Government of the Republic of Serbia

National Economic Reform Programme for 2015-2017

March 2015
Important disclaimer:

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I. GENERAL FRAMEWORK AND MAIN OBJECTIVES AND GUIDELINES OF THE ECONOMIC POLICY

The Government is strategically oriented towards the process of the European integrations for a faster acquisition of the full EU membership status. The general framework of the economic policy for the period from 2015 to 2017 has been defined by the development documents of the Government such as the following: 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 (hereinafter referred to as: SAA), National Program for adoption of EU acquis (2013 - 2016), general and sectoral national development strategies, Fiscal Strategy for 2015 with projections for 2016 and 2017. In order to fulfill the economic and political criteria for the membership in the European Union (EU), it is necessary to ensure the strengthening of the administrative capacities and stability of institutions which guarantee democracy, rule of law, respect for human rights and protection of minorities, development of market economy and strengthening its capacities in order to respond to the competitive pressure and market power from the EU, as well as creation of a stable economic and monetary environment. The next medium-term economic policy has been defined in line with the strategic development framework.

The basic objectives of the economic policy in the next medium-term are the following:

1. Establishing the macroeconomic stability by implementing the measures of fiscal consolidation and strengthening the stability of the financial sector;
2. Removing the obstacles for the growth of economic activities and competitiveness by implementing the comprehensive structural reforms.

In the next period the Government will pursue the economic policy focused on the creation of stability and predictable business environment necessary for the growth of economic activities and the increase of share of the private sector in production, employment and investment. To this end, in the previous period a great number of reform acts was adopted which implementation should bring to the elimination of structural weaknesses of the economy and the creation of the basis for the long-term sustainable growth. Among the most significant legal acts are the Law on Amendments to the Labour Law, Law on Privatisation, Law on Amendments to the Law on Bankruptcy, Law on Amendments to the Law on Planning and Construction, Law on Amendments to the Law on Pension and Disability Insurance, etc.

The economic restructuring of Serbian economy will be significantly supported by the decrease of irrational public expenditures and changes in the investment funding model which would encourage the economic growth and employment. The key role for that belongs to the fiscal policy and the stability of the national currency, more active attraction of foreign investment, prevention of the outflow of foreign currency through grey channels, discouragement of unnecessary import, encouragement of companies to substitute the import and strengthen the export offer. A special attention will be paid to the creation of the business environment which will be encouraging for businessmen and investors and the creation of conditions for easier business operations. The remaining economic reforms will be accelerated in order to improve the business environment, especially by strengthening the rule of law and additional decrease of inflexible labour market conditions. The objective is to establish such a business environment which will ensure the growth of foreign and domestic investment, accelerate economic restructuring and increase the economic productivity and competitiveness.
In order to achieve the macroeconomic stability and the economic growth, the Government has made a significant change in the fiscal policy. The expansive fiscal policy is replaced by the restrictive fiscal policy, achieving a relevant effects this year, as a result of the adopted measures limiting the growth of the largest expenditure category along with the increase of certain tax rates. In the next period, the restrictiveness of the fiscal policy will include implementation of the adopted program of fiscal consolidation, which will ensure the reduction of the high fiscal deficit and stabilisation of the general government debt by 2017. The reduction of the irrational expenditure, bureaucracy and unnecessary spending of the country will create the possibility of the increase of the investment activities in order to encourage the economic growth and employment, while maintaining the level of social protection for the most vulnerable groups of the society. The key role for that belongs to the fiscal policy and the comprehensive reform of the economic system.

Regarding the trend of growth of the public debt and the increasing financing costs, in the next three years the fiscal policy will be based on implementation of the measures to reduce expenditures, the fight against the grey economy and raising the efficiency of public revenue collection as well as the planned reforms in the domain of the public sector, especially public companies. When reducing the budget expenditures the attention will be paid to preserving the sources of potential growth and to improving the efficiency of public spending.

The basic objectives of the fiscal policy in the next period are the following:
- Reduce the ratio of public expenditures, fiscal deficit and public debt to the GDP;
- Strengthen the tax discipline, which includes the improvement of the tax collection system and the reduction of the grey economy;
- Strengthen the long-term fiscal sustainability through the implementation of the structural reforms, especially the reforms of the public sector.

The strong fiscal consolidation in 2015 of 3% of GDP on the expenditure side will lead to short-term economic downturns, after which an acceleration of the GDP growth in real terms is expected. The structure and dynamics of the adopted austerity measures were designed to ensure a sustainable path of recovery in the future. From the perspective of the economic growth it is important to emphasize that the savings will not be made at the expense of the capital investments which are the key to the start of the investment cycle, but primarily through the reduction of the current expenditures which were too large in comparison to the strength of the economy in the past. The planned fiscal adjustment will be carried out mainly by reducing the expenditures for the public sector employees, by reducing pensions, subsidies and other direct or indirect forms of assistance for state owned and public companies, but with the protection of the most vulnerable and poorest groups of the population. Also, the priorities of the fiscal policy in the future will be to strengthen the tax discipline, increase the efficiency of the tax collection and the fight against the grey economy. This will simultaneously ensure the improvement of general economic conditions and equal business activities and the reduction of the overall fiscal deficit.

From the perspective of the functioning of the public sector and the increase of its efficiency, the austerity measures will be implemented also by the abolition of the unproductive job positions and general rationalisation of the public sector operations. In the next period it is necessary to intensify the introduction of professionalization in the operations of public enterprises and the responsible corporative governance in those enterprises that will remain under state control, with the relocation of the social policy from public enterprises into the social protection system, as well as a gradual and responsible reduction of the state share in the economy. On the other hand, in other parts of the public sector, based on the comprehensive needs analysis, the rationalisation will be conducted in order to raise the quality of services of the functions provided by the state (education, health
care, public administration and local self-government, etc.). The objective is to establish an encouraging tax policy which will encourage both the economy and employment, including the transition to concessionary financing models and public-private partnerships wherever it is economically feasible and justified and zero tolerance for law violation and crime and corruption through the reformed institutions of the system.

In order to complete and facilitate the process of privatisation of the remaining companies with social capital through the process of restructuring or bankruptcy, the Law on Privatisation and the Law on Amendments to the Law on Bankruptcy were adopted. The Law on Privatisation provides more flexible methods and models of privatisation based on real market conditions which will make the procedure more efficient. The new legislation plans the privatisation through several models: the sale of capital, sale of assets, capital transfer without compensation and strategic partnership, model of public bidding with public auctions, that is, public tenders. In addition to the aforementioned, there is a regulated possibility to implement the measures for the preparation and relief of the liabilities of the privatisation entity as follows: conditional debt write-off, that is, conversion of the debt of the privatisation entity into a permanent share. The Law on Amendments to the Law on Bankruptcy introduces clearer rules which aim is to accelerate the bankruptcy proceedings and provide a better protection of creditors of the debtor.

National Bank of Serbia (hereinafter referred to as: NBS) will use measures and tools of monetary policy to support the implementation of the economic and fiscal policy of the Government, if that does not prejudice the achievement of the basic objective of the monetary policy relating to the maintenance of price stability, as well as the objective of financial system stability. In the future, the monetary policy measures will be focused on achieving the target inflation of 4±1.5%, i.e. its permanent stabilisation at a low level.

II. ECONOMIC TRENDS AND MEDIUM-TERM PROJECTIONS

1. Assessment of Trends in the International Economic Environment

International Monetary Fund (hereinafter referred to as: IMF) in the revised World Economic Outlook from October 2014 estimated the basic economic indicators at the global level and at the level of groups of countries. The global economic growth, for the third time this year was revised downward. The weaker economic results of the EU, followed with the strained economic relations with Russia, and expressed disinflationary pressures have marked the economic trends in the international environment. For the countries of the Euro zone, after an annual growth of GDP in the first (1.1%), second and third (per 0.8%) quarter in 2014, the growth of GDP was revised downward for 2014 from 1.1% to 0.8%. At the same time, a slight decrease of the unemployment rate is estimated to 11.6% as well as a decrease of the annual inflation to 0.5%.

The continuation of the disinflationary pressures in the Euro zone has forced the European Central Bank (hereinafter referred to as: ECB) to additionally ease the monetary policy, which has brought to a weakening of the euro against U.S. dollar. On the other hand, the growth of the economic activity in the USA in the first half of 2014 was beyond expectations, which influenced the decision of the USA Federal Reserve (hereinafter referred to as: FED) to continue with gradual decrease of the volume of quantitative easing.

For the year 2015 the IMF envisages real growth of GDP of the Euro zone of 1.3%, decrease of the unemployment rate to 11.2%, acceleration of the world trade growth to 5.0% and the annual inflation of 0.9%.
Table 1. International Environment - Macroeconomic Indicators

<table>
<thead>
<tr>
<th></th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real growth of gross domestic product¹, %</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>World total</td>
<td>3.3</td>
<td>3.3</td>
<td>3.8</td>
<td>4.0</td>
<td>4.1</td>
</tr>
<tr>
<td>European Union</td>
<td>0.2</td>
<td>1.4</td>
<td>1.8</td>
<td>2.0</td>
<td>2.0</td>
</tr>
<tr>
<td>Euro zone</td>
<td>-0.5</td>
<td>0.8</td>
<td>1.3</td>
<td>1.7</td>
<td>1.7</td>
</tr>
<tr>
<td>USA</td>
<td>2.2</td>
<td>2.1</td>
<td>3.1</td>
<td>3.0</td>
<td>2.9</td>
</tr>
<tr>
<td>Russia</td>
<td>1.3</td>
<td>0.2</td>
<td>0.5</td>
<td>1.5</td>
<td>1.8</td>
</tr>
<tr>
<td>Developing countries</td>
<td>4.7</td>
<td>4.4</td>
<td>5.0</td>
<td>5.2</td>
<td>5.2</td>
</tr>
<tr>
<td>World trade growth, %</td>
<td>3.0</td>
<td>3.8</td>
<td>5.0</td>
<td>5.5</td>
<td>5.6</td>
</tr>
<tr>
<td>Unemployment rate, %</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Euro zone</td>
<td>11.9</td>
<td>11.6</td>
<td>11.2</td>
<td>10.7</td>
<td>10.2</td>
</tr>
<tr>
<td>USA</td>
<td>7.4</td>
<td>6.3</td>
<td>5.9</td>
<td>5.8</td>
<td>5.5</td>
</tr>
<tr>
<td>Consumer prices, annual changes, %</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Euro zone</td>
<td>1.4</td>
<td>0.5</td>
<td>0.9</td>
<td>1.2</td>
<td>1.4</td>
</tr>
<tr>
<td>Developed economies</td>
<td>1.4</td>
<td>1.6</td>
<td>1.8</td>
<td>2.0</td>
<td>2.0</td>
</tr>
<tr>
<td>Developing countries</td>
<td>5.9</td>
<td>5.5</td>
<td>5.6</td>
<td>5.2</td>
<td>4.9</td>
</tr>
<tr>
<td>Increase in oil prices, in dollars, annual changes, %</td>
<td>-0.9</td>
<td>-1.3</td>
<td>-3.3</td>
<td>-2.0</td>
<td>-2.0</td>
</tr>
</tbody>
</table>

¹ World GDP calculated according to the purchasing power parity.
Source: IMF, World Economic Outlook, October 2014.

In the period from 2015 to 2017 the IMF expects that the global economic growth will follow the fiscal adjustment, improvement of the conditions on the financial market and more favourable labour market conditions. A significant improvement of the budget balance is expected, as well as a gradual increase in banks' credit activity and growth of domestic demand as the main driver of economic growth.

The revision of the IMF data from October 2014 also includes the trends of basic interest rates and trends of crude oil prices (average price of oil type "Brent", "Dubai Fateh" and "West Texas"). For 2014 and 2015 the IMF estimates interest rates on three-month euro deposits of 0.2%, and interest rates on six-month LIBOR on dollar deposits from 0.4% in 2014 and 0.7% in 2015. The IMF predicts a reduction in the price of crude oil by 1.3% in 2014 and 3.3% in 2015 (from $ 102.8 to $ 99.3).

In November 2014, the European Commission (hereinafter referred to as: EC) revised the growth of economic activities of the EU and the Euro zone downward in comparison with the March projection. In light of these events, in September 2014 the ECB lowered the reference interest rate by 0.10 pp, to 0.05%, confirming the commitment to the use of the policy of quantitative privileges in order to initiate the growth of economic activities in the Euro zone. Also the newly elected EC has prepared an investment plan for reviving the economy worth 315 billion euros.

According to the projections of the EC, the Euro zone economy will stagnate by the end of 2014. The slowdown in economic activity in Europe is the result of a weaker growth in labour productivity, uncertain labour market performances, slower recovery of investment activity and the deterioration of foreign trade activities due to the tensions in Ukraine and the MENA region. The growth was interrupted in Germany, stagnation was prolonged in France, and the recession was continued in Italy. For Germany, as the largest economy of the Euro zone and the main foreign trade partner of the Republic of Serbia, in 2014, the EC predicts the growth of 1.3%. The growth was revised down by 0.5 pp compared to the spring projections, due to unfavourable foreign policy situation in Ukraine, the reduction in global demand and falling investment. The economic growth in the period 2015 - 2017 will be
gradual, due to the weak recovery in the labour market, improvement of financing conditions and growth in external demand. It is expected that Italy continues the contraction in economic activity in 2014 (fall of GDP by 0.4%), with the record low inflation and high unemployment. A slight recovery is expected in 2015 and 2016 when the GDP growth is expected to be 0.6% and 1.1% respectively, due to a stronger recovery in domestic demand and continuing growth in net exports due to the increase in external demand.

The forecast of the economic growth in the Euro zone in 2015 and 2016 is 1.1% and 1.7% respectively. Strengthening the economic activities will be guided primarily by implementing structural reforms, as well as the recovery in the labour market and improved financing conditions. The main source of growth in this period will be private consumption, due to the spillover effects of the ECB’s monetary policy on improvement of credit activity and low inflation that will influence the increase of the disposable income of the population. A significant recovery in investment spending is expected from 2016. The export activity will record a moderate growth in the period 2015-2017, due to the strengthening of global demand, while strengthening of domestic demand will affect the growth of import, so that the contribution of net export to GDP growth will be neutral.

For Germany, as the largest economy of the Euro zone and the main foreign trade partner of Serbia, in 2015 the growth of 1.5% is predicted, while the growth for Italy is predicted to be 0.8%.

Table 2. Foreign Trade Partners of Serbia - Basic Economic Indicators

<table>
<thead>
<tr>
<th></th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real growth of GDP, in %</td>
<td>Italy</td>
<td>-1.9</td>
<td>-0.4</td>
<td>0.6</td>
</tr>
<tr>
<td></td>
<td>Germany</td>
<td>0.4</td>
<td>1.3</td>
<td>1.1</td>
</tr>
<tr>
<td></td>
<td>Euro zone</td>
<td>-0.5</td>
<td>0.8</td>
<td>1.1</td>
</tr>
<tr>
<td></td>
<td>Russia</td>
<td>1.3</td>
<td>0.3</td>
<td>0.3</td>
</tr>
<tr>
<td>Inflation, in %</td>
<td>Italy</td>
<td>1.3</td>
<td>0.5</td>
<td>0.5</td>
</tr>
<tr>
<td></td>
<td>Germany</td>
<td>1.6</td>
<td>0.9</td>
<td>1.2</td>
</tr>
<tr>
<td></td>
<td>Euro zone</td>
<td>1.4</td>
<td>0.5</td>
<td>0.8</td>
</tr>
<tr>
<td></td>
<td>Russia</td>
<td>6.8</td>
<td>7.5</td>
<td>7.0</td>
</tr>
<tr>
<td>Current account balance (% of GDP)</td>
<td>Italy</td>
<td>1.0</td>
<td>1.5</td>
<td>1.5</td>
</tr>
<tr>
<td></td>
<td>Germany</td>
<td>6.9</td>
<td>7.1</td>
<td>7.1</td>
</tr>
<tr>
<td></td>
<td>Euro zone</td>
<td>2.4</td>
<td>2.5</td>
<td>2.6</td>
</tr>
<tr>
<td></td>
<td>Russia</td>
<td>1.6</td>
<td>3.2</td>
<td>2.5</td>
</tr>
<tr>
<td>Consolidated fiscal balance, in % of GDP</td>
<td>Italy</td>
<td>-2.8</td>
<td>-3.0</td>
<td>-2.7</td>
</tr>
<tr>
<td></td>
<td>Germany</td>
<td>0.1</td>
<td>0.2</td>
<td>0.0</td>
</tr>
<tr>
<td></td>
<td>Euro zone</td>
<td>-2.9</td>
<td>-2.6</td>
<td>-2.4</td>
</tr>
<tr>
<td></td>
<td>Russia</td>
<td>0.2</td>
<td>0.6</td>
<td>0.2</td>
</tr>
<tr>
<td>Gross government debt, in % of GDP</td>
<td>Italy</td>
<td>127.9</td>
<td>132.2</td>
<td>133.8</td>
</tr>
<tr>
<td></td>
<td>Germany</td>
<td>76.9</td>
<td>74.5</td>
<td>72.4</td>
</tr>
<tr>
<td></td>
<td>Euro zone</td>
<td>93.1</td>
<td>94.5</td>
<td>94.8</td>
</tr>
<tr>
<td></td>
<td>Russia</td>
<td>13.9</td>
<td>15.9</td>
<td>16.8</td>
</tr>
<tr>
<td>Unemployment rate, in %</td>
<td>Italy</td>
<td>12.2</td>
<td>12.6</td>
<td>12.6</td>
</tr>
<tr>
<td></td>
<td>Germany</td>
<td>5.3</td>
<td>5.1</td>
<td>5.1</td>
</tr>
<tr>
<td></td>
<td>Euro zone</td>
<td>11.9</td>
<td>11.6</td>
<td>11.3</td>
</tr>
<tr>
<td></td>
<td>Russia</td>
<td>5.5</td>
<td>5.4</td>
<td>5.6</td>
</tr>
</tbody>
</table>

Source: European Commission, Autumn Forecast, November 2014

Disinflationary trend in the EU continues during 2014 due to low energy and food prices and the previous appreciation of the euro. With a gradual recovery of economic
activity and growth of wages, inflation should accelerate in the future, due to the disappearance of the effect of low energy and food prices and a slight increase in import prices. According to the projections of the EC in 2014 the predicted inflation is 0.5%, in 2015 it is 0.8%, and 1.5% in 2016.

Risks in achieving the stated projections of global economic recovery are closely related to geopolitical tensions in Ukraine and the MENA region. Also, the absence of structural, fiscal and institutional reforms may increase the economic differences within the EU and undermine the economic growth. The risks associated with the developed economies are related to the low inflation and the risk of stagnation, while the developing countries are faced with the possibility that, in the conditions of deteriorated external financial conditions, a great part of foreign capital can outflow and thus cause instability in the domestic financial markets.

