation of guides, publications and promotional materials	partially	A new guide for the application of regulations in the field of lifts is prepared and published on the TEHNIS website, preparation of a new guide for the application of the ATEX Regulation is in progress.		
7.8.	Holding round tables, informative meetings on the importance of QI for all stakeholders, especially for the industry	yes	In cooperation with the Chamber of Commerce of Serbia, ISS 10 educational seminars were held in 2017 (various topics in the field of QI, technical regulations for different products and product safety).		

**PSR 13. Labour market needs oriented qualifications**

1.	Drafting and adoption of the Law on dual education	yes	The Law on dual education was adopted in November 2017.		
2.	Establishment of the Office for dual entrepreneurial education	No		The establishment of the Office for Dual and Entrepreneurial Education would additionally burden the budget of the Republic of Serbia.	A strategic planning sector was set up in the Ministry of Education, Science and Technological Development, whose work description covers activities related to dual, entrepreneurial education, career guidance and counselling. Article 40 of the Law on dual education prescribes the establishment of a Commission for the development and implementation of dual education.
3.	Implementation of the methodology of enrolment in secondary schools which implies compliance of the education system plan and program with the needs of the labour market	yes	For the school year 2017/2018, a new enrolment plan was applied which took into account the needs of the labour market. The companies filled out the company's statement of intent expressing willingness to support and enable students to learn through the dual model of education. The licensing process is underway.		
4.	Adoption and verification of 9 new profiles in line with labour market needs and their implementation in the education system in 2017.	yes	New profiles have been adopted and verified. Names of nine new profiles: airplane and engine aviation technician, aircraft technician for airborne equipment, airplane electronics technician, radar systems mechatronics, rocket systems mechatronics, motor vehicle mechanic, metal processing operator, electrical technician for renewable sources energy, logistics technician and freight forwarder. These nine profiles were available for enrolment for students in the school year 2017/2018.		
5.	Promoting dual and entrepreneurial education through the caravan "The spirit of youth"	yes	The activities of promotion of dual and entrepreneurial education through the caravan "The Spirit of Youth" were implemented in 34 cities in Serbia, in accordance with the plan.		
7.	Active implementation of the Law on dual education	yes	An invitation was sent to the relevant institutions for delegating members of working groups for drafting of by-laws	The Law on dual education will actively apply from the school year 2019/2020.	

			prescribed by the Law on dual education.		
8.	Preparation of 2 profiles/sector descriptions	yes	The Sector for Development and Higher Education of the MoESTD analysed the submitted offer and demand of such research on the market and a given financial framework for these activities, estimated that it is possible to compile three sector profiles. The Foundation for the Advancement of Economics (FREN) has been selected by the Commission to compile three sectoral profiles: Education, Transport and Construction. The scheduled deadline for the delivery of studies on sector profiles is 31.5.2018.		
9.	Preparation for setting up the sector councils	yes	MoESTD has begun drafting a study on sector finance models. As a consultant for the development of a model for financing sector councils and establishing criteria for the formation of sector councils, the commission selected Mr. Mile Dzelalija, consulting company "Mile Dzelalija Consulting d.o.o". The deadline for delivery of the study is February 28, 2018.		
10.	Adoption of Serbian National Qualifications Framework	partially	The Council for Vocational Education and Adult Education, the National Council for Higher Education, the Institute for the Advancement of Education and the Serbian Chamber of Commerce adopted the application of the international classification of education ISCED 2013f in the Serbian National Qualifications Framework. Educational councils also adopted levels and qualification level descriptors. A unified database of qualifications that can be acquired in the Republic of Serbia and the Serbian National Qualifications Framework site ( <a href="http://noks.mpn.gov.rs">http://noks.mpn.gov.rs</a> ) has been established. An Inter-Ministerial Working Group for the Establishment and Implementation of the SNQF (Inter-ministerial working group) was formed, which prepared a proposal for the Action Plan for the establishment and implementation of the SNQF, which will include activities related to SNQF in 2018 which should be undertaken by the		

			institutions of the members of the IMWG.		
11.	Drafting the SNQF law and a public discussion	partially	In cooperation with the members of the IMWG, the Draft Law on the SNQF was prepared and a public discussion was held. There is ongoing gathering of opinions on the Draft Law on the National Qualifications Framework of RS and meetings with relevant institutions and ministries in relation to the prescribed provisions, in order to provide the best conditions for establishing an education system that is in line with the needs of the economy. The existing Working Group for the preparation of a harmonized occupational classification is in the process of being expanded in order to best understand the competencies of the Ministry of Education, Science and Technical Development and the Ministry of Labour, Employment, Social and Veterans Affairs in order to establish the best legal solutions.		
12.	Preparation for referencing SNQF at the EQF	partially	Part of the NQF is the National Qualification Database. The website of the National Qualifications Framework in Serbia has been established and the Qualifications Database is located there. The database contains formal and informal qualifications. At the moment we have 113 qualifications in the database. All qualifications are available in Serbian (Cyrillic, Latin) and English. The developer is to be engaged to make references with the existing qualifications with the European portal - Ploteus.		Additional activities are realized with the support of the project "European Qualifications Framework - National Coordinating Point 2017".
16.	Preparation of a referencing report for SNQF at the EQF	No		In accordance with the strategic documents, the adoption of the referencing report is planned for 2019.	

17.	Establishing a database of formal qualifications	yes	The website of the National Qualifications Framework in Serbia has been established and the Qualifications Database is located there. The database contains formal and informal qualifications.		A unified database of qualifications that can be acquired in the Republic of Serbia is located on the SNQF's website ( <a href="http://noks.mpn.gov.rs">http://noks.mpn.gov.rs</a> ). A total of 113 qualifications were entered into the qualifications database, out of which 59 with the qualification standard. Entering of new qualifications is ongoing.
18.	Recording qualifications for the database	partially	At the moment we have 113 qualifications at the database. All qualifications are available in Serbian (Cyrillic, Latin) and English.		
22.	Establishment of 2 sectoral groups based on cooperation agreements between MoESTD, institute for Improvement of Education and Serbian Chamber of Commerce	No		Since the Law on SNQF has not been adopted, the establishment of sectoral councils will follow after the adoption.	
26.	Creation of qualifications standards in 2 sectors and their accreditation (entry into the register)	partially	Qualifications standards were developed for 20 qualifications and they will be entered in 2018.		
28.	Development of education/study programs based on the qualifications standards	partially	Education programs have been developed on the basis of qualifications standards, at the pre-university level, but at the university level, curricula have not been developed on the basis of qualifications standards.		

**PSR 14. Improving the effectiveness of active labour market policies with special emphasis on youth, redundant workers and the long-term unemployed**

1.	Analysis of implemented measures of Employment Action Plan in the previous year and drafting and adoption of the Report on the implementation of the NEAP for the previous year	yes	Based on the analysis of the implemented measures in 2016, in cooperation with MoLEVSA, improved public calls/competitions for 2017. Report on the implementation of the NEAP for the previous year, 2016, adopted on June 7, 2017.		
2.	Conclusion of the NES Performance Agreement for the current year	yes	An agreement on the performance between MoLEVSA and NES concluded on 10.02.2017. In accordance with the planned reporting dynamics, a six-month implementation report was adopted and forwarded to the competent ministry.		

3.	Announcement of public call/competition by the NES for implementation of active labour market policies, in accordance with the NEAP for the current year	yes	NES on 07.02.2017 announced 11 public calls/competitions, for the implementation of ALMPs, in accordance with the NEAP for the current year. Also, public calls/competitions were announced in cooperation with local governments, in accordance with the Decision on participation in the co-financing of active labour market programs or measures envisaged by the local employment action plans.		The NES on 02.06.2017 announced the Public Competition for organizing the implementation of public works within the IPA 2012 Project.
4.	Deciding upon applications submitted under the public calls/competitions for implementation of ALMPs and implementation of ALMPs	yes	Processing of submitted applications has been completed and decisions have been made within the deadlines stipulated in the public calls/competitions.		
5.	Realization and monitoring of implementation of ALMPs	partially	In accordance with the adopted decisions, agreements on the implementation of ALMPs have been concluded. It is noted that certain ALMPs should be realized in a period that can last no more than 12 months, which affects the transfer of obligations to implement the measures in the next year. Implementation and monitoring of the implementation of ALMPs is ongoing continuously.		
6.	Adoption of the NEAP for the next year	yes	The National Employment Action Plan for 2018 was adopted in December 2017; it sets out the goals and priorities of the employment policy in 2018, i.e. concrete active labour market programs and measures to be implemented during the year, in which the social partners, relevant ministries, institutions and other interested parties.		

7.	Realisation of the relevant activities from the Action Plan for the implementation of the National Youth Strategy 2015-2017 according to the established dynamics	yes	<p>3 public calls were announced:</p> <p>1. Public call for support to local self-government units in the implementation of youth policy at the local level - Part B: Developing services and mechanisms that promote the entrepreneurial spirit, employability and employment of young people through cross-sectoral cooperation. 4 projects were approved and financed in the amount of 6,123,465 dinars</p> <p>2. Public call for stimulating different forms of employment, self-employment and entrepreneurship of young people. 21 projects approved by Youth Associations and Youth Associations in the amount of 39.816.162,33 dinars were approved and financed/</p> <p>3. Public call for support of local self-government units in the implementation of youth policy at the local level - Part B: Developing services and mechanisms that promote the entrepreneurial spirit, employability and employment of young people through cross-sectoral cooperation. Six projects were approved and financed in the amount of 7.320.000,00 dinars.</p>		
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**PSR 15. Improving the adequacy, quality and targeting of social protection measures**

1.	Revision of the measures and criteria for determining the prices of social protection services	No		The Decree on measures and criteria for determining the prices of social protection services has not been adopted. A final version of the Draft Decree has been drafted and the financial effects of the Decree are being ascertained.	
2	Amendments to the Law on Financial Support to Families with Children	Yes	Law on Financial Support to Families with Children - adopted on December 14, 2017; published in the "Official Gazette of the Republic of Serbia" No. 113 dated 17 December 2017; entered into force on December 25, 2017; it shall apply from 1 July 2018.		