2. Economic Trends and Outlook for 2014

Macroeconomic trends in 2013 are primarily marked by the growth in economic activity and export growth, along with a significant reduction in the foreign trade deficit and the current account deficit, as well as low inflation which was significantly contributed by the implementation of fiscal consolidation measures. The fiscal consolidation was initiated in late 2012, primarily with the measures regarding the revenue side, in the form of an increase in tax rates, and to a lesser extent regarding the expenditure side, by limiting the growth of public sector wages and pensions. According to the assessment by the Statistical Office of the Republic of Serbia (hereinafter referred to as: RSO), after the recession in 2012, the real sector in 2013 recorded an annual GDP growth of 2.6% in the atmosphere of the implementation of fiscal consolidation measures, with an annual growth of the physical volume of industrial production of 5.5% and agricultural production of 22.1%.

In 2013, the export of goods denominated in euros was increased by 25.8% and import of goods by 5.1%, with a reduction of foreign trade deficit by one quarter. The current account deficit was reduced by two-fifths, which, in addition to the increase in export, was contributed by fiscal consolidation. The increase in export was mostly contributed by the export of road vehicles, electrical machinery and apparatus, vegetables and fruit, cereals and non-ferrous metals (just over one-third of the total export). The increase of import was contributed by the import of road vehicles, oil and oil products, gas, electrical machinery and appliances and medical and pharmaceutical products, which fell under one third of the total import in 2013. At the labour market in 2013, it was recorded a reduction in the number of formally employed persons by 0.7%, with an increase in the number of actively unemployed persons\(^1\) by 1.7%, while the total average net salary was reduced by 1.5%. The unemployment rate, according to the Labour Force Survey (hereinafter referred to as: LFS) in 2013 was 22.1%, and the employment rate was 37.7%.

The annual rise in consumer prices in December 2013 was 2.2%, which is below the lower limit of the target tolerance band and it is the result of, above all, low aggregate demand, the falling food prices and a relatively stable exchange rate.

The decline in economic activity and low inflation are the dominant economic characteristics in the first ten months of 2014. Unfavourable weather conditions have caused

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1 “actively unemployed persons” is a common term and it has been in use for many years in the context of the labor market. The word “active” is used to distinguish between job seekers (including persons who are not active in job search) and unemployed persons, i.e. those who are actively seeking work. The term actively unemployed persons does not include the following categories: temporarily unable or unprepared to work, persons whose rights are inacted by the Law, employees who are looking for a change of employment, as well as other job seekers.
major flooding, which has significantly worsened the conditions in which economic activity took place. The major damage caused by floods has been made to industry, particularly to the sectors of mining and quarrying and electricity production. This, along with slowing down of the growth in countries that are major foreign trade partners of the Republic of Serbia, led to a deepening slump in economic activity in the second and third quarter. Export slows down the growth, and in the third quarter an annual decline was recorded. The trend of slowing annual inflation was continued, with the mitigation of the real salaries decline. On the labour market the decrease of formal unemployment was continued, and a slight decline in the number of actively unemployed persons was recorded, with an increase in the number of pensioners. The monetary policy was carefully eased due to the presence of internal and external uncertainties. To mitigate the depreciation pressures, as well as the excessive short- term fluctuations of the foreign exchange rate, the NBS intervened with an increased sale of foreign currency in the interbank foreign exchange market. In the area of the fiscal policy, the implementation of fiscal consolidation measures adopted during 2013 has been ongoing since the beginning of 2014.

Reduction of GDP in 2014 (-0.2% in the first quarter, -1.3% in the second quarter and a decrease of 3.6% in the third quarter, at the annual level) is the result of a decline in industrial production and the continued negative trends in the sector of construction, as a direct consequence of unfavourable weather conditions and severe floods. The consequences of the floods were most visible in the third quarter when the largest decrease in gross value added was recorded in the sectors of mining, manufacturing and energy. In that period, observed from the expenditure side, all components of GDP recorded a decline, while the net export and investment had the greatest impact on the decline in GDP. It is expected that the unfavourable economic trends will be halted in the last quarter of this year. It is estimated that GDP in 2014 will amount to 3,884 billion dinars, which is an increase of 0.2% compared to the previous year. As for the production side, a negative contribution to GDP is expected by the downturn in the construction and the services sector, except in the sectors of transport, information and communication, which will record growth in the volume of services.

Table 3. Basic Indicators of Current Economic Trends

<table>
<thead>
<tr>
<th></th>
<th>2013</th>
<th>I-X 2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Industrial production, physical volume</td>
<td>5.5</td>
<td>-6.3</td>
</tr>
<tr>
<td>Turnover in retail trade, real terms</td>
<td>-5.6</td>
<td>2.6</td>
</tr>
<tr>
<td>Export of goods denominated in euros</td>
<td>25.8</td>
<td>2.0</td>
</tr>
<tr>
<td>Import of goods denominated in euros, c.i.f.</td>
<td>5.1</td>
<td>1.3</td>
</tr>
<tr>
<td>Consumer prices, period average</td>
<td>7.8</td>
<td>2.1**</td>
</tr>
<tr>
<td>Average number of employees</td>
<td>-0.7</td>
<td>-1.6</td>
</tr>
<tr>
<td>Actively unemployed persons, period average</td>
<td>1.7</td>
<td>-0.5</td>
</tr>
<tr>
<td>Average net salary in real temrs, total</td>
<td>-1.5</td>
<td>-0.3</td>
</tr>
<tr>
<td>Average net salary in real temrs, public sector</td>
<td>-2.5</td>
<td>0.0</td>
</tr>
<tr>
<td>Average pensions in real terms</td>
<td>-3.4</td>
<td>-0.4</td>
</tr>
<tr>
<td>Trade deficit</td>
<td>-4,472.3</td>
<td>-3,553.2</td>
</tr>
<tr>
<td>Current account deficit*</td>
<td>-2,092.0</td>
<td>-1,617.6</td>
</tr>
<tr>
<td>Net FDI inflow*</td>
<td>1,228.8</td>
<td>1,156.1</td>
</tr>
<tr>
<td>NBS foreign exchange reserves, end of period</td>
<td>11,188.8</td>
<td>10,714.2</td>
</tr>
<tr>
<td>Foreign currency savings, end of period</td>
<td>8,418</td>
<td>8,512</td>
</tr>
</tbody>
</table>

* New balance of payments methodology (BPM 6)
** Data refers to the period January-November
Source: RSO, NBS, NEA, PF
Since May 2014 the industrial production has been recording the annual decline month after month which was the highest in September and then a slowdown of decline began in October. In the period January - October the production decline was accelerated in all sectors, but the sectors of mining and energy were those which production decline had largest impact on the annual decline in the total industrial production of 6.3% (14.3% and 18.5%, respectively). In addition, the decline in global demand and seasonal factors (collective vacations, repair) caused a decrease in the physical volume of production in manufacturing. The decrease in industrial production in this period was contributed by the following: electrical power generation, mining of coal and lignite, manufacture of petroleum products, production of motor vehicles and chemicals and chemical products. A positive growth in the physical volume of production was achieved in the production of computers and equipment, while the downward trend in production of basic metals was mitigated after restarting the blast furnace in the Smederevo Steelworks in July 2014. Significant changes in the trend of industrial production are not expected by the end of the year.

The floods have adversely affected the yield of the spring crops (wheat, raspberries and cherries), as well as the yield of plums and grapes, which, according to preliminary estimates of RSO, is well below the yield in 2013. Good results in the production of corn, sugar beet, soybean and sunflower will mitigate the negative impact of the decline in production of spring crops and will contribute to the growth of gross value added of agriculture in 2014 by 1.4%.

The turnover in retail trade since the beginning of the year has recorded a nominal and real annual growth led by slowdown of food prices growth and the seasonal factor. In the period January - October 2014, a growth in turnover of 4% was recorded in the current and 2.6% in constant prices. Tourist turnover measured by the number of arrivals and overnight stays decreased by 0.4% and 7.3%, respectively. The value of construction works in the first nine months of 2014 decreased by 4.1% compared to the same period in 2013. Observed by the type of constructions, the value of construction works in constant prices of accommodation buildings fell by 9.5%, while the other buildings decreased by 2%. The volume of transport services increased in the same period by 22.8% and telecommunication services by 4.9%, compared to the same period in 2013. Intensifying the activities of transport and telecommunications will mitigate the negative impact of the decline in industrial production and export growth slowdown on overall economic activity.

Negative effects of the floods were also reflected on exports, whose growth slowed down from the beginning of the year, and in the third quarter the export was by 10.6% lower than in the same period in 2013. The growth of export in the first ten months of 2% was mostly contributed by the growth of export of cereals and cereal-based products, followed by iron and steel, petroleum, refined petroleum products and related products. The slowdown in exports partly occurred due to a high base effect. The biggest impact on the decline in export had a reduced export of electricity, road vehicles and non-ferrous metals. In the period January - October 2014 the value of exported and imported goods was 9.3 billion euros and 12.8 billion euros respectively, which is an increase of 2% and 1.3% compared to the same period in 2013. The trade deficit in the same period amounted to 3.6 billion euros and was decreased by 0.4% compared to the first ten months of the previous year. The coverage of imports by exports in euros in the first ten months was 72.3% in this period. The largest foreign trade partners of the Republic of Serbia were the EU countries, accounting for 65% of total export and 63.4% of total import. A half of the total export in that period was focused on the markets of five countries: Italy, Germany, Bosnia and Herzegovina, the Russian Federation and Romania. Imports from Germany, the Russian Federation and Italy accounted for more than one-third of the total import. In the exchange with Italy, Bosnia and Herzegovina, Romania, Macedonia, Montenegro and the United States, a surplus of 1.4
billion euros was recorded. The lack of recovery of the real sector by the end of the year will be also reflected in export, which will record a modest growth of 2.1% in 2014. In addition to the expected rise in energy import, this will have as a consequence neutral contribution of net export to GDP.

In the period January - October 2014, the current account deficit amounted to 1,617.6 million euros, which is 36.1 million euros more, or 2.3% more than in the same period of 2013, which was contributed by the decrease in net inflows of remittances by 13.1%. Net inflow of foreign direct investment (hereinafter referred to as: FDI) amounted to 1,156.1 million euros, which is an increase of 159 million euros or 15.9%. The largest inflow of foreign direct investment in the first half of the year was recorded in the financial and insurance activities (267.9 million euros), manufacturing (231.7 million euros) and wholesale and retail trade (108.9 million euros). Total net foreign direct investment from the EU in the same period amounted to 608.3 million euros, which represents 85.3% of the total realised net FDI. The net inflow of portfolio investments in the period January - October of 322 million euros was by 605.3 million euros lower than in the first ten months of 2013. This decrease was mainly influenced by the reduced government borrowing based on long-term debt securities compared to the same period of the previous year. As for the financial loans, the residents in the same period made a net foreign debt of 487.2 million euros. The net indebtedness of the country regarding financial loans increased by 585.1 million euros. Based on due obligations, the NBS made payments in the amount of 505.9 million euros, of which the largest part (499 million euros) referred to the payments to the IMF. Banks continued paying off the foreign debts in 2014 (602.8 million euros), while the cross-border borrowing of companies increased by 36.4 million euros.

In the period January - October 2014 on the labour market at the annual level there was a reduction in the average number of formally unemployed persons by 1.6%, and the real average net salaries were reduced by 0.3%. In all sectors, in this period, there was a decrease in the number of employed, with the largest decreases recorded in the construction sector (-6.3%) and agriculture (-4.5%). At the same time, the average net salary per sector had a real increase in construction (3%) and industry (0.8%), while it decreased in the sectors of services (-0.3%) and agriculture (-1.9%).

According to the LFS data for the third quarter of 2014, the unemployment rate (persons of 15 and over 15 years of age) decreased from 20.3% in the second quarter to 17.6%. The decrease of the unemployment rate in this period was influenced by the seasonal factor, as well as an increase in the informal employment rate ("moonlighting") to 23.4%. Significant positive changes in labour market trends are not expected in the last quarter of 2014, primarily due to the implementation of the provisions of the amended Labour Law, referring to the changes of the period for calculation of past work and reduction of wages and pensions, as the most important measures of fiscal consolidation. Implementation of those measures will affect the reduction in disposable income and, consequently, private consumption which will be a limiting factor for a significant recovery of domestic demand.

In November year-on-year inflation was 2.4% and it "approached" the lower limit of the target tolerance band (2.5%). At the same time, in comparison with the previous month zero inflation was recorded. The increase in consumer prices in November compared to December 2013 was 2.2% and it was determined by an increase in prices of unprocessed food (6.7%), which contributed with more than one-third to the total inflation. The biggest monthly rise in consumer prices in the previous part of the year was recorded in January (1.4%), as a consequence of the increase in regulated prices (primarily tobacco prices), due to the harmonisation of excise duties, the seasonal rise in prices of fresh vegetables and an increase in the lower VAT rate. A slight deflation was recorded in March, July and August, influenced by the seasonal drop in prices of vegetables. Low aggregate demand and the
absence of a significant increase in regulated prices until the end of the year will contribute to the movement of the year-on-year inflation in that period around the lower bound of the target tolerance band, so that the average price growth in 2014 will amount to about 2.2%.

In November 2014 the NBS lowered its key policy rate by 0.5 pp to the level of 8%. Such a decision was due chiefly to low inflationary pressures. Monetary developments in October 2014 at year-on-year level were primarily characterised by the bank credit growth to businesses and households, recorded for the first time since March 2013, as well as by the increase in foreign exchange reserves of the NBS and the exchange rate depreciation.

The program of subsidized loans to the corporate sector led to the revival of the overall lending activity, which recorded year-on-year growth (1.1%) in October 2014. Subsidized loans are granted for maintaining liquidity, financing of long-term current assets and refinancing of existing loans. The credit activity of banks to the corporate sector, in October 2014, at the year-on-year level was characterised by a slow fall to 2.2% and a nominal growth of credits to households (6.5%), with an increase in bank deposits of 6%. In the period October 2013 - October 2014, banks, as the largest individual investors in government securities, increased their holding of these securities to around 100 billion dinars, while reducing investments in securities of the NBS by 80.7 billion dinars year-on-year.

According to the latest available data, the share of NPLs in total loans in October 2014 increased, comparing to October 2013, by 2.4 pp and it was at the level of 23.1%. At the same time, the share of households sector NPLs increased by 0.9 pp to the level of 10.2%, while the share of corporate sector NPLs increased by 4.1 pp to the level of 30.0%.

Movements in the exchange rate since the beginning of the year were characterised by the presence of depreciation pressures. Such movements were influenced by developments in the international financial markets and in certain periods were also driven by the seasonally-induced increase in demand for foreign currencies by domestic companies, primarily energy importers. Since the beginning of the year until the end of November the dinar experienced nominal and real depreciation by 4.9% and 2.8% respectively. The depreciation pressures in this period were additionally fuelled by the banks’ net foreign debt repayment, reduced foreign exchange inflow from investments, dividend payments by companies and banks in majority foreign ownership, including deterioration in the foreign trade deficit in the second half of the year. In order to mitigate the excessive short-term volatility of the exchange rate in this period, the NBS intervened in the interbank foreign exchange market by selling 1.245 million euros net.

The foreign exchange reserves of the NBS at the end of October 2014 increased by 415.9 million euros year-on-year and amounted to 10.7 billion dinars. The increase in foreign exchange reserves during this period was mostly a result of foreign exchange inflow based on the use of loans from the United Arab Emirates in August in the amount of 748.3 million euros. The level of foreign exchange reserves of the NBS covered money supply M1 by 313% and more than seven months of imports of goods and services. Foreign currency savings of households came to 8.5 billion euros at the end of October 2014, while savings in dinars amounted to 39.7 billion dinars. Year-on-year, foreign currency savings increased by 1.2%, while dinar savings increased by 63.4%. Despite the significantly higher growth rates of dinar savings, the share of savings in foreign currency (about 96%) is still dominant in the structure of total household savings.

3. Projection of Macroeconomic Indicators for the Period from 2015 to 2017

Based on the current economic trends and outlook in Serbia and the international environment, and having in mind the planned economic policies and started talks with the Government started intensive negotiations on a new arrangement with the IMF, the macroeconomic and fiscal framework presented in this document was agreed with the representatives of this international institution in November 2014.
IMF mission on a new arrangement, the basic macroeconomic aggregates and indicators for the Republic of Serbia in the period 2015 - 2017 have been projected.

GDP projections and related indicators were adjusted to the lower level for the period 2015 - 2017, primarily due to the slow and uncertain recovery of the countries of the Euro zone and consequent slowdown of the domestic export growth, but also due to austere measures of the fiscal policy which will bring to a decrease in domestic demand, primarily in private consumption by the population and government consumption.

Macroeconomic projections for the period 2015 - 2017 indicate a moderate recovery path. The projected cumulative growth rate of real GDP for the next three years of 3% is based on the growth of exports and recovery of investment activity. Acceleration of the growth of exports and investments are the leading development factors which will, along with the restructuring of the economy, provide the creation of a sound foundation for the acceleration of growth, reduction of internal and external macroeconomic imbalances, as well as creation of space for raising the living standards on real basis.

Conservative medium-term projection predicts an average real GDP growth of 1%, which will be based on the increased investments and exports of goods and services at an average annual real rate of 5.2% and 4.9% respectively, with an average annual decline in private (-0.2%) and government consumption (-5.7%). The implementation of the austerity measures of fiscal consolidation during 2015 will influence the decrease in private and government consumption, and also in domestic demand. The acceleration of GDP growth in 2016 and 2017 to 1.5% and 2.0% respectively, is primarily based on the growth of investment spending but also on a gradual recovery of the living standards on real basis. Fiscal policy measures and improvement of the business and investment environment will provide the foundation for a stable and sustainable growth in the coming years.

The new model of the country development includes the reduction of irrational spending, bureaucracy and unnecessary costs of the public sector and at the same time the increase in investment spending in order to encourage the economic growth and employment, followed by the social protection of the most vulnerable groups of the society. The medium-term macroeconomic projection predicts the increase in the share of investments to about 20% of GDP, decrease in the share of government consumption in GDP to 14.6%, and increase in the share of export of goods and services in GDP to over 45% at the end of 2017. The net inflow of foreign investments of about 1.3 billion Euros per year on average is necessary, in addition to the changes in the structure of investment towards, to a greater extent, the tradable goods sector. Financing of the balance of payments at the same time includes a decrease in the share of goods and services deficit and current account deficit (including donations) in the GDP to 7.6% and 4.3% respectively, at the end of 2017, in order to ensure the reduction of the absorption gap, the foreign debt sustainability, external liquidity and solvency.