7.	Completion of the process of standardization of services and licensing of social protection institutions and professionals, the drafting of relevant bylaws, as well as the establishment and strengthening of education programmes	partially	<p>The total number of licenses issued to the social protection organizations for the provision of services by the end of 2017 is 326. All service providers have not been licensed yet.</p> <p>The licensing of professionals in the social protection system runs according to the planned dynamics.</p> <p>A working version of the Amendment to the Rulebook on Licensing of Social Protection Organizations and working version of Amendments and changes of the Rulebook on detailed conditions and standards for provision of social protection services.</p>	A number of applications have not been resolved due to resolution of previous issues - submission of evidence of compliance with the standards in other areas (fire protection, sanitary approval, etc.).	
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## Annex 1. Consultations with civil society representatives and other stakeholders

ERP 2018-2020 is a result of intensive cooperation between the Ministry of Finance and the Republic Secretariat for Public Policy, on the one hand, and line ministries and institutions, on the other. In addition, several different phases in the document development process also involved social partners, representatives of the civil society, non-governmental organisations, professional public and business community, who had an opportunity to influence the development of and changes to the document in different ways. A chronological table overview of meetings and consultations with all stakeholders from the launch of ERP 2018-2020 development is provided below.

No	Activities undertaken
1.	<p><b>12 September 2017</b> – The <b>introductory meeting</b> on the development of the Economic Reform Programme 2018-2020 was held; the new – fourth cycle of ERP development was presented at the meeting, including the contents, time schedule and deadlines, novelties in the European Commission's guidance for ERP development, ECOFIN Council policy guidance of May 2017, and experiences in cooperation with the OECD and progress of cooperation with the civil society.</p> <p>On this occasion, the Platform for Monitoring the Implementation of the ERP 2018-2020 and the Employment and Social Reform Programme (ESRP) in the European integration process (hereinafter: Platform) was signed with a view to maximising civil society involvement in the process of ERP development and subsequent implementation. The Platform signatories were the Minister of Finance, the Minister of Labour, Employment, Veteran and Social Affairs and the Manager of the Social Inclusion and Poverty Reduction Unit of the Government of the Republic of Serbia, together with four organisations (European Movement, European Policy Centre, NALED and Centre for Democracy Foundation) on behalf of the National Convention on the European Union (NCEU). More information about the event, as well as Platform text, is available at:</p> <p><a href="http://www.minrzs.gov.rs/?view=lat&amp;action=news&amp;id=ministri-zoran-djordjevic-i-dusan-vujovic-na-uvodnom-sastanku-za-izradu-prob13f0a8f6ba6dcfffa3ae3cf8&amp;category=aktuelno">http://www.minrzs.gov.rs/?view=lat&amp;action=news&amp;id=ministri-zoran-djordjevic-i-dusan-vujovic-na-uvodnom-sastanku-za-izradu-prob13f0a8f6ba6dcfffa3ae3cf8&amp;category=aktuelno</a></p> <p><a href="http://www.minrzs.gov.rs/?view=lat&amp;action=news&amp;id=ministri-zoran-djordjevic-i-dusan-vujovic-na-uvodnom-sastanku-za-izradu-prob13f0a8f6ba6dcfffa3ae3cf8&amp;category=aktuelno">http://www.minrzs.gov.rs/?view=lat&amp;action=news&amp;id=ministri-zoran-djordjevic-i-dusan-vujovic-na-uvodnom-sastanku-za-izradu-prob13f0a8f6ba6dcfffa3ae3cf8&amp;category=aktuelno</a></p> <p><a href="http://socijalnoukljucivanje.gov.rs/sr/%d0%b5%d0%ba%d0%be%d0%bd%d0%be%d0%bc%d1%81%d0%ba%d0%b5-%d1%80%d0%b5%d1%84%d0%be%d1%80%d0%bc%d0%b5-%d1%83-%d0%bf%d1%80%d0%be%d1%86%d0%b5%d1%81%d1%83-%d0%bf%d1%80%d0%b8%d1%81%d1%82%d1%83%d0%bf%d0%b0/">http://socijalnoukljucivanje.gov.rs/sr/%d0%b5%d0%ba%d0%be%d0%bd%d0%be%d0%bc%d1%81%d0%ba%d0%b5-%d1%80%d0%b5%d1%84%d0%be%d1%80%d0%bc%d0%b5-%d1%83-%d0%bf%d1%80%d0%be%d1%86%d0%b5%d1%81%d1%83-%d0%bf%d1%80%d0%b8%d1%81%d1%82%d1%83%d0%bf%d0%b0/</a></p> <p>The objective of the initiative to sign the Platform was to establish effective dialogue between the Government of the Republic of Serbia and the civil society in the Republic of Serbia about the implementation of the key reform measures for the Republic of Serbia's economic and social development, contained in the relevant areas of the Economic Reform Programme and the Employment and Social Reform Programme. In the pilot phase of the Platform's operation, the Social Inclusion and Poverty Reduction Unit, through the Swiss Agency for Development and Cooperation, financially supported the signatory organisations in the implementation of activities consistent with the set objectives. Platform implementation resulted in very useful and tangible analytical documents, such as: Horizontal Overview of the Economic Reform Programme; Tax Administration Transformation; Improving the National Quality Infrastructure System; Raising the Competitiveness of the Manufacturing Industry; Development and Improvement of the National Broadband Communication Infrastructure, and Electronic Point of Single Contact. Outputs in the form of presentations, analytical overviews and infographics, were presented to the public on social networks and websites of the Platform signatories.</p>
2.	<p><b>The Preliminary List of Structural Reforms was made available to the public from 9 to 24 November 2017</b> on the websites of the MoF, Republic Secretariat for Public Policy (RSPP), the Office for Civil Society (OCS) and the National Convention on the European Union (NCEU), as part of the first round of public consultations. The list comprises 18 structural reforms in 9 areas, as defined in the EC Guidance.</p>