The recession tendencies during 2015 were caused by the implementation of the austerity measures of fiscal consolidation which will influence the reduction in private and government consumption in a short term, as well as in domestic demand. The acceleration of the GDP growth in 2016 and 2017 to 1.5% and 2.0% respectively, is primarily based on the growth of the investment spending but also on a gradual recovery of the living standards on real basis. The implementation of the fiscal policy measures and the improvement of the business and investment environment will provide the creation of the foundation for a stable and sustainable growth in the coming years.
Table 4. Projection of Basic Macroeconomic Indicators of the Republic of Serbia

<table>
<thead>
<tr>
<th></th>
<th>Projection</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2015</td>
</tr>
<tr>
<td>GDP, million dinars (current prices)</td>
<td>3,970,469</td>
</tr>
<tr>
<td>Real GDP growth</td>
<td>-0.5</td>
</tr>
<tr>
<td>Real growth of individual components of GDP, %</td>
<td></td>
</tr>
<tr>
<td>Private consumption</td>
<td>-3.0</td>
</tr>
<tr>
<td>Government consumption</td>
<td>-7.4</td>
</tr>
<tr>
<td>Investment</td>
<td>4.7</td>
</tr>
<tr>
<td>Export of goods and services</td>
<td>3.1</td>
</tr>
<tr>
<td>Import of goods and services</td>
<td>-1.5</td>
</tr>
<tr>
<td>Balance of goods and services, in EUR, % of GDP</td>
<td>-9.4</td>
</tr>
<tr>
<td>Current account balance, in % of GDP</td>
<td>-4.7</td>
</tr>
<tr>
<td>Inflation, period average, in %</td>
<td>2.7</td>
</tr>
<tr>
<td>Investment ratio, % of GDP</td>
<td>18.5</td>
</tr>
<tr>
<td>Unemployment rate, 15+</td>
<td>21.3</td>
</tr>
</tbody>
</table>

Source: MFIN

**Real Sector**

The medium-term prospects for the real sector are enabling the analysis of the cyclical position of the economy and the consideration of the expected sources of real GDP growth in terms of changes in factors of production and aggregate demand.

A decline in economic activity is expected in 2014. The unfavourable economic developments in 2014 were caused primarily by the reduction of the activity in the mining and energy sectors. In addition to that, from the production side, a negative contribution to GDP is expected by the downturn in the construction and the service sector, except in the sectors of transportation, information and communication which will record a growth in the volume of services. Despite the devastating floods, a slight increase in agricultural production of 1.4% is expected in 2014. As for the expenditure side, all the components of domestic demand will record a decrease, while the contribution of the net export will be neutral. The decrease in private and government consumption is the result of the reduction in household disposable income, as well as the implementation of fiscal consolidation measures (ban of new hiring in the public sector, the so-called "Solidarity Tax", limited growth of salaries and pensions - indexation in April 2014 of 0.5%).

The economic trends and prospects of the Republic of Serbia in 2015 will largely depend on developments and prospects in the international economic environment, primarily in the members of the Euro zone, which are the main partners of the Republic of Serbia in goods trading and investments. Fiscal consolidation measures will have a short-term influence on the slight decline in economic activity in 2015. Basic fiscal consolidation measures in the next three years are reduction of public sector wage bill and pensions and improvement and corporatisation of the largest public enterprizes. In addition to that, the adjustments on the expenditure side will be provided through a reduction of subsidies and expenditures for goods and services, as well as through more efficient operations of local municipalities. On the revenue side, the priority will be to fight against the grey economy and tax evasion.

The decrease in salaries and pensions will have a short-term negative effect on the GDP development. However, the effects of these measures on the living standard will be partially mitigated, having in mind that the reduction of income will not include the lowest wages and pensions. According to the preliminary estimates, reduction of GDP by 0.5% in the next year is expected, with conservative assumptions regarding the developments in the
international market and moderate recovery of the investment activity in the country. The completion of the process of restructuring of the enterprises is expected in 2015, which will have a short-term negative impact on the GDP development. However, the successful privatisation of these enterprises, along with the attraction of FDI, will neutralise these short-term negative effects and provide the foundation for a sustainable growth in the coming years.

After 2015, the acceleration of the growth of the economic activity is expected to occur based on the systematic improvement of the economic environment. The objective is to use the substantial reforms to establish a business environment which will provide an increase in foreign and domestic investments, acceleration of economic restructuring, creation of conditions for new employment and increase in productivity and competitiveness of the economy. Moderate acceleration of the GDP growth in 2016 and 2017 to 1.5% and 2.0% respectively, is based on the growth of the investment spending, primarily in the private sector, but also on the recovery of private consumption. The implementation of the fiscal policy and improvement of the business and investment environment will provide the creation of the foundation for a stable and sustainable economic growth in the coming years, as well as the rise of living standard of the population.

Graph 1. Real GDP Growth: Actual and Projected Rate and the Long-term Trend, in %

It is estimated that the growth of potential GDP in the coming years will be benefited by strengthening of the investment activity and to a lesser extent by the growth of participation rate. The expected increase in unemployment due to the completion of the process of restructuring of the state-controlled enterprises will be mitigated by the increase in the net employment in the private sector. Having in mind the current cyclical position of the Republic of Serbia and structural distortions inherited from the previous period, as well as the level of existing unused capacities, a special importance will be placed on finding the ways to increase the total factor productivity which recorded a decrease in the previous period primarily as the result of the decrease in the investment efficiency. For this purpose it is necessary to carry out structural reforms that will ensure a long-term sustainable development of the country on the basis of higher productivity in the economy.

The basic rule of efficiency and growth through the increased productivity is first to use the existing capacity of the economy in order to produce goods of a higher processing level. The output gap measuring the cyclicality of the economic activity in the pre-crisis period was negative, with the exception of 2007 and 2008 (1.1% and 1.9% respectively) driven primarily by a high domestic demand. In 2009, due to the economic downturn, there
was a deepening of the negative output gap which continued until 2013. A slowdown in the production potential of the economy is a consequence primarily of the decreased investment in production capacities, difficult financing of the current production activity of enterprises and negative developments in the labour market.

The projection of the potential growth for the period 2015 - 2017 is based on a moderate economic recovery, and the output gap is expected to be closed in 2017, after years of negative relations between the actual and potential GDP growth rate.

Graph 2. Sectoral Contributions to the GDP Growth, in pp

Despite the projected decline in economic activity in 2015 of 0.5%, it is expected that the contribution of construction and mining and energy sector to the GDP in 2015 will be significant and positive, primarily due to the recovery from the damage occurred in floods, recovery of the damaged capacities and restoration of the production at the previous level.

From the production side of the GDP, in the period 2015 - 2017, the largest contribution is expected from the growth of industrial production and recovery of the construction sector (contribution of 1.2 pp per year on average), while the service sector will have a negative impact on developments of economic activity (0.4 pp per year on average) mainly due to the implementation of fiscal consolidation measures.
As for the expenditure side of the GDP, in the period 2015 - 2017 the largest contribution is expected from the investment spending and the net export (contribution of 1.1 pp per year on average). The government consumption in the next three years will have a negative contribution to the GDP growth based primarily on the reduction of salaries in the public sector as well as other ways of rationalisation and improvement of the public sector efficiency. The expenditure-oriented fiscal consolidation will have a significant influence on the dynamics of the potential growth in the following period. Private consumption of the population will have a negative impact on the GDP developments in 2015 (contribution of -2.3 pp) due to the reduction in salaries and pensions, while the growth of consumption is expected for 2016 and 2017 due to the recovery in the labour market, primarily due to the acceleration of the growth of salaries and employment in the private sector and the growth of bank credit activity aimed towards the households.

The macroeconomic projection predicts a real growth of investments of 4.7% in 2015 and 5.5% in 2016 and 2017 respectively, which will be generated by starting a new investment cycle. The GDP growth in the next three years will be significantly contributed by net export as well (contribution of 2.2 pp in 2015, 0.6 pp in 2016, and 0.4 pp in 2017). The positive contribution of net export is a result of the recovery of main foreign trade partners of the Republic of Serbia, while the slower dynamics of import growth (2% of average annual growth) is a consequence of the announced fiscal consolidation measures, and thus reduced private and government consumption. The share of export of goods and services in the GDP in 2015 is estimated to be 44.2%, and in 2016 and 2017 it is expected to be 44.5% and 45.3% respectively.

The share of investments in the GDP in 2015 is estimated at 18.5%, and it is expected that the growth of the investment activity will continue in 2016 and 2017 which, in terms of restrictive fiscal policy, will enable the realisation of moderate rates of economic growth and more favourable developments in the labour market from 2016. The growth of private investments is of crucial importance having in mind the fact that the decline in the economic activity in the previous period, period of crisis, influenced the reduction of the potential GDP through the loss of economic capacities and significant deterioration of conditions in the labour market.
The predicted development scenario points out the strategic orientation of the Government towards the structural adjustments of the economy in order to ensure a sustainable growth path, based primarily on the increase of the overall investment activity through encouraging the private sector investments and exports, as the key factors for achieving the macroeconomic stability. The Government will pursue a responsible and predictable fiscal policy which objective is the stabilisation of public finances, achieved through the reduction of the consolidated government budget deficit and prevention of debt growth. The arrangement with the IMF and the implementation of measures regarding not only the revenue and expenditure side of the budget, but also the measures regarding the restrictions of further growth of the guaranteed part of public debt will be of particular importance for the implementation of the announced fiscal policy.

**Employment and Salaries**

The overall employment is expected to slow down its decline in 2015, after the large fall in previous years, while a slight increase in employment in private sector is expected in 2016. A medium-term projection of employment is based on the projected GDP growth and the increase in investments. The employment projection also includes the effect of completing the process of restructuring of state-controlled enterprises. At the same time, it is expected to establish the trend of the increase in the employment rate due to the improvement of the regulations on labour relations and employment. Amendments to the Labour Law removed the barriers in employment, increased the flexibility of the labour market and created the foundation for a reduction of the work in the grey zone.

![Graph 4. Actual and Projected Unemployment Rate, in %](image)

The slower growth of real net salaries in the private sector in comparison to the real GDP growth is expected, as well as the growth of gross salaries in line with the productivity growth in the private sector, which will bring to the reduction of unit labour costs and the improvement of the competitive position of the country.

**Monetary Policy, Exchange Rate and Inflation**

The inflation target is established at the level of 4% with a target tolerance band of 1.5 pp until the end of 2016. The set target is above the level of quantitative definition of price
stability and the level of inflation target in developed countries (2.0% or 2.5%), due to the need for eliminating price disparities, especially in the area of regulated prices.

The NBS will strive to achieve the inflation target using the basic instrument of monetary policy – the key policy rate, which is applied in main open market operations (at the moment, these are a one-week repo transactions). The level of the rate will be changed in a consistent and predictable manner, depending on economic trends and inflation projection, taking also into account its impact on financial stability. The NBS can use all other instruments within its competences (open market operations, required reserves, interventions in the interbank foreign exchange market, etc.) in order to achieve the medium-term inflation target, but they will have a supporting role. They should contribute to the smooth transmission of the effects of changes in the key policy rate to inflation and economic activity, as well as to the development of financial markets, without compromising the stability of the financial system.

Temporary deviations of inflation from the target will be allowed if the required change in monetary policy could cause macroeconomic instability. This particularly applies to cases of sudden changes in primary commodity prices or the prices of products which are under direct or indirect influence of the decision of the Government.

The NBS will continue to implement a managed floating exchange rate regime, and will intervene in the foreign exchange market in order to reduce excessive short-term fluctuations of the exchange rate in either direction, to preserve the stability of the financial system and maintain an adequate level of foreign exchange reserves.

Monetary policy easing continued in 2014 - the key policy rate was reduced by 150 basis points to 8.0% in total. The reduction of the key policy rate was determined by the present disinflationary effects, primarily those stemming from aggregate demand which will be reinforced by the cut in public sector wages and pensions, as well as those on account of low cost-push pressures. On the other hand, caution in the conduct of monetary policy was dictated by unfavourable fiscal trends, additionally burdened by the need to restore flood damage, and the risks from the international environment. The uncertainty in the international environment has increased due to the present geopolitical tensions over the crisis in Ukraine, reduction of the expansion of monetary policy of the FED and prolonging of the period of slow recovery of the Euro zone, which has a negative impact on domestic exports and capital inflows. The key policy rate was reduced last time in November, by 50 basis points, given the lower inflationary pressures and lower inflation projection for the coming period, as well as the adoption of additional credible fiscal consolidation measures, which should support the reduction of exposure of domestic economy to the risks from the international environment. In order to support credit, and thus economic activity, the NBS lowered the foreign exchange required reserve ratios by 1 pp in both November and December (to 27% for maturity up to two years and to 20% for maturity over two years).

In the next period, monetary policy measures will be focused on achieving the inflation target of 4±1.5%, i.e. its permanent stabilisation at a low level. The character of monetary policy will depend primarily on the effects of taken fiscal consolidation measures and structural reforms, as well as on developments in the international environment and their impact on domestic economic and financial flows, and on commodity prices in the domestic market. An important precondition for the inflation stabilisation is also the anchoring of inflation expectations at the level of the medium-term inflation target. Significant progress has been made in this respect - inflation expectations fell considerably during 2013 and stabilised in 2014 at the level of 4.5%.

The expected consistent implementation of fiscal consolidation, supported by a precautionary arrangement with the IMF, as well as further reduction of external imbalances, will contribute to the weakening of the pressures on the exchange rate in the future. Lingering
uncertainties in the international environment can have a short-term negative impact on capital flows towards the Republic of Serbia and the pressures on the exchange rate, but the credible implementation of fiscal consolidation measures can increase the resilience of the domestic economy to external shocks.

Since March 2014 year-on-year inflation has been moving below the lower bound of the target tolerance band. It is expected to return within the target tolerance band by mid-2015, under the impact of the growth in regulated prices and the lag effects of the depreciation of dinar from 2014, while the disinflationary effects of the decrease in prices of primary agricultural products and oil will gradually fade in the second half of the year.

Aggregate demand will keep the disinflationary impact in the next two years as well, even though the expected economic growth from 2016 onwards could lower the strength of that impact. The high unemployment rate, fiscal consolidation measures, weak credit activity, and the slow recovery of the Euro zone are the key factors keeping aggregate demand low.

The medium-term inflation projection is based on the planned fiscal consolidation (which should lead to a decline in risk premiums, decrease in domestic demand, and stabilisation of capital flows), anchoring of inflation expectations around the 4% target and the stabilising effect of greater openness of the Serbian market to the EU products (especially in terms of food prices). In addition, the NBS will be adjusting its monetary policy so that inflation moves within the target band. The said factors will ensure the maintenance of the inflation at the level of 4% in the next three years.

In addition, the stabilisation of inflation will be underpinned by the expected stability of the exchange rate, as well as by a decrease in the short-term pass-through effect from exchange rate to prices, which will reduce potential inflation volatility on this account.

Graph 5. Projection of Inflation, in %

The key risks of the achievement of the inflation projection are associated with the movements in the international environment, including the movement of the prices of primary products (oil and primary agricultural products), as well as the deviation from the assumption on the growth of regulated prices.

Projections of the Balance of Payments

Data from the balance of payments indicate that in the previous part of 2014 there were more unfavourable trends in foreign trade exchange and balance of payments of the
country due to the negative effects of the floods, a slowdown of external demand and lower inflows of remittances from abroad.

A precondition for the sustainability of balance of payments is to increase exports and net inflow of foreign capital. The macroeconomic projections predict a moderate growth of exports and foreign investment inflow in 2015, and a significant growth of exports in 2016 and 2017, with strengthening of the cost and price competitiveness. The projected path of real growth of exports of goods and services is based on a slight strengthening of the external demand for domestic products and the implementation of the structural reforms, which will enable the medium-term growth of market share in export markets and increase competitiveness. The continuation of a faster growth of exports of goods and services is expected in the period from 2015 to 2017 (4.8% on average per years) due to the growth of import of goods and services of 2% on average per year, denominated in euros. In order to increase the investment activity the largest part of imports will be directed to capital and intermediate products.

The mid-term and long-term sustainability of the current account balance will depend on the implementation of structural reforms and an increase of the competitiveness of exports of goods and services, but also on interest costs, which would put great pressure on the growth of the current account deficit in the case of a drastic deterioration in financing conditions in international markets. In this regard a very important role is played by the sustainable fiscal position and reduction of internal macroeconomic imbalances. It is expected that the effects of fiscal consolidation, by reducing the government spending, will bring to the reduction of the current account deficit. However, these effects will be partially neutralised by higher expenditures for interest.

Graph 6. Balance of Foreign Trade and Current Account

A faster growth of exports than imports will allow a reduction of the deficit of goods and services to 7.6% of GDP in 2017. A lower level of the current account deficit (with donations included) with the share of 4.3% in GDP is also expected in 2017. Reduction of negative net exports of goods and services, primarily as a result of changes in the structure of the domestic economy, will contribute to the reduction of external imbalances and risks of external debt sustainability and external liquidity.
The expectations for the period of next three years are to have an inflow to the current account of balance of payments based on current transfers, as well as an outflow based on factor payments. The most important component in current transfers is the revenue from remittances, while within the factor payments the key outflows are based on payments of interest of foreign loans. It is estimated that the net current transfers with non-interest income based on factors in the period 2015 - 2017 will amount to 2.5 billion euros per year on average. A negative balance is expected on the basis of net interest payment, which will reach 1.2 billion euros in 2017. The net effect of current transfers and net factor payments in the next three years will be positive and stable and is estimated to reach about 1.4 billion euros per year. The surplus of current transfers balance and net factor payments will cover on average 47% of the deficit of foreign trade balance of the Republic of Serbia in the period 2015 - 2017.

Based on the projected trends of foreign trade, current transfers and net factor income, the projections of the current payments balance were derived. Current payments balance excluding donations will be negative and will amount to 1.5 billion euros on average in the
period 2015 - 2017. In addition, in the structure of the capital inflow the dominant share will be the share of foreign direct investment which will be the main source of financing of the current account deficit and will amount to 1.4 billion euros on average in 2016 and 2017 respectively.

It is estimated that the total external debt of the Republic of Serbia in 2017 will record a downward trend mainly due to the stabilisation and reduction of public external debt.

Foreign exchange reserves of the Republic of Serbia in the period 2015 - 2017, as estimated, will cover the seven-month imports of goods and services.

External Sector and Its Medium-Term Sustainability

External imbalance has been significantly reduced over the past two years. This has been realised due to the increase in the coverage of imports by exports of goods and services to around 80.0%. The degree of openness of Serbia’s economy, measured by the share of trading in goods and services in GDP increased to nearly 100%. Such movements in exports were also supported by free trade agreements with Serbia’s major foreign trade partners and the effects of foreign direct investments from the previous years. The degree of openness is estimated to slightly increase over the upcoming period.

EU countries represent the most significant market for placing products coming from the Republic of Serbia. The share of exports to this market has been continuously increasing over the past few years in terms of Serbia’s total exports. The export share in CEFTA countries has decreased (to 19%), whereas slightly above 7% of Serbia’s total exports is placed on the Russian market.

External adjustment in the period following the crisis was mainly of structural character and it was a consequence of a shift in the growth model from final consumption to net exports and investments. A further reduction in the current account deficit was expected in the previous programme, as well as its getting closer to the level of the estimated structural deficit in the medium term of about 4% of GDP. Nevertheless, the floods which hit Serbia in May, and whose effect on growth in the current account deficit to GDP ratio is estimated at 1.0 percentage point, slowed down the process of external adjustment in 2014. The implementation of the new BPM6 methodology and revision of data due to improvements in the coverage of certain transactions brought about a higher than projected deficit. On the other hand, cyclical factors acted in the direction of reducing the current account deficit in 2014, in regard to the higher negative production gap in Serbia compared to its major foreign trade partners, which resulted in a greater negative effect on imports compared to exports. The implementation of fiscal consolidation measures shall also have a positive effect on the current account, which will affect low import growth. Cyclical factors will continue to work in the direction of reducing the current account deficit in 2015. The adopted measures of fiscal consolidation and structural reforms will influence the improvement in the current account in the medium term through their contribution to a reduction in consumption and imports, but also through the recovery of the eurozone and Serbia’s major foreign trade partners.

The expected savings in imports due to the implementation of fiscal consolidation measures will be annulled to a large degree by increasing the payment of interest on the external part of public debt (based on issued securities and financial credits). The expected increase of FDIIs will reflect on a more significant role of total earnings in the primary income account in future. A stable inflow of remittances of about 8% of GDP is expected in the

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2 A twelve-month moving average.
3 Central European Free Trade Agreement.
following period on these grounds. This should result in a further decrease in the share of the current account deficit to about 4-5% of GDP in the 2015-2017 period.

The inflow of capital in the period from 2015 to 2017 is expected based onFDIs of about 4% of GDP and government borrowing both on the basis of securities issuance on domestic and foreign markets (especially in 2015), as well as based on the taken loans, while the private sector will continue with deleveraging. As a result of a further reduction in external imbalance in the following three years and capital inflow ensuring the coverage of the current account deficit, an increase in foreign exchange reserves is expected, as well as their maintenance at an adequate level. It is estimated that these reserves will ensure the coverage of more than seven months of goods and services imports.

The global decline in prices of raw materials and processed products in the global market, as a consequence of the economic crisis in a large number of states, and a decline in demand, influenced a somewhat greater reduction in export than import prices of the Republic of Serbia until October 2014. However, if the low price of oil is maintained, it may be expected that terms of trade will improve in 2015. Unlike 2013, the price competitiveness of Serbia in the first ten months of 2014 was improved. The real effective exchange rate measured against the euro and dollar\(^4\) depreciated by 1.5% year-on-year, whereas the effect of nominal depreciation (-2.8%) was partly moderated by a faster increase in domestic prices in comparison to foreign prices. Likewise, the real effective exchange rate of dinar, measured against the currencies of 35 most significant foreign trade partners of Serbia\(^5\), depreciated in the same period by 3.3%. It is expected that the nominal depreciation of dinar from the second half of 2014, along with the achieved price stability, will contribute to the additional improvement in price competitiveness in the upcoming period.

In first nine months in 2014, a slight improvement in the external cost competitiveness of the Republic of Serbia was noticed, measured by movements in the real exchange rate of the euro calculated based on unit labour costs\(^6\), which depreciated by 0.7% year-on-year. Improvement in the cost competitiveness was positively contributed by the nominal depreciation of the exchange rate of the dinar against the euro of 3.1% year-on-year, whereas faster growth in domestic unit labour costs (3.4% year-on-year) compared to the eurozone (1.0% year-on-year) acted in the opposite direction. Growth in domestic unit labour costs in the observed period is the consequence of reduced productivity, triggered by a decline in economic activity after the floods in May, which predominately hit industrial and agricultural sectors. Unit labour costs in the entire industry achieved growth of 5.4% year-on-year, whereas in terms of manufacturing that produces the majority of tradeable goods and which was the least hit by floods, the costs grew by 0.6%year-on-year. Given the temporary character of the floods effects, it is expected that the recovery of economic activity and productivity growth shall positively contribute to the improvement in the cost competitiveness in the upcoming period, and that the additional contribution to a decrease in unit labour costs should also be expected based on lower wages in the public sector.

The greatest risk to the country’s the external solvency is the high share of the total foreign indebtedness within the international investment position in GDP, which reached 93.2% in the first half of 2014. Foreign financial assets were reduced, whereas foreign financial liabilities increased, which affected the increase in the negative international investment position. The government sector (except for the NBS) increased its negative international investment position, whereas in banking and other sectors the negative

\(^4\) Currency basket and price basket shall be composed of euro and US dollar, i.e. of indexes of consumer prices in the Euro zone and the USA, in the ratio 80:20.

\(^5\) In this case, an average share of euro shall be 48.2%, and the US dollar 3.9%.

\(^6\) Calculated as the product of the nominal foreign exchange rate against euro and relations of unit labour costs of the entire economy of Serbia and Euro zone.
international investment position was reduced. In terms of functional division, the negative international investment position increased based on FDIs and portfolio investments, whereas it declined in terms of financial loans. The coverage of the negative international investment position of domestic sectors by foreign exchange reserves reached about 32.2%, indicating satisfactory external liquidity of the state - the coverage of short-term foreign debt at the remaining maturity by foreign exchange reserves reached 283.2% in June 2014, and the coverage of imports by foreign exchange reserves was 6.7 months.

As of 2015, the negative international investment position of the private sector is expected to increase, primarily because of the expected inflow of FDIs, which is to be spurred by the expected recovery of the eurozone and further progress of the Republic of Serbia in EU accession. Increased government borrowing in the international capital market will cause an increase in the negative international investment position of the public sector. Nevertheless, consistent implementation of the fiscal consolidation programme is expected to reduce the negative international investment position of the public sector as of 2017.

Risks in terms of foreign indebtedness of the state derive from the increase in the share of dollar debt in public debt. For this reason, costs of servicing obligations of the state are sensitive not only to dinar fluctuations against the euro, but to the relation of the dollar against the euro, which is entirely affected by exogenous factors. Aside from the level and unfavourable currency structure, external public debt over the last five years is also characterised by the average interest rate which is higher than the growth rate of GDP. The expected reduction in expansiveness of monetary policies of the majority of leading world economies might reflect on the growth in borrowing costs both based on the expected growth in interest rates, as well as based on the expected strengthening of the dollar against the euro.

The possibility of a further reduction in external imbalance will predominantly depend on foreign demand in the years to come, that is on the recovery dynamics of the eurozone and the most significant foreign trade partners, the possibility of external financing given the expected reduction in expansiveness of monetary policies of the majority of leading world economies, as well as on fiscal consolidation effects. The condition for a more appreciable export growth is also an increase in competitiveness (through a reduction in costs and the risk of doing business and investing in the Republic of Serbia, including the simplification of administrative procedures). This would open the room for further growth in the share of Serbian exports in world exports, which currently equals about 0.08%. A special importance for foreign trade growth is also the continuation of EU accession, intensifying economic cooperation with the CEFTA region countries, completing the negotiations with the World Trade Organization, and improving the overall investment climate for the purpose of attracting foreign investors in tradeable sectors. Adoption of reform laws will significantly improve the institutional and structural factors and also improve the quality of the business environment, which should also influence the progress of the Republic of Serbia on the ranking list of competitiveness in the following year.

Financial Sector

The impact of the crisis on the market of Serbia required from the NBS to enforce countercyclical regulatory measures, whose efficient implementation was possible primarily due to creation of significant capital positions and reserves accumulated during the previous period. Precisely those reserves, which are created as a result of conservative approach to supervision, have adequately absorbed all of the losses caused by the crisis, and still represent the key banking safety net to all potential shocks. Still, non-performing loans continue to represent the major problem in the banking sector of Serbia. Gross NPL indicator is at the
level of 23.05%. By the end of October 2014, the total non-performing loans in the banking sector reached 437.7 billion RSD (3.7 billion EUR).

The insurance sector in Serbia is still underdeveloped, and measured by the relation of the total premium and gross domestic product, as well as by the total premium per capita, it is much under average of the EU member states, indicating its development potentials in the future. Further development of the insurance sector is expected in the field of life insurances considering the number of citizens, lack of insurance protection and savings potential. The National Assembly of the Republic of Serbia has adopted the new Law on Insurance in December 2014 regulating the right in the field of insurance with the EU acquis communautaire currently in force, with the purpose of preparing the domestic market of insurance for integration in the unified market.

Further development of voluntary pension funds could contribute to development of the capital market. Likewise, in lack of the foreign financing sources, by strengthening the domestic institutional investors, such as the funds, influence could be made on the development of the domestic dinar sources.

The most significant risks to which the financial system of the Republic of Serbia is exposed are the following: (1) high level of euroisation, (2) high share of non-performing loans in the total loans and (3) risk of foreign deleveraging. The key systemic risk with which the financial system of the Republic of Serbia is facing for many years now, would be the high level of euroisation. About 70% of the total credits were approved to the households and corporates in the foreign currency. The economy is additionally exposed to the foreign exchange risk through cross-border (foreign currency) loans composing around 50% of the total corporate debt. Having in mind the deep roots of euroisation, reduction of its degree shall be a long-term process. For this reason, the Dinarisation strategy was defined and mutually implemented by the NBS and the Government. Another systemic risk is related to the non-performing loans whose share in the total loans in October 2014 reached 23.1%. This risk was particularly expressed in the lending activity toward corporates. Nevertheless, despite the high share of the non-performing loans, financial stability of the sector is not threatened, which is confirmed by the results of the stress tests. A possibility of the banking sector to absorb the potential losses based on the current level of non-performing loans is still on a satisfactory level, if you have in mind that the level of the non-performing loans is entirely covered by provisions. The third key risk against the stability of the domestic financial system shall be the risk of the uncontrolled foreign deleveraging, which is the consequence of the bank owner’s structure in Serbia. Out of the total of 29 banks with business operation in Serbia, 21 are in foreign ownership. Having regards that the subsidiary foreign banking groups constitute about 75% of assets of the banking sector, risk of deleveraging domestic financial sector is not disregarding.

Further harmonization of banking sector regulations with the EU legislation is expected to be conducted in the following period. Taking further steps with the aim of complying with the Basel III standards i.e. with corresponding EU legislation is planned to be taken during 2015. In this respect, it is planned that the two remaining phases stipulated by the Strategy for implementation of the Basel III standards in Serbia are conducted - the effects assessment and determination of the dynamics for implementation phase and legislation drafting phase. The phase approach is appropriate manner to implement Basel III standards in the banking sector of the Republic of Serbia, which will ensure shorter time distance between the periods of effects assessment and the implementation through regulation. Both phases should be conducted by the end of 2015.

4. Risks of Projections Realisation and Alternative Growth Scenarios
Fiscal strategy for the following three fiscal years is facing a specified number of external and internal risks of realisation concerning the envisioned macroeconomic scenario.

Increase of risks in terms of the recovery of the global and European economy is significantly contributed by the uncertainty on the international market of capital which is related to the continuation in expansitory monetary policy of FED and uncertainty in terms of effects of measures of the ECB. Global economic recovery shall be slowed down with the significant differences in the growth rates among the groups of countries. The economy of the USA records positive growth rates, economies of the Euro zone are in stagnation, while the Russian economy records significant slowing down followed by the negative outlooks for the future. In accordance with the uncertainty increase on the global scales, the ECB and the IMF additionally reduced their earlier projections concerning the growth of the GDP of the Euro zone, China and Japan in their projections from December 2014, i.e. January 2015.

Global growth in the following period shall be stimulated by the lower price of oil, which shall reflect the increase of supply. However, the positive effect of the lower oil price, may be overpowered by the insufficient investments, due to the continuation in adjustments to the reduced expectations of growth in the medium term in many developed and developing countries. Negative risks against the Euro zone shall represent a low level of investments and decreased demand of developing countries even besides initiating the programme of securities redemption by the ECB and euro depreciation which should stimulate economic growth. A special burden to the European economy represents the Ukrainian crisis and the relations between the EU and the Russian Federation.

A possible continuation of the unfavourable tendencies in the EU shall affect slowing down of export and capital inflow in the Central and Eastern Europe, as well as the possible increase of indebtedness costs. Recovery of the economy of Serbia shall predominately depend on the speed of recovery of the Euro zone and the regional economies, and based on this on the increase of the foreign demand and inflow of foreign capital, fluctuations of the foreign interest rates, food prices, and oil derivates prices.

Internal risks of projections fulfillment shall be related to the slower implementation of the structural reforms and economic policy measures, decline in the aggregate demand, deterioration of the investment climate, decrease of foreign direct investments inflow, increase of risks premium to foreign loans for domestic entities, etc.

Having regards to the external and internal risks of realisation of macroeconomic projections for 2015 and the following two years, an alternative scenario with a larger real decline of the GDP in 2015 was made followed by the slower growth in the following two years when compared to the presented basic scenario.

An alternative scenario would come from the key assumption that in the following three years there will be a risk of a serious decline in domestic demand, as the consequence of fiscal consolidation and reduced inflow of investments as the key initiator of economic activity. What should be added to this would be the internal risk related to postponing and slowing down the structural reforms planned for the next medium term period due to which no significant effects of implementing reforms in question would ensue concerning stabilisation of public finances and speeding up the economic growth. External risk associated with the slower economic recovery of EU 28 and the countries in the region would also have a negative impact on the economic activities which would additionally reduce the export demand and capital inflow as the basic growth initiators.

Starting from the referred assumptions on which the alternative scenario is based, an average annual rate of the real decline of GDP in the period from 2015-2017 of 0.3% is projected, having in mind that the drop in 2015 would be exceptionally high (3%), and in the years to come the cumulative growth rate of 2% of GDP would be achieved.
Fiscal consolidation measures combined with the structural reforms represent a dominant factor of the medium term macroeconomic framework. Based on the basic scenario, these measures will affect the unfavourable trends of the aggregate demand and GDP in the next year, but they should be the grounds for the faster economic growth in the following period. This scenario assumes a larger inflow of investments which are supposed to provide a serious incentive for the economic activities.

Based on the alternative scenario fiscal consolidation would have a stronger negative effect than the expected, restructuring of the public sector would have a slower pace, and the inflow of investments would be smaller. In the majority of the European countries which opted for the more significant harmonisation of public finances over the last years, the real decline of GDP reached over 3%, and in some cases even above 15% (Latvia) due to the fiscal multipliers effect and unfavourable external environment (EU crisis). Slower resolving of issues of enterprises in restructuring and harder discovering of strategic partners for large systems would bring poorer inflow of investments. If the unfavourable external environment is added to this, there could ensure a poorer recovery of demand, unfavourable trends in the labour market, insufficient export growth, that is a slower economic recovery after the first year shock of fiscal consolidation.

A positive scenario which would bring better results in the economy when compared to the one envisioned by the basic scenario, would concern resolving the status of companies in the chemical and metal industry. Activating Železara Smederevo d.o.o. and resolving the issues in the chemical industry would have multiple positive implications regarding the economic activity through reducing the foreign trade deficit and substitution of import by domestic production. Furthermore, a direct impact on reviving the chemical and mining complex and launching Železara Smederevo d.o.o., based on the assumption that all capacities would be completely utilised, would ensure the cumulative growth of GDP of around 2 pp in the following period.
III. FISCAL FRAMEWORK FOR THE PERIOD FROM 2015 TO 2017

1. Fiscal Policy Medium-term Objectives

The fiscal policy objective in the medium term would consider stopping the general government public debt growth and its relative decrease in the long term, i.e. reducing the debt to GDP ratio to 45%, in line with the general fiscal rule.

The general government public debt was doubled over the last couple of years, so that it is assumed that by the end of 2014 it will reach around 70% of GDP. The debt amount might rise even above 85% of GDP until 2017 without the made changes to the fiscal policy. Increase of the debt stocks represents the result of high deficits in the past years, but also of strong guaranteed debt rise and costs repayment growth based on the financial system stabilisation. Further delay of debt stabilisation would question sustainability of public finances, that is the possibility for expenditures financing, especially in terms of the legal liabilities such as salaries, pensions, and social assistance and transfers which exceed 60% of the total public expenditures, but also the further servicing of debt repayments.

Significant fiscal consolidation measures were adopted together with the budget rebalance already in 2012, and it was also continued with the implementation of the measures in the 2013 budget. The measures were, primarily, concerning revenue side of the budget, and they were related to amending a large number of taxation rates and abolishing a considerable number of parafiscal fees. On the expenditure side, the most significant measure regarded limiting the growth of salaries and pensions. During 2014 the main instruments of fiscal consolidation were reducing salaries in the public sector net wages exceeding 60.000 RSD and additional hiring freeze. Fiscal consolidation measures gave various results. On one hand, the restrictive fiscal policy has resulted in the decline of certain macroeconomic aggregates, so that over 2013 and 2014 there was a real decline of private, public and investments. Also there was a strong rise of illegal tobacco market. However, in the second half of 2014 there was a significant progress noted when the effects of the taken measures finally started to reveal in the sense of reducing the fiscal deficit when compared to the previous year. In the period from January-October, the primary deficit, that is the deficit reduced for expenditures and revenues based on interests, was at the lowest level ever since 2009. The growth of current expenditures was stopped, stabilisation and revenues growth also occurred, but the interest expenditures growth, guaranteed debt expenditures rise and covering of losses of public enterprises and state banks have caused new deficit and debt growth.

Further public finances fiscal consolidation is inevitable, having regarded the current unsustainable position and burden for citizens and economy represented by the high deficit, debt ratio and future required assets for its repayment. Significant support to the efforts for public finances recuperation should be provided by the IMF. Concluding arrangements with this institution shall additionally strengthen the credibility of the policy implemented by the Government in the field of public finances and this shall ensure a favourable status and perception of investors on the international financial market. In order not to cause additional burdening of economy in the sense of increasing taxation, reduction of deficit shall be predominately based on expenditures adjustment. Major fiscal consolidation measures shall be represented by the reduction of salaries in the public sector as well as pensions, and rationalisation of the public sector, primarily through improving and corporatisation of business operations in public enterprises. In terms of the revenue collection, the priority will be combating against grey market and tax evasion, with the least possible changes to the existing taxation policy. The expenditures policy shall be directed to respecting special fiscal rules, which are related to indexation of wages and pensions, in accordance with the latest amendments to the Law on the Budget System, but also to the further relative reduction of
current expenditures, especially the ones intended for subsidies and budget loans for

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economy, based on the anticipated completion of the process of state enterprises restructuring
and privatisation and public enterprises efficiency increasing. The medium-term fiscal
framework with the proposed measures of fiscal consolidation envisions a significant
reduction of the general government deficit to 3.8% of GDP until 2017, along with the
stabilisation of the public debt ratio to 78.7% of GDP. This involves cumulative adjustment
in terms of the deficit of about 4% of GDP, in the period from 2014 to 2017.

Implementing the countercyclical fiscal policy, in the medium term, by respecting the
principles of fiscal responsibility and defined medium-term fiscal framework, shall contribute
to reduction of debt ratio in GDP. In the long term, further reduction of the public debt is
anticipated to the amount of 45% of GDP, in accordance with the Public debt decreasing
program. In this chapter, in terms of the debt scope, the general government debt does not
include debt part on the grounds of restitution, in order to ensure consistent comparison with
the general fiscal debt rule.

Changes in Methodology

Expenditures presented in this document include expenditures for purchasing financial assets for the
purpose of implementing public policies (economic classification 621) and the bulk of the principal
repayment based on the activated guarantees (economic classification 613 and 615) which have been
classified so far as financial transactions "below the line" and were not included in the deficit
calculation. Expenditures for purchasing financial assets are shown, in this document, in the category
Net budget loans. Repayments of activated warranties for the PE Roads of Serbia are not included in
expenditures and deficit, since this enterprise belongs under general government scope, as well as the
EU 225 debt repayment, since it represents repayment of the direct debt.

When compared to the previous fiscal strategies, the difference is also seen in presentation of
expenditures for employees and social contributions revenues. In the previous fiscal strategies in
terms of expenditures and revenues, employer contributions were not shown, i.e. revenues and
expenditures were shown based on the net principle. Such method of presenting had no effects on
deficit since it dealt with the same amount, but it did reduce the income and expenditures total
amounts. In this fiscal strategy, expenditures for employees and social contributions are shown based
on the gross principle.