	<p>The Preliminary List of Structural Reforms is available at:</p> <p><a href="http://www.mfin.gov.rs/pages/article.php?id=13408&amp;change_lang=ls">http://www.mfin.gov.rs/pages/article.php?id=13408&amp;change_lang=ls</a></p> <p>During this period, a contribution was received from only one civil society organisation – the Network of Organizations for Children of Serbia (MODS), concerning structural reform 18 – Improved adequacy, quality and targeting of social protection. Proposals for improving ERP 2018-2020 were as follows: establish a national mechanism for the achievement of the Sustainable Development goals; improve public policy and programmes for children; introduce systematic policy impact assessment; improve the process of planning and budgeting funds for children; introduce IT networking of institutions; improve assessment of needs for community-based social services for children and families and their continuous monitoring; improve the award criteria and the implementation of the Decree on Earmarked Transfers and their monitoring; develop a plan and guidelines for the transformation of residential institutions for children and reallocate funds to child and family support services; pass the Law on Financial Support to Families with Children and set up dedicated social funds. The proposals will be considered in the next cycle of ERP development, given that activities under structural reform 18 are still under implementation.</p>
3.	<p><b>On 17 November 2017, a technical discussion on the contents of the Preliminary List of Structural Reforms</b> for the ERP 2018-2020 was organised by the MoF and RSPP, and participants included civil sector representatives (NCEU, Economics Institute, Belgrade Open School, NALED, Institute of Economic Sciences, Centre for Democracy Foundation).</p> <p>The meeting involved a smaller number of relevant participants, with whom the following matters were discussed: the manner of selecting structural reforms, the Preliminary List set with the relevant sectors, cooperation with European institutions and recommendations in the “European Semester Light” process (EC and ECOFIN Council), as well as possible gaps in areas in which further analyses would be useful. An objection raised at the meeting concerned the order of the proposed structural reforms, which appeared to imply that the topics of social policy and employment were the least important, given that they were at the end of the list.</p> <p><a href="http://europeanwesternbalkans.rs/cetvrta-faza-izrade-programa-ekonomskih-reformi-2018-2020/">http://europeanwesternbalkans.rs/cetvrta-faza-izrade-programa-ekonomskih-reformi-2018-2020/</a></p>
4.	<p><b>From 4 to 20 December 2017, in cooperation with the NCEU, European Policy Centre (CEP) and Centre for Democracy Foundation, 10 meetings</b> with representatives of trade unions, science and business communities, NGOs and the civil society were organised; at the meetings, Ministry of Finance representatives presented the ERP development process and the Preliminary List of Structural Reforms 2018-2020.</p> <p>Reports on meetings are available at:</p> <p><a href="http://eukonvent.org/sastanak-radne-grupe-nkeu-za-poglavlje-20-predstavljanje-erp-a-i-esrp-a/">http://eukonvent.org/sastanak-radne-grupe-nkeu-za-poglavlje-20-predstavljanje-erp-a-i-esrp-a/</a></p> <p><a href="http://eukonvent.org/odrzan-sastanak-rg-7-nkeu-u-okviru-platforme-za-pracenje-sprovođenja-erp-a-i-esrp-a/">http://eukonvent.org/odrzan-sastanak-rg-7-nkeu-u-okviru-platforme-za-pracenje-sprovođenja-erp-a-i-esrp-a/</a></p> <p><a href="http://cep.org.rs/en/partnerships/platform-for-monitoring-the-implementation-of-the-erp-and-esrp/">http://cep.org.rs/en/partnerships/platform-for-monitoring-the-implementation-of-the-erp-and-esrp/</a></p> <p>At the meetings, detailed discussions were held on the ERP, the “European Semester Light” process and individual areas, in particular the following ones: public finance management; energy, transport and telecommunications market; sectoral development; foreign trade and investment incentives. Concrete proposals for improving the document were made at the meetings: introduce a new priority structural reform – Adoption of the Industrial Policy and an Accompanying Action Plan, since the said strategy represents one of the closing benchmarks for Chapter 20 – Enterprise and industrial policy; present ERP 2018-2020 at the Social and Economic Council meeting; adopt bylaws governing the area of road transport carriers; improve the tax policies in order to reduce the grey economy, etc. The European Policy Centre (CEP), as one of the signatories of the Platform for Monitoring the Implementation of the ERP 2018-2020 and the ESRP, developed multiple analyses pertaining to the ERP 2018-2020 and the proposed priority structural reforms (Horizontal Overview of the ERP; Raising the Competitiveness of the Manufacturing Industry; Development and Improvement of the National Broadband Communication Infrastructure and Tax Administration Transformation), available at:</p>