2. Fiscal Trends in 2013 and 2014

At the end of 2012, the first major package of fiscal consolidation measures was

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passed. The measures were mostly related to the revenue side, since a great number of tax
rates was increased. As for the expenditure side, the measures included the limits of growth
of wages and pensions, the abolition of own revenues of budget users, the rationalisation of
expenditures for goods and services and subsidies. The development side of this package
referred to the attraction of investment and solving the problems of liquidity in the economy.
The plan was ambitious since it had planned a decrease of deficit by around 2.5% of GDP in
the first year. Although the GDP growth was higher than expected (2.6% instead of 2.0%),
the revenue projections were not achieved. The main components of growth were exports and
agriculture which cannot have abundant revenues in a short run. On the other hand, numerous
changes in tax policies had a negative impact on consumptions, causing, inter alia, the
strengthening of the grey economy market. However, the deficit was decreased by 1.7% of
GDP, and some of the measure implemented will show their full effect in the second half of
2014. In 2013, the rates of contributions for pension and disability insurance were amended
(hereinafter referred to as: PDI) as well as wage taxe so that a part of the funds was directed
from the budget of local self-governments to the budget of the Republic of Serbia. This
measure was introduced in order to solve the unequal allocation of revenues, that is, surplus funds at the local level compared to the high budget deficit of the Republic of Serbia.

The budget of the Republic of Serbia for 2014 continued with the restrictive effects of the fiscal policy. A reduction of wages was introduced for the public sector workers earning more than 60,000 RSD net, and deducted amounts were directed to the budget as a non-tax revenue. A strict control of employment was introduced as well in order to reduce the number of employees through natural outflow (attrition). In addition, the rationalisation of discretionary expenditures was continued, especially for goods and services and subsidies. On the revenue side, a special VAT rate was increased from 8% to 10%, and significant results were expected from the fight against the grey economy. On the expenditure side, however, the increasing weight of the interest expenditures and necessity of solving the problems in public enterprises and financial sector are reasons that the target deficit still remains high. In 2014, due to the early parliamentary elections and the consequences of the catastrophic floods in May, the expenditures further increased, and additional funds were allocated to finance the problematic parts of the public sector.

The fiscal consolidation measures did not provide the expected result in certain tax categories. That primarily refers to VAT and excise duties for tobacco products. As for VAT, the revenues are lower than it was expected on several grounds. On one hand there is still a low purchasing power of the population, inherited from the past, which is reflected in household spending, and on the other hand, the floods which had occurred in May brought to a decrease of domestic production, which also has an impact on the decrease in aggregate demand. Also, there was a change in the consumption structure since the demand for domestic products was substituted by the imported goods which influenced the collection of VAT on imported goods, which, in the first ten months of the current year compared to the previous year, recorded a nominal and real growth of 10.4% and 8.1% respectively, while the reduced domestic production brought to a lower collection of gross and net domestic VAT.

There is still a shortfall in collection of excise duties on tobacco products this year, despite the growing fight against the grey market whose effects are visible in the second half of 2014. When it comes to the excise duties on oil products there was a overperformace in comparison with the initial budget, even though there was no drastic increase in consumption. The growth was mainly a result of the introduction of fuel marking which ensured the quality and control of fuel trade and the elimination of the grey market. The nominal and real growth in comparison with the previous year was 19.3% and 16.8% respectively, which was also stated in the revised budget projection. For other excise duties there was a shortfall due to a reduced consumption of certain excise products and lower indexation due to low inflation.

Revenues from income tax, whose largest part is the tax on wages, are lower in nominal and real amount in comparison with the previous year due to the reduction in rates and the increase in non-taxable part, which was included in the initial projection for 2014. Unfavourable developments in economic activity and employment had an impact on the shortfall of these revenues compared to the plan. Finally, the reduction of wages in public sector since December 2014 will additionally reduce revenues from income tax. The situation is similar with the social contributions since they most depend on the trends of the wage bill in economy.

The effects of the new tax rate, which has been applied since 2013 (an increase from 10% to 15%) in taxes on corporate income, has been fully achieved. In the first ten months of 2014, there was a nominal and real growth of 33% and 30.3% respectively in comparison with the period of 2013.

Customs revenues were realised in a higher amount compared to the initial budget as a result of imports movements as a determinant of customs revenue. Customs revenues are decreasing each year due to the implementation of the SAA and other free trade agreements.
Since the harmonisation of tariff rates is near to its end, which brings to a gradual change of annual effects of the SAA implementation, in the coming years it can be expected to have a stabilisation of customs revenues and a termination of their decline.

Within the category of other tax revenues, the biggest growth was achieved by property tax, which is included in the revenue of local self-governments, which achieved the nominal and real growth of 59.6% and 56.3% respectively, compared to the first ten months in 2013, which is a result of the new manner of calculation and inclusion of fees for land use in this tax category.

Regular nontax revenues were higher than in the plan shown in the budget, with minor differences in the structure. Non regular (ad-hoc) nontax revenues, very heterogeneous in structure, are expected to have a better collection, as well as a different structure (NIS payment of dividends, increase of the payment obligation of public companies profit from 50% to 70%, etc.).

The expected revenue from donations was increased by 2.3 billion dinars to 9 billion dinars, with a greatly changed structure than previously. While the budget mostly included the revenues from IPA Funds, which were mostly not realised, now it includes the revenues in the amount of 4.5 billion dinars on the basis of the assistance for reconstruction of the flooded areas.

On the expenditure side there was a change in tendencies in comparison with the previous years. The growth of expenditures for employees and pensions was stopped, the interest payments is the category with the strongest growth, and the allocations for the state-owned companies and the stabilisation of the financial sector were increased.

Trend of expenditures for the employees is the result of the regular indexation of individual wages during the year (0.5% in April), employment trends in the state sector and dynamics of other expenditures for employed (compensation costs, social benefits, rewards, etc.), and also the austerity policy regarding new employment. The new economic measures envisage savings on the expenditure side, including the reduction of expenditures for wages and pensions. Consequently, the regular wages and pensions indexation planned for October was abolished.

The funds used for repayment of interest are higher in real terms by 18.8% compared to the same period of the previous year. These expenditures are a growing part of total expenditures, and they will continue to grow in the coming period, as a consequence of high public debt and relatively high interest rates at which the government borrows.

Subsidies paid in the period January - October 2014 were lower in real terms compared to the same period in 2013 by 2.7%. In order to get a real picture on the trends in this category it is necessary to highlight the significantly different dynamics of payment of subsidies in agriculture, which amount in the observed period this year was significantly higher, as well as the amount of subsidies of PE "Roads of Serbia", while the subsidies paid from the local level of government, as well as the subsidies for private companies and for "Serbian Railways" JSC are lower in comparison to the observed period of the previous year. Also, subsidies for national broadcasting companies, started to be paid this year from the budget.

Capital expenditures in the period January - October 2014 were higher in real terms than in the same period in 2013, but the execution of these expenditures was significantly lower than the initially planned amount. This especially refers to the project loans. The revision provided significant savings on this category of expenditures.

The following table shows the revenues, expenditures and fiscal deficit. The first column represents the initial plan of revenues, expenditures and deficit based on the Law on the Budget of the Republic of Serbia for 2014 and adopted Fiscal Strategy for 2014 with the projections for 2015 and 2016, the second column represents the estimation based on the
adopted supplementary budget, followed by execution for the first ten months of 2014. The data do not include the revenues and expenditures of indirect budget users.

Table 5. General Government Revenues, Expenditures and Fiscal Result in 2014 - Initial Budget, Estimation Based on the Revision and Execution in the First Ten Months, in billions of RSD:

<table>
<thead>
<tr>
<th></th>
<th>Budget</th>
<th>Estimation (supplementary budget)</th>
<th>Execution January - October</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>PUBLIC REVENUES</strong></td>
<td>1,656.5</td>
<td>1,589.2</td>
<td>1,305.4</td>
</tr>
<tr>
<td>Current revenues</td>
<td>1,649.8</td>
<td>1,580.2</td>
<td>1,291.0</td>
</tr>
<tr>
<td>Tax revenues</td>
<td>1,492.3</td>
<td>1,418.6</td>
<td>1,172.3</td>
</tr>
<tr>
<td>Personal income tax</td>
<td>156.2</td>
<td>143.2</td>
<td>117.3</td>
</tr>
<tr>
<td>Corporate income tax</td>
<td>65.8</td>
<td>75.5</td>
<td>64.4</td>
</tr>
<tr>
<td>Value added tax</td>
<td>430.0</td>
<td>398.1</td>
<td>335.0</td>
</tr>
<tr>
<td>Excise</td>
<td>227.6</td>
<td>211.2</td>
<td>171.5</td>
</tr>
<tr>
<td>Customs</td>
<td>29.5</td>
<td>31.0</td>
<td>25.4</td>
</tr>
<tr>
<td>Other tax revenues</td>
<td>55.5</td>
<td>54.3</td>
<td>43.8</td>
</tr>
<tr>
<td>Contributions</td>
<td>527.6</td>
<td>505.4</td>
<td>415.0</td>
</tr>
<tr>
<td>Non-tax revenues</td>
<td>157.5</td>
<td>161.6</td>
<td>125.8</td>
</tr>
<tr>
<td>Donations</td>
<td>6.7</td>
<td>9.0</td>
<td>7.3</td>
</tr>
<tr>
<td><strong>PUBLIC EXPENDITURES</strong></td>
<td>1,946.4</td>
<td>1,897.5</td>
<td>1,462.0</td>
</tr>
<tr>
<td>Current expenditures</td>
<td>1,720.3</td>
<td>1,711.5</td>
<td>1,361.2</td>
</tr>
<tr>
<td>Expenditures for employees</td>
<td>486.9</td>
<td>460.8</td>
<td>378.0</td>
</tr>
<tr>
<td>Purchase of goods and services</td>
<td>263.9</td>
<td>252.8</td>
<td>190.7</td>
</tr>
<tr>
<td>Interest payments</td>
<td>119.8</td>
<td>118.4</td>
<td>99.6</td>
</tr>
<tr>
<td>Subsidies</td>
<td>103.1</td>
<td>116.4</td>
<td>77.8</td>
</tr>
<tr>
<td>Social assistance and transfers</td>
<td>706.2</td>
<td>702.1</td>
<td>573.9</td>
</tr>
<tr>
<td>of which pensions</td>
<td>512.6</td>
<td>507.3</td>
<td>423.0</td>
</tr>
<tr>
<td>Other current expenditures</td>
<td>40.3</td>
<td>61.4</td>
<td>41.2</td>
</tr>
<tr>
<td>Capital expenditures</td>
<td>132.5</td>
<td>102.4</td>
<td>69.9</td>
</tr>
<tr>
<td>Net lending</td>
<td>61.3</td>
<td>50.7</td>
<td>11.5</td>
</tr>
<tr>
<td>Activated guarantees</td>
<td>32.3</td>
<td>32.9</td>
<td>19.4</td>
</tr>
<tr>
<td>Fiscal balance</td>
<td>-289.9</td>
<td>-308.3</td>
<td>-156.6</td>
</tr>
<tr>
<td>Fiscal balance % of GDP</td>
<td>-7.5</td>
<td>-7.9</td>
<td>-</td>
</tr>
</tbody>
</table>

Source: MFIN

According to the estimation based on the supplementary budget, the consolidated deficit of the state sector will be higher by around 0.4% of GDP than the deficit which was initially planned for 2014, principally due to the lower collection of revenues than expected. The lower collection of revenues was greatly influenced by the following factors:

- slower nominal growth of private consumption partially caused by lower inflation;
- unfavourable development of the macroeconomic environment which was significantly contributed by the floods in May (real GDP growth estimation for the budget was 1%, and the current estimation is the decrease of 2%);
- growth of activity in the grey market, especially in the market of tobacco products.

Lower revenues collection initiated the need for adjustment on the expenditure side, since further increase of tax rates would not bring any effects. The expected effect of the measures on the expenditure side in 2014 was a decrease of the consolidated expenditures for
about 1.3% of GDP. The biggest reduction is expected in capital expenditures and net lending, expenditures for employees, pensions and expenditures for purchase of goods and services.

As for the republican budget, the revision envisages higher expenditures of about 0.2% of GDP. The biggest growth is expected for subsidies, particularly the subsidies in economy (subsidized interest) and for other current expenditures (for election costs and compensation for the damage occurred in the floods). With the reduction of rate of contributions for health insurance from 12.3% to 10.3%, there is a obligation that the missing resources should be compensated by the transfers from the republican budget, which was included in the budget revision for 2014. On the other hand, the changes in rates of contributions for pension and disability insurance from 24% to 26% reduced the need for subsidies from the budget to the Pension and Disability Insurance Fund, which provided an additional saving of about 5 billion dinars. The full effect of the measures on the expenditure side are expected in 2015.

3. Fiscal Projections for the Period from 2015 to 2017

The following table shows the projected deficit amounts presuming that in the following medium term fiscal consolidation measures are not in force. Among other things, the primary result is shown, obtained from the total fiscal balance decreased by revenues and expenses based on collected / paid interests. The relationship between the primary deficit and the output gap is one of the indicators of fiscal policy character. Taking into account that since the middle of 2009 a significant decrease of this indicator has been noted, it can be said that there is a certain degree of consolidation. On the other hand, the growing trend of expenditure share is becoming an increasing problem. Consolidated fiscal result is a fiscal outcome within which the expenditure side includes the financial transactions of the state such as payment of activated guarantees, recapitalization of banks (whose balances are negative) and enterprises, assumption of debts of other governmental entities, and more. Although these expenses have not so far been treated as an item of expenditure, and therefore as part of the deficit, their execution was actually reflected in the rise of the levels of public debt. By including these expenses in expenditures a tighter connection is established between an achieved fiscal result and the net change in the public debt level.

Table 6. Fiscal Aggregates in the Period 2014-2017 in % of GDP, Scenario without Fiscal Consolidation Measures

<table>
<thead>
<tr>
<th></th>
<th>estimate</th>
<th>projection</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2014</td>
<td>2015</td>
</tr>
<tr>
<td>Public revenues</td>
<td>40.9</td>
<td>40.3</td>
</tr>
<tr>
<td>Public expenditures</td>
<td>49.0</td>
<td>47.6</td>
</tr>
<tr>
<td>Consolidated fiscal result</td>
<td>-8.1</td>
<td>-7.3</td>
</tr>
<tr>
<td>Primary consolidated fiscal result</td>
<td>-5.1</td>
<td>-4.0</td>
</tr>
</tbody>
</table>
The previous table shows what the trend of the share of revenues, expenditures, deficit and public debt would have been in the period from 2014 to 2017, if the Government already by the end of this year had not adopted new measures of fiscal consolidation altogether with supplementary budget. Despite the reduction in the fiscal deficit, due to the existence of measures which have been adopted in the previous period, the debt keeps growing trend.

The medium-term fiscal framework, together with the proposed measures of fiscal consolidation provides a significant reduction in the general government deficit to 3.8% of GDP by 2017, stabilizing at the same time public debt level and reversing its trend (78.7% of GDP in 2017). This implies a cumulative adjustment in the deficit of 4% of GDP. Cumulative adjustment is calculated as the difference in the deficit in 2014 without measures and the projected deficit in 2017 with the measures.

Table 7. Basic Fiscal Aggregates in the Period 2014-2017, in % of GDP, Scenario with the Implementation of Fiscal Consolidation Measures

<table>
<thead>
<tr>
<th></th>
<th>estimate</th>
<th>projection</th>
</tr>
</thead>
<tbody>
<tr>
<td>General government debt</td>
<td>69.9</td>
<td>78.7</td>
</tr>
<tr>
<td></td>
<td>83.1</td>
<td>86.1</td>
</tr>
<tr>
<td>Real GDP growth rate</td>
<td>-2.0%</td>
<td>1.0%</td>
</tr>
<tr>
<td></td>
<td>1.3%</td>
<td>1.8%</td>
</tr>
</tbody>
</table>

The target deficit in 2017 is 3.8% of GDP. After a strong reduction in the deficit in 2015 of about 2% of GDP in the remaining two years the adjustment will be somewhat lower. It should be noted that the application of specific measures leads to an increase in certain expenses, which reduces the effects of adjustment. Namely, the rationalization of the public sector requires greater resources on the basis of social benefits such as severance pay and unemployment compensation, in the years when the measures are applied. The projections of fiscal aggregates in the period 2015 - 2017 are based on projections of macroeconomic indicators for the specified period, the planned tax policy that implies further harmonization of the laws and directives of the EU and appropriate measures on the revenue and expenditure side, including the reform of large public companies.
Movements of fiscal aggregates in the medium term are largely the result of the application of fiscal consolidation measures. Some of the measures have resulted in a temporary increase in certain categories of expenditure. Completion of the process of restructuring and rationalization of the public sector requires additional expenditures in the form of necessary resources for severance pay and unemployment compensation. On the other hand, there is the effect of activity reductions in salaries and pensions on aggregate demand and some reduction of revenues on that basis. These additional effects are taken into account in the design of the fiscal framework by 2017.

The two most important measures, the reduction in public sector salaries and pensions, have been applied even during the adoption of the supplementary budget for 2014, so that the effect of these measures occurs already in December 2014. In addition, in accordance with the legislation, there was no indexation of salaries and pensions in October 2014. In this way, additional savings of several billion dinars have been achieved.

1) **Decrease in salaries of public sector employees** - Linear reduction has been envisaged of 10% of the net salaries of public sector employees who receive more than 25,000 dinars. This measure will apply to the entire public sector, including all budget users, public companies, local administration and other entities that are classified in the public sector. There will be no reduction in salaries for the employees whose monthly incomes are up to 25,000 dinars. For employees who receive between 25,000 and 27,500 dinars, it is anticipated that the salaries after the reduction will be 25,000 dinars.
Table 8. Example of Calculating Salaries After Reduction in the Public Sector, in RSD

<table>
<thead>
<tr>
<th>Net salaries in the public sector before introducing reduction</th>
<th>The decrease in net salaries</th>
<th>Net salaries in the public sector after reduction</th>
</tr>
</thead>
<tbody>
<tr>
<td>25,000</td>
<td>0</td>
<td>25,000</td>
</tr>
<tr>
<td>50,000</td>
<td>5,000</td>
<td>45,000</td>
</tr>
<tr>
<td>100,000</td>
<td>10,000</td>
<td>90,000</td>
</tr>
</tbody>
</table>

Saving on this basis should be about 0.5% of GDP annually at the level of the general government. To prevent irrational use of these funds, but also to ensure maximum realization of effects of these measures at all levels, it is envisaged that all the institutions and companies that are not part of the general government, and local governments, pay funds obtained from the reduction of salaries directly to the budget of the Republic of Serbia. These funds will be enumerated as a form of nontax revenue in the budget of the Republic of Serbia. The lack of disposable funds of the population based on decrease in salaries will affect personal consumption and revenues from taxes on consumption. These assumptions have been directly taken into account in the baseline projection of VAT gross collection trend and other indirect taxes in the future.