	<a href="http://cep.org.rs/projects/koordiniranje-pracenja-implementacije-programa-ekonomskih-reformi-erp/">http://cep.org.rs/projects/koordiniranje-pracenja-implementacije-programa-ekonomskih-reformi-erp/</a>
5.	<p><b>On 12 December 2017</b>, Ministry of Finance representatives participated in <b>45<sup>th</sup> Assembly of the Standing Conference of Towns and Municipalities of Serbia (SCTM)</b>; on this occasion, in addition to the 2018 Budget Law, they presented to local government representatives the work done on the development of the Economic Reform Programme 2018-2020 and the Preliminary List of Structural Reforms 2018-2020. This was the second consecutive time that the ERP was presented at the SCTM Assembly, thus enhancing the importance of local governments in the reform process. The report on discussions with the SCTM is available at:</p> <p><a href="http://skgo.org/reports/2107/Lokalni-budžeti-moraju-biti-razvojni-">http://skgo.org/reports/2107/Lokalni-budžeti-moraju-biti-razvojni-</a></p>
6.	<p><b>On 15 December 2017, at the National Assembly of the Republic of Serbia</b>, a consultative meeting was held between Dr Dušan Vujović, Minister of Finance, and the members of the Committee on Finance, National Budget and Control of Public Funds and the Committee on European Integration of the National Assembly of the Republic of Serbia; the meeting was also attended by members of the Parliamentary Committee on Stabilisation and Association. Macroeconomic policy and priority structural reforms were presented at the meeting. After the presentation of the “European Semester Light” process and the work on the ERP 2018-2020, which was under development, the members of the parliamentary committees exchanged views with the Minister of Finance on structural reforms, the issue of deficit, economic growth, public debt, balanced regional development, direct incentives for agriculture, infrastructure projects, Tax Administration reform etc.</p> <p>Information about the event, the MoF presentation and a video recording are available at:</p> <p><a href="http://www.parlament.gov.rs/30_sednica_Odbora_za_evropske_integracije.33034.941.html">http://www.parlament.gov.rs/30_sednica_Odbora_za_evropske_integracije.33034.941.html</a></p>
7.	<p><b>The Final Conference of the pilot phase of the Platform</b> for Monitoring the Implementation of the Economic Reform Programme (ERP) and the Employment and Social Reform Programme (ESRP) in the European integration process was held on <b>21 December 2017</b>; it was organised by the European Movement in Serbia and the Social Inclusion and Poverty Reduction Unit (SIPRU) of the Government of the Republic of Serbia. The work on Platform implementation was presented at the conference by the signatories and stakeholder representatives, and a discussion was held on the ERP development process, cooperation with European institutions, as well as structural reforms and their implementation.</p> <p>Information about the event and the presentation of civil society representatives on Platform activities are available at:</p> <p><a href="http://socijalnoukljucivanje.gov.rs/rs/sipru-retrospektiva-odrzana-zavrсна-konferencija-platforme-za-pracenje-primene-erp-i-esrp/">http://socijalnoukljucivanje.gov.rs/rs/sipru-retrospektiva-odrzana-zavrсна-konferencija-platforme-za-pracenje-primene-erp-i-esrp/</a></p>
8.	<p><b>On 29 December 2017, Draft ERP 2018-2020 was posted on the websites of the MoF, RSPP, OCS, NCEU, and 19 January 2018 was set as the deadline for providing comments and suggestions.</b></p> <p><a href="http://www.mfin.gov.rs/pages/article.php?id=13524">http://www.mfin.gov.rs/pages/article.php?id=13524</a></p> <p>No comments were received from stakeholders during this period, in view of the fact that the final discussion on the fourth ERP development cycle was scheduled for 19 January; however, a number of comments were received after the deadline.</p>
9.	<p><b>On 19 January 2018, the final consultations and a meeting with stakeholders’ representatives were held – ERP 2018-2020 presentation</b> at the Deputies Club, with participation of Dr Dušan Vujović, Minister of Finance, and in cooperation with the National Convention on the European Union. NCEU representatives expressed their satisfaction with the transparency and inclusiveness of the process in all its stages, as well as with the fact that they had had an opportunity to be deeply involved in ERP development methodology, to educate their members about this process and to develop targeted analyses.</p> <p>NCEU representatives announced that, in the forthcoming period, they would intensify cooperation with the relevant parliamentary committees in order to exchange the experiences gained in areas relevant to the ERP. It was suggested that more attention should be paid to communication with the public, and the importance of the Platform for Monitoring the Implementation of the ERP and ESRP and the extension of this form of cooperation was stressed. NCEU working groups’ representatives presented the results of</p>

their work on ERP monitoring in the respective domains of their working groups (economic policy, education, environment, social policy) and an overview of the status of recommendations in this ERP cycle:

- In the discussion, special attention was given to the part of the document outlining the macroeconomic framework, with emphasis on the crucial importance of better public investment management and the fact that the sources of GDP growth are increasingly addressed;
- NALED representatives highlighted the numerous activities they implemented in the area of fighting the grey economy, which are important for the reforms in the ERP; attention was drawn to many analytical documents prepared in this ERP cycle;
- It was stressed that special attention should be dedicated to education and indicators useful for monitoring in this area were proposed;
- In the area of agriculture, it was highlighted that special attention should be given to elderly households, farmers' associations, implementation of food production and safety standards, strengthening the link between science and the business sector, and provision of an institutional framework for financing farming;
- It was underscored that the area of the environment was not encompassed by the ERP, while it was of paramount importance for the population and the European integration process and had a major potential for economic development; the need to develop the "green transition" concept was also noted;
- It was suggested that digitalisation should be a separate area in the ERP and a proposal was made to amend the document by including "Digitalisation in economic and non-economic activities", in view of the importance of digitalisation as a driver of structural changes in the contemporary world and in order to remove the risk of falling into a "digital gap";
- The need for e-government development was highlighted, in particular the importance of e-health, introduction of the relevant accounting standards, energy efficiency, higher allocations for science and protection of critical infrastructure in conformity with EU standards;
- Representatives of Nezavisnost Trade Union stressed that it was necessary to put more emphasis on the negative aspect of informal employment growth, as well as the share of workers working in the informal sector, because of poverty; they also suggested a higher focus on the goal to ensure more better and safer jobs, as well as the fight against the grey economy, and highlighted the importance of linking the ERP with the ESRP.

Information about the event is available at:

<http://mfin.gov.rs/newsitem.php?id=13534>

<http://eukonvent.org/zavrsne-konsultacije-nkeu-sa-ministrom-finansija-o-programu-ekonomskih-reformi-2018-2020/>

Stakeholders' comments could be submitted throughout the ERP development cycle to: [erp@mfin.gov.rs](mailto:erp@mfin.gov.rs).

## Annex 2. List of Institutions Participating in the Preparation of ERP

Pursuant to the Minister's Decision no. 337-00-72/2017-24 of 24 October 2017, the Working Group was established for ERP Preparation and Monitoring of Implementation. The members and deputy members of the Working Group are ERP coordinators and their deputies who, in line with the guidelines, actively participated in the preparation of the document. The ministries and institutions that participated in the drafting of the document are the following:

- Government of the Republic of Serbia – Prime Minister's Office – Delivery Unit,
- Office of the Minister without Portfolio in Charge of Innovation and Technological Development,
- Office of the Minister without Portfolio in Charge of Regional Development and Operation of Public Enterprises,
- Ministry of Construction, Transport and Infrastructure,
- Ministry of Public Administration and Local Government,
- Ministry for European Integration,
- Ministry of Labour, Employment, Veteran and Social Affairs,
- Ministry of Health,
- Ministry of Culture and Information,
- Ministry of Defence,
- Ministry of Agriculture,
- Ministry of Justice,
- Ministry of Economy,
- Ministry of Education, Science and Technological Development,
- Ministry of Mining and Energy,
- Ministry of Foreign Affairs,
- Ministry of Trade, Tourism and Telecommunications,
- Ministry of Finance,
- Ministry of Youth and Sports,
- National Bank of Serbia,
- National Employment Service,
- Statistical Office of the Republic of Serbia,
- Public Policy Secretariat ,
- Team for Social Inclusion and Poverty Reduction.

### Annex 3. Implementation of Recommendations to Serbia from the Economic and Financial Dialogue between the EU Member States and the Western Balkans and Turkey from May 2017

Recommendations	Structural reforms
<p>III. Securing the continuous reduction of the budget deficit in 2017 and mid-term. Using all additional fiscal room to reduce the deficit through planned goals, while continuing to increase capital expenditure. Adopting a reliable and binding system of fiscal rules, in order to secure the consolidation of efforts.</p>	<p>Favourable fiscal trends continued in 2017 as well. At the end of the year, fiscal performance can be expected in the form of a balanced budget or a surplus, while the public debt continued to decrease. Fiscal consolidation measures implemented in the previous period led to a reduction in the general government public debt-to-GDP ratio by about 9 p.p. in 2017 compared to 2016, or from 74% to 65% of GDP. In the coming medium term period, fiscal performance is planned to exceed the level projected by the ERP document for the period 2017-2019, while the level of public debt is to decrease further.</p> <p>Debate regarding the establishment of the new system of fiscal rules is ongoing. All relevant government agencies, as well as international institutions such as the IMF and the European Commission are taking part in it.</p>
<p>III.2. Supporting the fiscal scenario through even stronger reform of state enterprises and the Tax Administration. Improving the structure of budget expenditure through further reduction in public expenditure on wages and pensions and their share in GDP.</p>	<p>With the adoption of the Transformation Programme Action Plan for the period 2018-2023 (5 December 2017) as well as the Decision on the Core and Non-core Activities of the Tax Administration, the TA is focusing on the core tax activities and the first phase of the organisational unit consolidation. Additional simplification and harmonisation of tax procedure, as well as the improvement of operational activities aimed at combating the informal economy are intended to contribute to the reduction of compliance costs, easier and fairer business conditions and improved tax collection. Strategic risk management has been improved through the development of the Compliance Plan for 2017, based on the compliance risk map, the IMF advice and TADAT recommendations (<i>Tax Administration Diagnosis Assessment Tool</i>). In the context of improving taxpayer services, new electronic tax returns and services are constantly being introduced so in 2018 e-filing has been made possible for the main tax types. A dedicated Taxpayer Service Department has been formed, applying the client approach to taxpayers. The one-stop-shop system – Your Tax Officer service counter has been introduced in 37 Tax Administration branches, which became operational in the July 2017 – January 2018 period. Additional activities have been planned related to the improvement of tax audit and collection, tax-law operations, as well as more efficient management of human resources, material resources and the improvement of IT systems bearing in mind the alignment with EU standards in the accession process.</p> <p>Reducing public spending continued in 2017 as well. The estimated reduction in the share of wages and pensions in 2017 is about 0.4% of GDP and such developments will continue in the coming medium term period as well.</p>
<p>III.3. Implementing the remaining measures of the NPL reduction strategy. Continuing the efforts promoting the use of the dinar, <i>inter alia</i>, also by holding, in the future, the differentialisation of the mandatory reserve rate in foreign currency and in dinars. Finalising the reform and privatisation of two large state banks and finding a solution for two remaining small state banks. Monetary policy ought to be in accordance with the achievement of the new inflation target.</p>	<p>The NBS has implemented all the activities provided for by the Action Plan for the Implementation of the NPL Resolution Strategy, specifically in the area of bank supervision, accounting and reporting standards, data publication, NPL market, as well as collateral management. The NBS has demonstrated its commitment to resolving this complex issue in the banking sector in accordance with its competences, with the aim of preserving and reinforcing the stability of the banking system, not only by monitoring banks' activities in the context of regulations amended in accordance with the action plan and communicating on an ongoing basis with the banks through its regular supervisory activities, but also by continuing its regulatory activities in this context in 2017 as well.</p> <p>The share of NPLs in total loans was halved compared to when the Strategy was adopted and at the end of November 2017 it was 11.1%, which is below the pre-crisis level.</p> <p>Considering that the promotion of more widespread use of the dinar constitutes its strategic orientation, the National Bank of Serbia will, in the coming period as well, continue to implement measures and activities aimed at further</p>