2) Reduction of pensions - This measure provides the progressive reduction in pensions for all pensioners who receive income over 25,000 dinars. The pension amounting to between 25,000 and 40,000 dinars will be reduced by 22% to the amount over 25,000 dinars, while all pensions over 40,000 dinars will be further reduced by 25% to the amount over 40,000 dinars. Pensions amounting to 25,000 dinars will not be reduced. It is estimated that the impact of this measure on reducing the deficit will be around 0.5% of GDP.

Table 9. Example of Calculating the Reduction of Pensions, in RSD

<table>
<thead>
<tr>
<th>The amount of pension</th>
<th>Reduction of pension</th>
<th>The pension amount after reduction</th>
</tr>
</thead>
<tbody>
<tr>
<td>25,000</td>
<td>0</td>
<td>25,000</td>
</tr>
<tr>
<td>40,000</td>
<td>3,300</td>
<td>36,700</td>
</tr>
<tr>
<td>60,000</td>
<td>8,300</td>
<td>51,700</td>
</tr>
</tbody>
</table>

3) The new rule for indexation of salaries and pensions - The Law on the Budget System prescribed the indexation of salaries and pensions twice a year by 0.5% in 2015 and 2016, and in 2017 in line with inflationary trends and GDP growth. One of the measures of fiscal consolidation is a modification of the fiscal rules for indexation, through amendments to the Law on Budget System. Accordingly, salaries and pensions will increase in the years in which it is expected for the share of these categories of expenditure within GDP to be up to 7% of GDP and 11% of GDP, respectively. The effects of these measures are not significant in the first two years (0.1 - 0.2% of GDP), but the effect in 2017 will be around 0.5% of GDP as it was then predicted significantly higher indexation.

4) The rationalization of the public sector - Public sector reform is an essential condition for the consolidation of public finances and establishment of a healthy economic environment. Excess and unfavourable structure of the employees are problems that cause inefficiency of the public sector and represent a burden on the entire economy. Reducing the number of employees by 5% annually in the next three years should bring savings of around
0.3% of GDP annually. It is considered that the largest part of this reduction would be achieved by natural turnover of staff, i.e. through retirement with limited filling of job vacancies. It is very important not to reduce the number of employees at the expense of the quality and efficiency of the state bodies, which means that before the implementation of these measures a serious analysis must be made of the number and structure of employees in all parts of the public sector. Implementation of these measures carries with it the proper conduct of policy in the field of social protection, in the form of severance pay and unemployment compensation. Required funds on this basis have been included in the medium-term fiscal framework.

5) Reduction of subsidies - Significant space for savings on expenditure in the period from 2015 to 2017 exist in the domain of expenditures on subsidies. In this regard, significant savings have been planned for 2015, primarily through the reduction of incentives for agricultural production. The abolition of subsidies is envisaged on land area larger than 20 hectares, as well as state-owned land that has been leased. The reduction of subsidies is envisaged for JP "Serbian Railways" and public broadcasting companies, based on the reduction of operational costs. In 2016 subsidizing public broadcasting companies will be completely abolished. In 2015, the effect of reducing the deficit should be around 0.2% of GDP, while in 2016 this effect is expected to be around 0.5% of GDP.

6) The savings on goods and services - Savings on procurement will be achieved through regulatory changes which will result in the equalization of conditions for participation in this process for domestic and foreign suppliers, which will bring to savings effect of at least 0.1% of GDP.

7) The reform of public enterprises - One of the goals of structural and fiscal measures is also the reform of public business enterprises, especially large systems. The rationalization of their operations and their transformation into for-profit companies will be a priority in the future. Fiscal effects of the restructuring of public enterprises will be reflected in the payment of a share of profit or dividends into the budget. On this basis it is expected between 0.3% and 0.5% of GDP annually.

8) The fee for gas transport - Introducing the transit fees for gas in the amount of 2 dinars per cubic meter should bring additional revenue of PE "Srbijagas" in the amount of 0.2% - 0.3% of GDP per year which would result in budget liabilities reduction by the same amount on the basis of the guaranteed debt to be paid on behalf of the company.

9) Financing local government - During 2015, the amendments to the Law on financing local self-government will be adopted, which would have as a result effective reduction of transfers from the budget of the Republic of Serbia and encourage local self government units to more efficient collection of own revenues. These changes would take effect in early 2016 and should reduce the general government deficit to around 0.2% of GDP.

Fiscal Projections for the Period from 2015 to 2017

Looking from the perspective of their share in GDP, total general government revenues, excluding indirect beneficiaries, are showing a downward trend, given that nominal GDP growth is faster than nominal revenue growth. The reason for this trend is the fact that the revenues largely depend on developments in private consumption, which in conditions of slow growth and limited disposable income grows more slowly than nominal GDP. GDP growth in 2016 and 2017 will be primarily determined by a slight recovery of private consumption and investments, which in the short term are not generous regarding revenue collection. In the case of higher growth rates over the long term a higher growth of employment and salaries can be expected also, which would lead to a significant growth of
personal consumption. In addition, the revenue trend will depend on the success of fighting the grey economy and tax evasion eradication.

Table 10. Total Revenue and Grants in the Period 2014 - 2017, in % of GDP

<table>
<thead>
<tr>
<th></th>
<th>estimate</th>
<th>projection</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2014</td>
<td>2015</td>
</tr>
<tr>
<td>PUBLIC REVENUES</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current revenues</td>
<td>40.9</td>
<td>40.3</td>
</tr>
<tr>
<td>Tax revenues</td>
<td>36.5</td>
<td>35.3</td>
</tr>
<tr>
<td>Personal Income Tax</td>
<td>3.7</td>
<td>3.6</td>
</tr>
<tr>
<td>Corporate income tax</td>
<td>1.9</td>
<td>1.9</td>
</tr>
<tr>
<td>Value added tax</td>
<td>10.2</td>
<td>10.1</td>
</tr>
<tr>
<td>Excise</td>
<td>5.4</td>
<td>5.4</td>
</tr>
<tr>
<td>Customs</td>
<td>0.8</td>
<td>0.7</td>
</tr>
<tr>
<td>Other tax revenues</td>
<td>1.4</td>
<td>1.4</td>
</tr>
<tr>
<td>Contributions</td>
<td>13.0</td>
<td>12.2</td>
</tr>
<tr>
<td>Non-tax revenues</td>
<td>4.2</td>
<td>4.8</td>
</tr>
<tr>
<td>Grants</td>
<td>0.2</td>
<td>0.2</td>
</tr>
</tbody>
</table>

Source: MFNI

Fiscal consolidation measures significantly determine the trend of macroeconomic aggregates in the future, especially the trend of GDP and private consumption. On the other hand, measures relating to the reduction of salaries and pensions in the public sector will have a double impact on the overall level of general government revenue (in the form of an increase or decrease):

- Nominal reduction of salaries and pensions in public sector will have a negative effect on the trend of the real level of private consumption, which will be partially compensated for by the trend of the wage bill into the private sector;
- Projected inflation level, together with the trend of the real level of private consumption, leads to the stagnation of a nominal level of consumption as a determinant of collection of indirect taxes in 2015 and then its slight increase;
- Reduction of public sector salaries directly affects the trend of the level of direct taxes (salary taxes and social contributions);
- A reduction of salaries in parts of the public sector which are not financed directly from the budget of the Republic of Serbia (local governments and public enterprises) will affect the revenue side, by displaying anticipated savings on the revenue side as part of nontax revenues;
- The assumption is that the consumption of excise goods is inelastic in income terms and that quantitatively expressed trend of consumption is to some extent autonomous in relation to the overall level of spending. On the other hand, the trend of prices of these products directly and largely affects the volume of grey market;
- The increase in the profitability of the parts of the public sector will cause a higher payment received from public companies in the future, and together with the introduction of a new category of dedicated revenues in the form of fees for mandatory strategic oil reserves will affect the amount of total tax revenues.

*Personal income tax.* The personal income tax is projected at around 3.3% of GDP at the end of the period. The reason for the gradual decline of this tax is reduction in earnings and rationalization of public sector employment. These effects will be partially offset by the
trend of the wage bill in the private sector. The predominant form of income tax is a tax on salaries, and therefore the trend of the wage bill and employment are the main factors affecting the trend of revenues from income tax. A certain level of risk exists if nominal wage growth does not occur in the private sector or is lower than expected.

Contributions for compulsory social insurance. Contributions for CSI represent the largest single type of public revenues. Contributions share in GDP was 13.0% in 2014 and dropped to 11.2% by the end of the period. The trend of the share of this public revenue in GDP has a similar trajectory as well as the trend of the share of taxes on salaries given that for their projection the same assumptions on salaries and employment were used in the medium term. Contributions are tax category in which the tax indiscipline is the most prominent and the largest debt of taxpayers is registered. The beginning of performing activities of Central registry of compulsory social insurance should enable better control and collection of these revenues. In the recent period there have been significant changes in the levels of the rates at which social contributions are calculated and collected and in accordance with them revenues from this tax form have been projected. In June 2013, the rate for pension contributions was increased from 22% to 24%, while reducing the tax rate on salary from 12% to 10%. In August 2014, pension and disability insurance contribution rates increased from 24% to 26%, whereas health insurance rate was reduced from 12.3% to 10.3%.

Corporate income tax. By amendments to the Law on Corporate Income Tax in 2013 the corporate income tax rate was increased from 10% to 15%, and the full effect of these changes was recorded in 2014. During the next period an unchanged share of this tax to GDP is predicted, given that significant changes in the profitability of the economy are not expected. By the amendments to the regulations governing the payment of corporate income tax from 2013 a significant elimination of tax incentives is foreseen, and therefore there is a possibility of higher revenue realization on this basis.

Value added tax. The VAT revenues are characterized by a slight decline in the share of GDP, given that a slower growth in private consumption in relation to nominal GDP growth has been projected. The main determinant of VAT trend is private consumption led by disposable income of the population. Disposable income as a determinant of consumption depends on salaries trends in the public sector, as well as pensions, social assistance and the trend of the wage bill in the private sector and other forms of income, including remittances. For 2015 it is envisaged that the nominal amount of private consumption will stagnate, and in the next two years it is expected to grow slightly. The reason for this lies in the fact that fiscal consolidation is implemented through a reduction in salaries in the public sector and pensions, the completion of the restructuring process and the planned reduction in the number of employees in the public sector. On the other hand, a higher level of allocations through various forms of social protection at the level of general government, a slight nominal salaries growth in the private sector and moderate growth in other forms of income result in nominally unchanged amount of private consumption.

During 2013 the standard VAT was increased followed by rise in reduced VAT rate in 2014. Any change in tax rates introduces some distortion in the structure and in the level of consumption, as well as the extent of the grey market and thus affect the efficiency of collection of all forms of consumption tax. In the initial period, usually the collection rate gets worse and there are no full effects of applying the new rates. It may be noted that in the second half of 2014 there was stabilization of collection and establishment of a new equilibrium in the consumption structure. The first results of more efficient collection and control of taxpayers are notable and it is expected that this trend will continue in the coming year, but the effects of the fight against the grey economy are not explicitly given in the projected values due to caution. A modest growth in export has also been projected in the coming period, which will lead to lower growth of VAT refund and if there is a greater
increase in export demand that may affect the overall level of collected VAT. Risks to the realization of VAT projections are similar to those related to taxes on personal income and lie in the trends of salaries in the private sector, the overall growth of the economy as well as in the level of the grey economy, i.e. efficiency in the fight against it.

Excise duties. Revenues projections from the excise tax has been made on the basis of the planned excise policy, the projected consumption of excisable products (oil derivatives, tobacco products, alcohol and coffee) and full harmonization of the nominal amount of excise tax on individual products. Within the excise policy, in relation to all of excise goods, gradual harmonization with EU directives is expected to continue in the following medium term. This includes the adoption of a medium-term plan for the gradual adjustment of the excise burden. For cigarettes, it will be directed through a gradual increase in excise duties, so that the EU minimum of 1.8 euros per pack could be reached in an acceptable timeframe. It is essential that these changes are carefully designed so that the changes in the structure and volume of consumption that may threaten revenues could be avoided, but also so as not to be opposed to the objectives of public health policy.

The legal market of tobacco products decreased by 20%, expressed quantitatively, in 2013, and in the first half of 2014 compared to the first half of 2013 it dropped by the same percentage. In the second half of 2014 a modest recovery of revenues from excise taxes on tobacco products occurred and, unlike the previous period, there was growth compared to the same period observed in 2013. Measures in combating illegal trade in this type of excise products have begun to yield results, but the final assessment of the extent of the legal market will be possible to make at the beginning of 2015, when complete data become available. In 2015, the nominal amount of the specific excise duty should amount to over 53 dinars (the exact amount depends on the realized inflation in 2014) in the first half of the year, and slightly below 56 dinars in the second half of the year. This alignment has been envisaged by the existing legislation. However, because it is highly uncertain to predict the structure and scope of the legal market consumption, reaction of producers in terms of prices and other factors, in 2015 for excise duty revenue projections purposes, a further reduction of the legal market of tobacco products from 8 - 10% is expected compared to 2014. It should be noted that prior to 2013 the average annual decline in consumption was fairly uniform, about 2 - 4%, and can be attributed to "natural" drop in consumption due to the trend of the rise of prices of tobacco products and the global campaign against the consumption of tobacco products. It is expected that in 2016 and 2017, the decline in consumption of tobacco products will be on the "natural" level. In 2016 the nominal amount of excise tax, besides its complying with inflation, will be further increased in accordance with the Law on Excise, and in 2017 will be adjusted by inflation rate. If there are positive improvements in tobacco market conditions and the reduction of the shadow economy, there is a positive risk to the collection of this type of income.

Unlike tobacco products, the situation in the market of petroleum products is much more favourable. After several years, the trend of decrease in the volume of the legal market of gasoline, has been stopped, and for the first time there is even a slight increase in consumption. The reasons for this are manifold: better control and the effects of marking petroleum products, weakening of effects of substitution of gasoline by liquefied petroleum gas and convergence of gasoline prices to the prices in the region. Consumption of diesel fuel is continuously growing, and this is happening due to inter alia, the measures for combating illegal trade and the introduction of various substitutes of fuel for use in agriculture, under the category of excise products. On the other hand, consumption of liquefied petroleum gas for the first time decreases after reaching the level of consumption of gasoline in the previous period. In the future, due to caution, a continued growth in consumption of gasoline and diesel fuel has not been assumed, but the expected amount of consumption in 2014 has been
used for the projection. In 2015, the excise tax on diesel and liquefied petroleum gas are increased in accordance with the Law on Excise, and excise taxes on gasoline remain unchanged. In 2016 and 2017 the excise tax on all types of fuel is adjusted for inflation. In this case, there is a chance for greater revenue collection if the growing trend of the legal market of petroleum products continues.

Revenues from excise taxes on alcoholic beverages and coffee have been designed in accordance with the existing structure of consumption and inflation trends in the upcoming period.

**Customs.** The main determinants for the projection of revenues from customs are import and exchange rate trends. Customs revenues have declined in the past due to the implementation of the SAA and other free trade agreements and the gradual reduction and elimination of customs tariffs. Given that the harmonization of customs tariffs came to an end, this reduction in customs revenues is not significant as it was the case in previous years, and therefore stabilization of the share of customs duties in GDP is expected.

**Other tax revenues.** These revenues, of which the greatest part consists of property tax, and taxes on the use, possession and carrying of goods, are designed in accordance with the trend of inflation, since the inflation component has been embedded in a significant part of these tax forms. The level of these revenues is relatively stable and reactions to economic downturn have not largely been expressed. This is the reason that in times of major crisis and slower growth in other tax revenues, the share of this category to some extent increases. In the upcoming medium term the share of other tax revenues is stabilizing. These tax revenues have increased significantly in 2014 due to changes to regulations concerning taxes on property in the part relating to a property tax of legal entities, i.e. including fees for the use of land in property tax. It should be expected that the local government units, due to the loss of other incomes and reduction in transfers from the central budget, improve the collection of property tax, which is one of the most significant revenue type.

**Nontax revenues.** The share of non-tax revenues in GDP has been reduced over the medium term, after the jump in 2015. This jump is a result of the expected payment of funds based on the reduction of salaries in the public sector (public enterprises and local government), higher revenues from dividends and profit from public enterprises, as well as the introduction of fees for mandatory oil reserves. Non-tax revenues mainly consist of various fees, commissions and sales of goods and services, whose trend is largely dependent on demand and economic activity, and whose nominal growth in the future will be slower than GDP growth.

**Grants.** With the developing process of approaching membership in the EU, IPA funds which can be used, have increased, and therefore these funds make up the predominant part of the revenues obtained from donations.
### Table 11. Total Expenditures in the Period 2014 - 2017, in % of GDP

<table>
<thead>
<tr>
<th></th>
<th>Assessment</th>
<th>Projection</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>2014</td>
<td>2015</td>
</tr>
<tr>
<td><strong>PUBLIC EXPENDITURES</strong></td>
<td></td>
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</tr>
<tr>
<td>Current expenditures</td>
<td>48.9</td>
<td>46.1</td>
</tr>
<tr>
<td>Expenditures for employees</td>
<td>11.9</td>
<td>10.7</td>
</tr>
<tr>
<td>Purchase of goods and services</td>
<td>6.5</td>
<td>6.4</td>
</tr>
<tr>
<td>Interest repayment</td>
<td>3.0</td>
<td>3.5</td>
</tr>
<tr>
<td>Subsidies</td>
<td>3.0</td>
<td>2.6</td>
</tr>
<tr>
<td>Social assistance and transfers</td>
<td>18.1</td>
<td>17.8</td>
</tr>
<tr>
<td>out of which pensions</td>
<td>13.1</td>
<td>12.4</td>
</tr>
<tr>
<td>Other current expenditures</td>
<td>1.6</td>
<td>1.2</td>
</tr>
<tr>
<td>Capital expenditures</td>
<td>2.6</td>
<td>3.1</td>
</tr>
<tr>
<td>Net lending</td>
<td>1.3</td>
<td>0.1</td>
</tr>
<tr>
<td>Activated Guarantees</td>
<td>0.8</td>
<td>0.7</td>
</tr>
</tbody>
</table>

Source: MFIN

Fiscal adjustment on the expenditure side of general government during the observed period was 7% of GDP. The largest part of the adjustment relates to the expenditures for employees and pensions as these two items make up more than 50% of total expenditures. In addition, the completion of the restructuring process of social enterprises, addressing issues of inefficient public enterprises and the stabilization of the financial sector should contribute to the reduction of expenditures. On the expenditure side, investments in infrastructure represent the priority in the future, so that in case of creating additional fiscal space available funds would be focused in that direction.

**Expenditures for employees.** The reduction of the wage bill will take place on two grounds. On one hand, all public sector employees who receive more than 25,000 dinars will have their salaries reduced by 10%, and on the other side it is planned to rationalize the number of employees. In addition, in accordance with the new fiscal rule for indexation, growth of this category has not been envisaged. During 2015, the comprehensive reform of the salary system has been planned.

**Purchase of goods and services.** For this category of expenditure a relatively stable share in GDP after 2015 has been predicted. This will be contributed by, among other things, changes to regulations in the domain of public procurement which provide the same conditions for domestic and foreign suppliers, as well as the reform of financing local government.