	<p>strengthening confidence in the national currency and greater use of the dinar in the financial system. Under the mandatory reserve instrument, the National Bank will keep higher mandatory reserve rates on the banks' foreign currency liabilities than on dinar liabilities, thus continuing to stimulate greater use of dinar funding by banks.</p> <p>In the coming period, monetary policy decisions will depend on an evaluation of the strength of inflationary, or deflationary impacts of inflation factors. The NBS will carefully monitor and assess the developments in the domestic and international market and will use all instruments available to it in order for inflation to remain low and stable in the medium term, i.e. within the 3±1.5% target band.</p> <p>The Government of the Republic of Serbia has, through the Ministry of Finance, initiated the adoption of a series of legal acts and institutional solutions in accordance with the NPL Resolution Strategy, as follows:</p> <ul style="list-style-type: none"> <li>- Adoption of the Law on Real Estate Appraisers and all accompanying bylaws, the preparation of National Standards and Code of Ethics for certified appraisers, as well as the formation of the Appraiser Board, as the regulatory body in this area;</li> <li>- Amendments to the Corporate Income Tax Law, as regards the tax treatment of debt write-off, as well as amendments to the Personal Income Tax Law;</li> <li>- Improvement of the institutional capacity of the Deposit Insurance Agency, in order to ensure more efficient resolution of the NPL portfolio under this institution's management;</li> <li>- Adoption of the Law on Consensual Financial Restructuring;</li> <li>- Development of a diagnostic study of the Development Fund and the Export Credit and Insurance Agency;</li> <li>- Adoption of amendments to the Law on the Bankruptcy Supervision Agency, as well as the preparation of draft amendments to the Bankruptcy Law;</li> <li>- Adoption of amendments to the Law on Execution and Security;</li> <li>- Adoption of amendments to the Mortgage Law, and</li> <li>- Improvement of the institutional capacity of the Republic Geodetic Authority in terms of efficient functioning of the legal framework for mortgages.</li> </ul> <p>Regarding the implementation of reforms and the privatisation of state-owned banks, a report has been adopted containing proposals for the management of capital in the banks in which the Republic of Serbia has an equity interest, strategically oriented towards the continuation of the privatisation process and the improvement of the operation of Komercijalna Banka a.d. Beograd, as well as intensification of the ongoing procedure of reorganisation, restructuring and modernisation of operation of Banka Poštanska Štedionica a.d. Beograd.</p>
<p>Π4. Gradually adapting the tariffs for electric energy so that they reflect real costs. Further improving collection and avoiding future accumulations of arrears in the energy sector. Making progress in the announced restructuring of Srbijagas debt and the implementation of the EPS downsizing plan. Expanding the scope of <i>Single project pipeline</i> in order to cover all major investment projects, regardless of their source of funding and establishing clear connections with the budget process.</p>	<p>The Energy Agency approved adjustments to electric energy prices for public supply in 2015, 2016 and 2017 (August 2015 – 4.5%, October 2016 – 3.8% and October 2017 – 2%).</p> <p>The price of electric energy for guaranteed supply was increased by 2% in 2017 based on the EPS analysis aimed at determining the level of necessary price increase for guaranteed supply and approval of the World Bank. Price increase for the period 2018-2020 will be determined after new analyses are conducted.</p> <p>In March 2016, the Plan for Financial Restructuring of JP Srbijagas was adopted, which defined measures for increasing revenues and reducing costs. This company has made a decision which defines mechanisms for gas supply discontinuation on the basis of the conclusion that the Government has adopted and obliged JP Srbijagas to consistently implement the policy of collecting revenues, i.e. in accordance with business policies, methodology and law, to stop the delivery of natural gas to customers who does not settle current obligations. Also, JP Srbijagas has adopted the methodology for assessing investments and formed an Audit Committee in charge of overseeing the internal control system, as well as internal and external audits.</p> <p>Continuous efforts are invested in increasing the collection rate in JP EPS (in the</p>