**Interest repayment.** Extremely high level of public debt and high fiscal deficits have caused interest to become one of the most important expenditure items. The cost of interest payments are on a strong growth path and until the end of 2017 they will reach 4% of GDP. Fiscal consolidation measures will slow down the growth in the last two years of the observed period.

**Social assistance and transfers to households.** The largest category within transfers to households are pensions. Reducing the amount of pensions and pension system reform will contribute to a significant reduction in the share of pension expenditure in GDP. Their share in GDP should fall from 13.1% in 2014 to 11.2% in 2017. In addition to the nominal pension cuts, the lack of indexation in accordance with the new rules and amendments to the pension system adopted during 2014 will also contribute to such a trend. Other forms of social benefits and transfers to households in the period from 2014 to 2016 will be adjusted by applying the prescribed indexation of current and planned changes of policies in this area and the projected number of users. In addition, an increase in funds required for certain types of social assistance is expected due to the sharp fiscal consolidation measures in the future. This
includes increased funding for severance pay and unemployment compensation. Public expenditure share on social benefits decline from 18.1% of GDP, which was the share percentage in 2014 to 15.9% in 2017. Significant changes in social policy is the payment of maternity leave in the amount of 100% of salaries, starting from 2014.

Subsidies. Fiscal adjustment in the reporting period will largely be implemented by reducing total amount of funds for subsidies. The most important measure in this regard is the abolition of subsidies for land area larger than 20 hectares, as well as state-owned land that is leased. The reduction of subsidies for "Serbian Railways" JSC and public broadcasting services has also been envisaged based on the reduction of operational costs. The abolition of subsidies to public broadcasting services has been planned for 2016.

Other current expenditures. This category is represented by different expenditures, such as grants to NGOs, political parties, religious and sports organizations, penalties, damage compensations, etc. In the previous period, the level of this category was around 1% of GDP, but in 2014 the share of these expenditures in GDP increased to 1.6%. The main reason is compensation for damages caused by catastrophic floods. In addition, expenses for conducting the elections had impact on the growth of this item in 2014.

Capital expenditures. Priority area on the expenditure side is represented by capital investments. By reducing the current consumption of the government sector the space is created for maintaining the level of public investments at around 3% of GDP in the upcoming medium term. Bearing in mind the limited resources, investments of national importance will have a special importance in the planning of investments in the medium term (Corridor X and XI). To significantly increase the share of capital expenditure in terms of fiscal adjustment, a stronger and more dynamic economic growth is necessary.

Net lending. This category represents (among others) funds that are given to ensure liquidity and recapitalization of state-owned enterprises and banks. These expenditures have particularly been evident in the period from 2012, when several state-owned banks found themselves in difficulties because of bad credit policy. The assumption of debt of airline company JAT and providing liquidity of PE "Srbijagas" should be added to this. Since new problematic cases are not expected in the banking sector and given that one of the priorities in the upcoming period is the reform of public enterprises, stabilization of these expenditures is expected at 0.1% of GDP.

Activated guarantees. Activated guarantees and payment of guarantees on commercial transactions are debt obligations of public companies which the central budget took upon itself, given that these companies are not able to fulfill them. The largest expenditure on this account are related to "Serbian Railways" JSC, Smederevo steelworks, JAT and Galenika. It should be noted that significant resources on this basis are paid on behalf of PE "Roads of Serbia", but that these expenditures are classified as classical debt repayment considering that the company is part of the general government. Similar to the budget loans, there will also be a reduction of the importance of these expenditures if the problems of inefficient public enterprises are properly solved.

Debt Reduction Program

In accordance with the principle of fiscal responsibility, if the general government debt exceeds 45% of GDP, the government is obliged to propose measures that will bring targeted debt level, i.e. return the debt to a sustainable path. The economic crisis that began in late 2008 resulted in the decline or slowdown in the growth of budget revenues. In terms of the absence or insufficient level of structural measures, there was a constant yearly increase in the level of fiscal deficit. In the period from 2008 to 2013, the general government deficit increased from 2.6% to 5.3% of GDP, whereas the public debt entered into an explosive
growth path, wherein the ratio of debt to GDP doubled. The public debt with around 30% of
GDP at the end of 2008 reached 61.1% of GDP at the end of 2013, increasing debt level by
about 3.4 pp compared to the previous year.

Fiscal consolidation measures adopted in late 2012 and throughout 2013, to a certain
extent impeded this trend, but the level of public debt continued to grow significantly. The
fact that previously adopted fiscal consolidation measures have yielded certain results can be
viewed from the structure of recorded fiscal results. The constant decline in the share of
primary deficit from 2012 speaks in favour of it, but it is not enough to stabilize the share of
the public debt in GDP due to a significant increase of interest expense. The level of public
debt, especially its pace of developments in the past, is not fiscally sustainable in the future. It
is necessary to implement additional steps in the consolidation process in the coming period,
and in conditions of absence or slow growth of economic activity.

The provided measures, previously described in this document, by which cumulative
adjustment on the expenditure side is achieved of around 7% of GDP in the period 2014 -
2017, lead to lowering of the general government deficit to 3.8% of GDP in 2017. At the
same time there is stabilization of the debt at the level of 78.7% of GDP, which still
represents a high level compared to international standards.

The fiscal deficit is not the only factor that affects the level of public debt and,
therefore, it is necessary to implement additional measures through improved management of
public debt:
- Limitation on the issuance of new guarantees, especially the guarantees of public
enterprises for current liquidity and guarantees to local-self government units;
- Limitation of concluding new project loan agreements in cases where previously
approved loans were not efficiently used;
- Repurchase of a part of the more expensive debt using funds from a more favourable
loans and privatization revenues, if there are options to do so.

The program of measures for reducing the fiscal deficit and fiscal framework for the
period 2015 - 2017, by which a drop in consolidated fiscal deficit to 3.8% is expected in
2017, represents a basic scenario and is an integral part of the program for reducing public
debt.

In accordance with the fiscal rules it is necessary to predict the dynamics of lowering
the level of public debt to 45% of GDP. In this program, simulation of lowering the level of
debt to the legally prescribed level, is set to 2030 with the assumptions on which it is based.
Such a long period of adjustment is based on the assumption that the annual adjustment of the
deficit larger than 1 pp GDP is not viable in the long term and in the conditions of slow or
moderate growth, without major consequences for the population and economy in general.
For the same reason, a path of fiscal surpluses has not been predicted, which implies that,
public debt share after a certain period declines only due to the growth of GDP.

The assumptions in the baseline scenario are:
- fiscal adjustment in the period after 2017 is at a slightly lower level than in the period
2014 - 2016;
- decline followed by gradual increase of the share of public revenue of 0.2% of GDP on
average per year due to the increase in collection efficiency;
- achieving fiscal balance in the year 2024 and its maintenance in the period thereafter;
- net increase of guarantees issued on average around zero after 2017;
- real GDP growth of 3% in the long term, implying average growth to an extent greater
than the potential;
- an annual inflation rate of about 4% on average in the observed period;
- average nominal change in the exchange rate of 2% per year in the observed period;
- no significant negative effects on the trend of interest rates;
- no significant inflow on privatization in the period 2018 - 2030.

Table 12. Simulation of the Overall Debt Level in the Baseline Scenario by 2030

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<tbody>
<tr>
<td>Revenues</td>
<td>39.7</td>
<td>40.9</td>
<td>40.3</td>
<td>39.1</td>
<td>38.2</td>
<td>38.2</td>
<td>38.4</td>
<td>38.5</td>
<td>38.7</td>
<td>38.8</td>
<td>39.0</td>
<td>39.1</td>
<td>39.3</td>
<td>39.4</td>
<td>39.6</td>
<td>39.8</td>
<td>39.9</td>
<td>40.1</td>
</tr>
<tr>
<td>Expenditures</td>
<td>45.0</td>
<td>48.9</td>
<td>46.1</td>
<td>43.8</td>
<td>41.9</td>
<td>41.1</td>
<td>40.6</td>
<td>40.2</td>
<td>40.0</td>
<td>39.7</td>
<td>39.4</td>
<td>39.1</td>
<td>39.3</td>
<td>39.4</td>
<td>39.6</td>
<td>39.8</td>
<td>40.0</td>
<td>40.1</td>
</tr>
<tr>
<td>adjustment of expenditures</td>
<td>-3.9</td>
<td>-2.9</td>
<td>-2.3</td>
<td>-1.8</td>
<td>-0.7</td>
<td>-0.4</td>
<td>-0.3</td>
<td>-0.3</td>
<td>-0.3</td>
<td>-0.3</td>
<td>-0.3</td>
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<tr>
<td>Fiscal result</td>
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<td>-7.9</td>
<td>-5.9</td>
<td>-4.7</td>
<td>-3.8</td>
<td>-2.9</td>
<td>-2.2</td>
<td>-1.7</td>
<td>-1.3</td>
<td>-0.9</td>
<td>-0.4</td>
<td>0.0</td>
<td>0.0</td>
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<td>0.0</td>
<td>0.0</td>
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</tr>
<tr>
<td>The public debt in GDP</td>
<td>61.1</td>
<td>69.9</td>
<td>77.7</td>
<td>79.2</td>
<td>78.7</td>
<td>77.3</td>
<td>75.2</td>
<td>72.8</td>
<td>70.0</td>
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<td>64.0</td>
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<td>57.6</td>
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<td>51.8</td>
<td>49.1</td>
<td>46.7</td>
<td>44.4</td>
</tr>
<tr>
<td>The public debt in GDP, without</td>
<td>61.1</td>
<td>69.9</td>
<td>78.7</td>
<td>83.1</td>
<td>86.1</td>
<td>97.4</td>
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<tr>
<td>the application of measures</td>
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</tr>
<tr>
<td>GDP real growth rate, in%</td>
<td>2.6</td>
<td>-2.0</td>
<td>-0.5</td>
<td>1.5</td>
<td>2.0</td>
<td>3.0</td>
<td>3.0</td>
<td>3.0</td>
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</table>

The results of this simulation are clearly showing that even after 2017, it is necessary to take further measures to reduce the fiscal deficit, because otherwise there would be no decline in public debt ratio in GDP. The greatest burden of fiscal adjustment is at the beginning of the observed period with a gradual decline. Total cumulative adjustment from 2015 to 2024 on the expenditure side is about 10 pp or about 1 pp per year on average. Past experience tells us that in the long run this level of consolidation is at the upper limit of possibilities, but doable. A significant contribution to reducing expenditures in the later period, due to a gradual decrease in the level of debt, enables the reduction of interest expenditures, which represents a positive change in the structure of expenditures. Trend of interest expenditures in the period 2014 - 2017 significantly reduces the effects of the savings achieved in other positions, and their reduction, as they represent least productive expenditure form, is a priority. Economic growth acceleration in the future, increase in employment and consumption growth will certainly have an important role in the process of reducing public debt in GDP, which together will have a positive impact on the trend of public revenues.

Graph 11. Comparison of Different Scenarios and the Impact on the Level of Public Debt

Graph 11 shows the simulation of alternative scenarios of public debt, depending on changes in certain assumptions in the baseline scenario. For a better comparison, a variation of a single variable was made as the risk factor that affects the level of debt. In reality, there
are many possible combinations of trends of various factors which have an impact on the public debt.

*Scenario "slow growth"* means the average real GDP growth of about 2% in the observed period with the same level of fiscal deficit, which does not mean the same level of fiscal adjustment (as a GDP share). At the end of the period, public debt reaches the level of 62.9%. The risk assumed by this scenario of prolonged slow growth (which in the current circumstances does not look so modest), lies in the fact that despite the same level of fiscal adjustment on the deficit side, the level of public debt is not falling fast enough. On the other hand, the slow growth itself produces higher levels of fiscal deficit, and the need for greater reduction in expenditure is necessary for already unfavourable trajectory to be kept. There is a risk of entry into a spiral of slow growth due to high deficit and necessity for austerity measures.

*Scenario "no consolidation after 2018."* implies the absence of further measures to reduce the fiscal deficit, while it does not fall below 3.7% of GDP in the observed period. In this case there is no reduction in the level of public debt, despite the previously implemented measures of fiscal adjustment in the period 2015 - 2017. In the case of the combination of this and the previous scenario the level of debt would take on even more unfavorable trajectory.

*Scenario "more guarantees issued"* implies the abandonment of the measure relating to the growth of net issued guarantees. In this case the assumption of an annual net gain has been introduced of about 1%, which maintains the level of net growth of issued guarantees present in the period before 2014. At the end of the observed period, the level of public debt rose by around 10% of GDP than targeted one. It is evident that numerous positive effects can be achieved by better control and the introduction of stricter criteria for the issuance of new guarantees.

*Scenario "without the application of measures"* assumes a different path of debt share also in the period from 2015 to 2017. The initial level of debt in 2015 rose by 1 p.p, and in 2017 is higher by 7.4 pp. This scenario represents the worst variant, which implies the absence of fiscal consolidation measures in the next three years. The trajectory of the debt arising from this scenario is the least favourable, has an explosive path and quickly reaches dramatic proportions. The assumption is that the fiscal deficit is maintained at the level of 2013 of about 5% annually, while others presented scenarios assume full implementation of the measures at least until 2018, so in this way the scale and impact of the absence of fiscal consolidation measures over the next three years is most clearly shown.

The assumptions of the baseline scenario are quite rigorous, involving a significant reduction in the share of public expenditure in GDP, the absence of net guarantees growth and constant and significant GDP growth rates. In spite of that, lowering of the debt share to the legal level is slow and time consuming process. By comparison, if the goal was to reduce the level of debt to 45% of GDP in 2027 (3 years earlier), a stronger fiscal adjustment and achieving a fiscal surplus of around 0.25% of GDP would be needed already from 2022. The following Graph shows the projected fiscal results in two variants of which the basic scenario is in accordance with the program for debt reduction and alternative scenario involves lowering the debt to 45% of GDP in 2027. For this to be achieved much greater fiscal adjustment is required, respectively in 2018 for such a result an additional average adjustment on the deficit side of 0.8% of GDP would be needed in the period 2018 - 2025, amounting to about 54 billion per year, and a total of over 600 billion dinars of cumulative adjustment in that period. For that amount, an increase in revenues would be needed, as well as reduction in expenses or creation of a combination of measures on the revenue and expenditure side. After 2025, it is necessary to maintain a fiscal surplus at the reached level.
4. Cyclically Adjusted Fiscal Balance

The cyclically adjusted fiscal balance is the fiscal balance from which an isolated impact of the economic cycle has been excluded, and the baseline identity is the following:

$$ B = CB + CAB $$

A part of the fiscal balance (B) that automatically adjusts to cyclical fluctuations is called cyclically adjusted fiscal balance (CAB), and the aim of the procedure is the isolation of the cyclical component of the fiscal balance (CB), which is the result of the presence of the output gap. Actual fiscal balance will be equal to the cyclically adjusted one if the output gap is zero, i.e. if the growth rate of real GDP equals the potential one.

For evaluating cyclically adjusted deficit, OECD disaggregated approach was used, involving the evaluation of the elasticity of individual categories of cyclically sensitive revenues and expenditures. Cyclically adjusted balance is calculated by the following formula:
\[ \text{CAB}_t = B_t - \eta \frac{(Y_t - Y^*_t)}{Y^*_t} \]

In the above formula, \( \eta \frac{(Y_t - Y^*_t)}{Y^*_t} \) represents the cyclic part of the balance presented as the product of the coefficient of balance sensitivity in relation to the output gap (\( \eta \)) and the estimated output gap in the reporting year ((\( Y_t - Y^*_t \)) / \( Y^*_t \)). The coefficient of sensitivity of the fiscal balance is equal to the difference between the coefficients of sensitivity of revenues and expenditures \( \eta = \eta_T - \eta_G \).

To evaluate overall sensitivity of public revenues the elasticity of the following categories of revenues are firstly evaluated (revenues whose tax base is considered cyclically sensitive): income tax, corporate income tax, social security contributions and taxes on consumption.

On the expenditure side, in the framework of the OECD methodology, evaluating the elasticity of the unemployment gap is performed, because it is assumed that only that component is cyclically sensitive, or under the influence of the business cycle. Although some other categories of expenditure may be considered to be cyclic (a part of social assistance expenditure), according to the OECD approach they are considered discretionary.

For elasticity evaluation it is necessary to estimate the elasticity of individual tax basis in relation to the output gap, and this is done by using appropriate econometric methods. The next step in determining the coefficients of sensitivity of revenues and expenditures (\( \eta_T \) and \( \eta_G \)), is weighting of the obtained elasticities that take share in primary revenues or expenditures and by summing them up the coefficients of total elasticity are obtained.

By multiplying the obtained elasticities of revenues and expenditures with the share of cyclically sensitive revenues and expenditures in GDP (period average), we get the coefficients of sensitivity of public revenues and expenditures, and revenues have been estimated to amount \( \eta_T = 0.386 \) whereas expenditures \( \eta_G = -0.01 \). The total sensitivity of the fiscal balance obtained as the sum of the sensitivity of revenues and expenditures is \( \eta = 0.386 - (0.01) = 0.387 \).

The results and their interpretation are largely dependent on the length of the series used in elasticity econometric assessment, on the reliability of statistical data, the existence of structural breaks in the series, changes in methodology and coverage. The choice of method for evaluating the output gap has a significant impact on the assessment of the fiscal position. The following table shows the estimated output gap obtained on the basis of Cobb-Douglas production function. By using other methods (Hodrik-Prescott filter, Kalman filter, etc.) qualitatively similar results have been obtained. All methods of assessment in the aftermath of the crisis give lower values of potential growth, so that the values of the negative output gap are relatively lower, and positive output gap is reached at the end of the projection period.