	<p>period January - November 2017, a collection rate of 98.7% was recorded, while it was 93.7% in the same period in 2016).</p> <p>EPS Group is conducting downsizing in the period 2015-2019. In accordance with the adopted EPS Group Downsizing Plan (of 5 August 2016) and the EPS Group Downsizing Plan for 2017 (of 18 September 2017), through attrition and voluntary terminations accompanied with the payment of severance pay, up to 31 December 2017 the number of employees at the EPS Group was reduced by 2,987.</p> <p>In June 2017 the Government of the Republic of Serbia adopted a Decree on the Content, Manner of Preparation and Assessment, as well as the Monitoring of the Implementation of and Reporting on the Execution of Capital Projects, in order to ensure the evaluation of all positive and negative impacts of those projects, as well as the effective and efficient management of public assets.</p>
<p>II5. Regulating the amount and number of tax-related fees at the state level. Developing a regulatory framework for new financial instruments, including micro funding. Establishing a risk management system with the aim of improving the functioning of the Tax Administration and securing better targeting and efficiency of inspections.</p>	<p>The Draft Law on Fees for the Use of Public Goods has been prepared as part of the efforts of the Working Group that was formed by the Minister's decision. The Ministry of Finance is in the process of conducting public consultations on the Draft Law, as requested by the Economic and Finance Committee of the Government of the Republic of Serbia on 27 December 2017. Public consultations on the Draft Law are conducted in the period from 3 January to 28 February 2018.</p> <p>The National Bank of Serbia is looking into the possibilities and scope of the regulatory framework with regard to the operation of non-depository financial institutions that will create additional potential for financing SMEs, especially micros and start-ups.</p> <p>In 2016, based on activities defined by the Tax Administration Transformation Programme for the period 2015-2020, the TA established the Strategic Risk Division tasked with reviewing macroeconomic indicators and providing guidelines for the development of operational plans. The newly-formed division, with the support of local and international expertise, began work in April 2016 and developed the Tax Compliance Plan for 2017, incorporating, <i>inter alia</i>, the IMF's advice and recommendations of the TADAT mission.</p> <p>This Plan spells out the Tax Administration's focus on activities that will facilitate voluntary compliance, safer collection of public revenues and efficient dealing with all forms of non-compliance.</p> <p>This complex and comprehensive task implies the engagement of all the organisational parts of the Tax Administration. The Compliance Plan identified high-risk areas with very low compliance rate, which, for that reason, constitute a potential threat with regard to compliance in all segments of the analysis.</p> <p>The basic goal of development of the Compliance Plan is a timely identification of key compliance risks, their monitoring and quantification, all with aim of ensuring informed decision-making by the Compliance Committee, as well as implementation of the Decision of the Government of the Republic of Serbia which in December 2016 proclaimed 2017 and 2018 to be the years of combating the informal economy.</p> <p>The harmonisation of sectoral laws with the Law on Inspection Oversight (after analysing 147 separate laws regulating inspection oversight in certain areas, it was established that 88 separate laws needed to be amended). The database regarding inspections and working groups that is available at <a href="http://www.inspektor.gov.rs">www.inspektor.gov.rs</a> is being constantly updated. An initiative has been launched aimed at improving permanent dialogue between businesses and the inspection by supporting the introduction of advisors/experts for ongoing dialogue and assistance to businesses. The newly-formed Office for IT and E-government was assigned jurisdiction for the area of e-inspections.</p>
<p>II6. Reducing high non-wage labour expenses for jobs at the lower levels of wage distribution in a</p>	<p>The National Employment Action Plan for 2017 identified groups of hard-to-employ persons who are given priority when it comes to participation in all the programmes and active labour market policies, which include social assistance</p>

<p>fiscally neutral way. Aiming at active measures on the labour market for vulnerable social groups, including welfare recipients. Introducing dual education in vocational training and education in close cooperation with social partners and the business community.</p>	<p>recipients who are fit for work. The said document also states that of the total number of the unemployed included in the public works programme, at least 70% should belong to the had-to-employ groups. Furthermore, social assistance recipients are particularly recognised as one of the targeted groups to which the subsidy for the employment of the unemployed applies. Moreover, for the purpose of implementing integrated services for social assistance recipients, and adequate and timely integration or reintegration in the labour market, in 2017 protocols were again signed on the cooperation between centres for social work and NES branches. As a result of these activities, in 2017, 11,461 social assistance recipients were included in active labour market policies.</p> <p>Work on introducing the concept of the National Model of Dual and Entrepreneurial Education in Serbia has been ongoing since September 2016, so currently in 13.8% of vocational high schools in the territory of the Republic of Serbia there are dual education profiles. The total number of enrolled students in the 2017/2018 school year is 4,559 (1,482 in dual profiles and 3,077 with elements of dual education), while 205 companies have been licensed to organise work-based learning (67 companies for dual educational profiles and 138 companies with educational profiles with elements of dual education).</p>
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