### Table 13. Fiscal Balance and Components for the Calculation of Cyclically Adjusted Balance in the Period 2005 - 2017, in % of GDP

<table>
<thead>
<tr>
<th></th>
<th>output gap</th>
<th>fiscal balance</th>
<th>primary fiscal balance</th>
<th>the cyclical component of the fiscal balance</th>
<th>cyclically adjusted fiscal balance</th>
<th>cyclically adjusted primary fiscal balance</th>
<th>nature of fiscal policy - fiscal impulse</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>-0.7</td>
<td>1.1</td>
<td>2.1</td>
<td>-0.3</td>
<td>1.4</td>
<td>2.3</td>
<td>-</td>
</tr>
<tr>
<td>2006</td>
<td>-1.4</td>
<td>-1.4</td>
<td>-0.1</td>
<td>-0.5</td>
<td>-0.9</td>
<td>0.5</td>
<td>1.9</td>
</tr>
<tr>
<td>2007</td>
<td>1.1</td>
<td>-1.9</td>
<td>-1.3</td>
<td>0.4</td>
<td>-2.3</td>
<td>-1.8</td>
<td>2.2</td>
</tr>
<tr>
<td>2008</td>
<td>1.9</td>
<td>-2.6</td>
<td>-2.1</td>
<td>0.7</td>
<td>-3.4</td>
<td>-2.8</td>
<td>1.0</td>
</tr>
<tr>
<td>2009</td>
<td>-2.7</td>
<td>-4.4</td>
<td>-3.8</td>
<td>-1.0</td>
<td>-3.4</td>
<td>-2.7</td>
<td>0.0</td>
</tr>
<tr>
<td>2010</td>
<td>-2.1</td>
<td>-4.6</td>
<td>-3.5</td>
<td>-0.8</td>
<td>-3.8</td>
<td>-2.7</td>
<td>0.0</td>
</tr>
<tr>
<td>2011</td>
<td>-1.1</td>
<td>-4.8</td>
<td>-3.5</td>
<td>-0.4</td>
<td>-4.4</td>
<td>-3.1</td>
<td>0.4</td>
</tr>
<tr>
<td>Year</td>
<td>2012</td>
<td>2013</td>
<td>2014</td>
<td>2015</td>
<td>2016</td>
<td>2017</td>
<td></td>
</tr>
<tr>
<td>------</td>
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<td>------</td>
<td>------</td>
<td>------</td>
<td>------</td>
<td></td>
</tr>
<tr>
<td>Output gap obtained by using the Cobb-Douglas production function.** For the period from 2014 - 2017 projected values are shown.</td>
<td>Output gap obtained by using the Cobb-Douglas production function.** For the period from 2014 - 2017 projected values are shown.</td>
<td>Output gap obtained by using the Cobb-Douglas production function.** For the period from 2014 - 2017 projected values are shown.</td>
<td>Output gap obtained by using the Cobb-Douglas production function.** For the period from 2014 - 2017 projected values are shown.</td>
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<td>Output gap obtained by using the Cobb-Douglas production function.** For the period from 2014 - 2017 projected values are shown.</td>
<td>Output gap obtained by using the Cobb-Douglas production function.** For the period from 2014 - 2017 projected values are shown.</td>
<td></td>
</tr>
<tr>
<td>2012</td>
<td>-2.2</td>
<td>-7.0</td>
<td>-5.2</td>
<td>-0.8</td>
<td>-6.1</td>
<td>-4.4</td>
<td>1.3</td>
</tr>
<tr>
<td>2013</td>
<td>1.2</td>
<td>-5.3</td>
<td>-3.1</td>
<td>0.5</td>
<td>-5.8</td>
<td>-3.5</td>
<td>-0.8</td>
</tr>
<tr>
<td>2014</td>
<td>-1.1</td>
<td>-7.9</td>
<td>-4.9</td>
<td>-0.4</td>
<td>-7.5</td>
<td>-4.5</td>
<td>1.0</td>
</tr>
<tr>
<td>2015</td>
<td>-2.2</td>
<td>-5.9</td>
<td>-2.5</td>
<td>-0.8</td>
<td>-5.0</td>
<td>-1.6</td>
<td>-2.9</td>
</tr>
<tr>
<td>2016</td>
<td>-1.1</td>
<td>-4.7</td>
<td>-0.9</td>
<td>-0.4</td>
<td>-4.3</td>
<td>-0.5</td>
<td>-1.2</td>
</tr>
<tr>
<td>2017</td>
<td>0.3</td>
<td>-3.8</td>
<td>0.2</td>
<td>0.1</td>
<td>-3.9</td>
<td>0.1</td>
<td>-0.6</td>
</tr>
</tbody>
</table>

The following graph shows the actual fiscal and cyclically adjusted fiscal balance, as well as the output gap in the period 2005 - 2013 with projections for the period 2014 - 2017. Looking at the past few years, the positive effect of the cycle can be noted in 2007, 2008 and 2013, where there is a positive output gap. The effect of the cycle is such that leads to fiscal balance that is lower than it would be if the economy was on the path of potential growth. Conversely, in the period of the biggest crisis from 2009 to 2012, the impact of the cycle is negative, the output gap reaches high negative values, and the actual fiscal balance is higher than the cyclically adjusted. In 2015, due to the projected decline, output gap reaches a high negative value, which is then reduced and in 2017 moves to a positive value. The consequence of the positive effect of the cycle is reflected in the lower value of the real fiscal deficit in relation to cyclically adjusted fiscal deficit in that year.
Significant structural changes can be seen from the cyclically adjusted trends and in particular from cyclically adjusted primary balance. Although the influence of the cycle is not completely off, as well as specific one-off effects to the fiscal balance, however, one can see a certain trend change. Since 2012, there was an apparent stagnation and then in projected period after 2015, there has been decline in the cyclically adjusted primary balance. This primarily means that certain structural changes in the tax and expenditure system began to yield results and that the fiscal consolidation process effectively began to unfold. This primarily refers to measures taken on the revenue side in 2012 and 2013. The full effects of these measures began to be realized not until 2014 when dramatic drop of public revenues share in GDP was slowed down. Development of expenditures for salaries and pensions has largely been limited even before decisions about their reduction, which contributed to the stabilization of the primary balance.

The trend of cyclically adjusted primary balance is used as an indicator of fiscal policy character. The last column of table 13. shows the fiscal impulse, obtained as the difference between cyclically adjusted primary balance in the current year and cyclically adjusted primary balance in the previous year. In addition, a positive (plus) sign in front of the number indicates an expansive character of fiscal policy and a negative (minus) sign indicates a restrictive character of fiscal policy. The chart 14 displays periods of expansive and restrictive fiscal policy, as well as the size of the impulse itself. The fiscal impulse is the relative change in balance, and aims to analyze the effects of fiscal policy on the trend of the output gap. The primary fiscal balance has been taken into account because it excludes interest expenses as a form of unproductive expenditure without any real effect on the trends in the economy. The size of interest expenses in practice has more countercyclical effect due to the effect of crowding out the private sector. The absolute assessment of the character of fiscal policy, at the end of the day, should be sought at the level of cyclically adjusted fiscal balance.

When the output gap is included in the analysis, evaluation of the effects of fiscal policy in terms of its pro-cyclicality or counter-cyclicality can be made. Pro-cyclical policy is characterized by the presence of an expansionary fiscal policy in periods of growth above potential (or restrictive policy in a recession), and the reverse is true for the countercyclical...
one. As a result of pro-cyclical fiscal policy, changes in expenditures follow the trends of nominal GDP, and a cyclically created component of the revenue growth is then used for reducing the tax burden, or in most cases for an increase in expenditures, rather for a decrease in the fiscal deficit.


Countercyclical policy was conducted in the period from 2009 to 2012, during the crisis, given the relatively expansionary fiscal policy in conditions of high negative output gap. Economic logic dictates at first glance such behaviour, whether it is conscious or is due to the structure of the tax system and public expenditures system, i.e. influenced by the effects of the automatic stabilizers. However, as a result of expansionary policy, which has not resulted in an acceleration of growth, when only by measures of fiscal policy the structural reasons cannot be eliminated for the existence of a negative output gap, both actual and cyclically adjusted balance are deepened and public debt is entering a phase of expansion.

In the Graph above, it can be observed that the relatively significant structural adjustments were carried out in 2013 due to changes in tax policy at the end of 2012. The full effects of the measures were not manifested in 2013, but a part of the effects was conveyed into the next period, which gave specific impulse to fiscal policy restrictiveness. In 2014, fiscal consolidation impulse was not interrupted, but it has not been reflected in the presented fiscal balance figures, due to significant sums allocated for the rehabilitation of the financial sector and individual companies in the real sector. In 2015 and 2016 there is a negative output gap to be closed in 2017.

Measures adopted in the previous period, as well as fiscal consolidation measures relating to the period (primarily nominal reduction of pensions and salaries in the public sector), represent structural changes in public finances.

On the other hand, in 2015 projected interests expense and capital expenditures for infrastructure projects are growing. Among other things, during 2015, the process of restructuring social enterprises ends and the disbursement of subsidies to these companies is terminated, while on the other hand, an additional cost appears in the form of severance pay for the employees who lose their jobs. The same applies to the reduction in the number of employees in the public sector. Nevertheless, the combination of measures envisaged by the program of fiscal consolidation in the period 2015 - 2017 should show the greatest structural

* For the period from 2014 - 2017 projected values are shown.
effects in 2015. In 2016 and 2017, the effects of public sector reform, the completion of the restructuring process and the abolition of certain subsidies are starting to produce results in terms of savings on the expenditure side, thus prolonging the effects of fiscal consolidation. Certain effects are expected on the revenue side as well. Looking at the primary balance, fiscal adjustment is more significant, and cyclically adjusted primary balance moves to a surplus.

In the period 2015 - 2017, law envisaged increase in excise tax on tobacco products and petroleum products, as well as a certain degree of increase in the efficiency of revenue collection at central and local level have certain effects on the fiscal adjustment and the contribution to fiscal policy restrictiveness.

The approaching of the actual growth rate to the potential level (closing of output gap) to some extent reduces the need for restrictive fiscal policy. In the context of stabilisation of the public debt, the effects of savings measures in the observed period lead up to its stagnation and a slight decrease, but for a serious reduction in public debt to GDP ratio, continuation of fiscal consolidation is necessary even after 2017. Real GDP growth above the potential one in the longer term would enable the process to be facilitated.

5. Public Debt Management

In line with international practice and the Law on Public Debt ("Off. Gazette of RS", no. 61/05, 107/09 and 78/11), the Ministry of Finance of the Republic of Serbia - Public Debt Administration is preparing Public Debt Management Strategy for the upcoming medium term. Public debt management strategy should be supported, and consistent with, the general government's medium-term macroeconomic framework and an integral part of the fiscal strategy.

Public Debt Management Strategy of the Republic of Serbia defines the following general objectives and principles:
1) It is necessary to ensure financing of the fiscal deficit of the Republic of Serbia, in terms of short-term deficit (liquidity) and long-term deficit, as a part of the policy of maintaining the stability of public finances;
2) It is necessary to define the acceptable level of risk, and it needs to be determined in terms of the targeted debt portfolio structure in terms of currency structure, the structure of interest rates, term structure and debt structure in line with instruments;
3) It is necessary to support the development of the market of government securities that are issued in the domestic and international market so that the developed market could help to reduce the cost of borrowing in the medium and long term, in accordance with high diversification of the portfolio of debt;
4) It is necessary to ensure transparency and predictability of the process of borrowing.

At the end of October 2014 the total public debt of the general government amounted to 2,700.4 billion, or 69.5% of GDP. Out of that amount, the direct debt was 2,341.9 billion dinars whereas indirect liabilities amounted to 303.0 billion dinars, 53.2 billion dinars referred to non-guaranteed debt of local government units and 2.3 billion dinars referred to non-guaranteed debt of "PE Roads of Serbia". Domestic direct liabilities amounted to 961.2 billion dinars, while foreign direct obligations were of 1,380.7 billion dinars. Regarding indirect liabilities, the internal debt was 82.1 billion dinars, and the external one amounted to 220.9 billion dinars. When the total public debt is divided into the internal and external public debt, the amounts were 1,084.1 billion and 1,616.3 billion dinars, respectively.

As of 31 October 2014, the largest part of the public debt of the Republic of Serbia is still denominated in EUR (42.3%). Then the most represented are American dollars with 30.1% and RSD with 22.2%. The rest of the debt is denominated in special drawing rights
4.2% and 1.2% in other currencies. The largest part of the public debt of the Republic of Serbia 76.3% is with a fixed interest rate, while the variable interest rate applies to 23.7% of total public debt. The largest part of public debt at variable interest rates is tied to Euribor and Libor in EUR; 64.1% of the total public debt at variable interest rates is related to this type of debt. 12.9% refers to the liabilities related to the reference interest rate of NBS, 10.3% refers to the liabilities related to the US dollar Libor, while 12.7% applies to other liabilities associated with other types of variable interest rate (mostly a variable interest rate for SDR).

Taking into account the projected primary deficit budget of the Republic of Serbia for the period 2014 - 2017, including the extent of withdrawal of loan funds for projected 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 debt balance of the central government should be at the level of 76.9% of GDP at the end of 2017 and at the level of general government 78.7% of GDP.


<table>
<thead>
<tr>
<th></th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP</td>
<td>3,884.0</td>
<td>3,970.0</td>
<td>4,195.0</td>
<td>4,455.0</td>
</tr>
<tr>
<td>Primary deficit</td>
<td>63.2</td>
<td>35.2</td>
<td>-27.6</td>
<td>-65.0</td>
</tr>
<tr>
<td>Interest</td>
<td>111.8</td>
<td>133.5</td>
<td>155.6</td>
<td>171.0</td>
</tr>
<tr>
<td>Public debt</td>
<td>2,660.2</td>
<td>3,022.0</td>
<td>3,250.9</td>
<td>3,423.8</td>
</tr>
<tr>
<td>The debt of the central government, in % GDP</td>
<td>68.5%</td>
<td>76.1%</td>
<td>77.5%</td>
<td>76.9%</td>
</tr>
<tr>
<td>Non-guaranteed debt of local government-GDP</td>
<td>1.4%</td>
<td>1.6%</td>
<td>1.7%</td>
<td>1.8%</td>
</tr>
<tr>
<td>General government debt, in % of GDP</td>
<td>69.9%</td>
<td>77.7%</td>
<td>79.2%</td>
<td>78.7%</td>
</tr>
</tbody>
</table>

The debt of local government in the future has been projected to remain at the relative level of around 2.5% of GDP. Debt on the basis of commitments that are not included in the stock of public debt under the Maastricht criteria, is expected to be around 7.0% of GDP at the end of 2017, while the public debt of the general government according to this criterion should be at the level of 71.7% of GDP at the end of 2017. The growth of the share of debt which, according to the Maastricht criteria is not included in the public debt from 4.1% of GDP at the end of 2014 to 7.0% of GDP at the end of 2017 was caused by an increase in borrowing of solvent entities, such as PE "Electric Power Serbia", the Agency for deposit insurance and the use of new lines of apex of loans from the European Investment Bank by domestic banks.

In cooperation with experts from the World Bank, Public Debt Administration has prepared an analysis of the costs and risks of alternative strategies of borrowing, using the model of the World Bank (Medium Term Debt Strategy Model - MTDS) aimed at optimizing the portfolio and improving efficiency of public debt management. By using the MTDS model the baseline scenario and three alternative scenarios have been analyzed (four analysed strategies), and shocks on the interest rates and foreign exchange rates have also been taken into consideration (sensitive analysis).

Financial and fiscal risks may lead to the growth of public debt greater than the anticipated baseline scenario. The risks that are present and can lead to the growth of debt and the cost of servicing the public debt are:

1) refinancing risks;
2) foreign exchange risk;
3) market risk (interest rate risk, inflation risk);
4) liquidity risk;
5) credit risks;
6) operational risks;
7) risks associated with the distribution of servicing costs (debt structure, the concentration of liabilities).

Other factors affecting the achievement of Public Debt Management Strategy in addition to the above mentioned risks are macroeconomic indicators - real GDP growth, unemployment levels, the current account of the balance of payments, inflation, the development of the world economy and the main foreign trade partners of Serbia, lower tax and non-tax revenues than the planned ones and higher expenses than the planned ones during the budget year, the higher level of local government debt than the planned one in the medium term and the activation of guarantees.

Graph 15. Effect of Changes in the Exchange Rate of the Dinar Against a Basket of Currencies from the Portfolio of Public Debt to the Change of Public Debt Ratio to GDP - Central Government Level

The graph 15 presents public debt to GDP ratio trends for the central government level, depending on changes in the exchange rate of the dinar against a certain currency basket. Basic set of projections is presented with alternative scenarios depending on the appreciation or depreciation of the exchange rate in the range of 10% of appreciation to 20% of depreciation of the dinar against a basket of currencies. By applying these scenarios, it can be seen that the ratio for 2017 would range from 70.9% of GDP to 88.8% of GDP, while the baseline scenario would be at the level of 76.9% of GDP.

In order to minimize the exposure to variable interest rates, due to the expectation that there will be an increase in variable interest rates with the highest share of public debt - Euribor, contracting new liabilities is made at fixed rates, where possible, especially in the domain of loans earmarked for financing investment projects with lenders such as the European Investment Bank, the German Development Bank - KfW and the EXIM Bank of China. Regarding exposure to Euribor growth, if there is an increase in this rate by one pp, growth in interest expense occurs at the level to 4 billion dinars (about 3% of the planned expenditures for interests).

Bearing in mind the limitations and potential risks related to financial market, debt management strategy in the upcoming medium-term provides funding of the expenses of the Republic of Serbia mainly through the issuance of government securities in the domestic and international financial market. The goal is to have financing done mainly through the
issuance of local currency securities in the domestic financial market. However, the current situation suggests that, despite a solid commitment to the continued development of the domestic market for government securities, one part of the funding will have to be provided in the medium term in the international financial market. The decision of the annual borrowing is made in the framework of the Law on the budget for a fiscal year, and in accordance with the change of the main fiscal aggregates it is possible to change the plan of borrowing during the fiscal year. In the medium term, it is expected a further development of the secondary market for government securities, and one of the incentives for the development of this market segment will be provided by issuing long-term government securities in domestic currency in amounts per issuance, which can be considered as benchmark size issues in terms of international standards.

One of the basic principles on which a new arrangement with the IMF will be based is that the Republic of Serbia in the upcoming period will not give guarantees for new loans of public enterprises, which are used for funding liquidity. In this way, the practice that has been applied in the period 2010 - 2014 is abolished when a large volume of loans for liquidity of "PE Srbijagas", Galenika ad and JAT Airways was covered by guarantees of the Republic of Serbia. In the medium term guarantees will be provided only for loans designated for investment projects and for encouraging further growth and development of the economy and for reaching EU standards in the field of energy efficiency, use of renewable energy sources and environmental protection.

In the medium term, public debt growth on the basis of overtaking commitments from individual institutions of the public sector is not anticipated, nor the state interventions aimed at maintaining financial stability through the issuance of securities, as the practice was in the period 2012-2014.

6. Budget Sensitivity Analysis

Fiscal risks are considered to be circumstances which, if implemented, lead to a more significant drop in revenues or increased expenditures and the factors that otherwise affect the size of the deficit and public debt. The realization of the planned volume of revenues, expenses and fiscal results depend on the success of fiscal policy to minimize the probability of realization of risk. Success in managing fiscal risks depends on political, macroeconomic and social circumstances in the country and in the region. If the implementation and realisation of medium-term macro-fiscal framework is based on a comprehensive program of fiscal consolidation, the risks associated with its implementation, of any kind, represent a significant source of fiscal risk.

Decline in economic activity. The negative scenario that in the next period implies economic contraction or lower growth would lead to a significant reduction in capital inflows, reduction in foreign trade, and on the basis of reduced activity to the narrowing of the current account deficit. In this case there would be a relative decrease of revenues, and consequently a larger deficit, if there would not be an additional adjustment on the expenditure side. According to the estimates of sensitivity of the fiscal balance, any change in the real growth of 1 pp GDP leads to a change in the fiscal result of around 0.4% of GDP. In the event that in the next three years lower rates of real GDP growth are realized (by 1 pp less on average per year) than planned, the cumulative increase in the fiscal deficit would amount to over 50 billion dinars.

Inflation. Inflation is the major determinant of overall macroeconomic stability. Due to the modification of fiscal rules on indexation of salaries and pensions in the coming period, inflation will to a lesser extent influence the trend of the overall level of expenditure than it was the case in the past. As far as the revenue side is concerned, the impact of inflation on
indirect taxes can be beneficial in the short term, but due to the inevitable adjustment of the real level of spending this effect is lost if the level of disposable income is limited. Exchange rate changes have a similar short-term effect. Some revenue items are adjusted annually for inflation (mainly nontax revenues and the level of specific excise rates), so from that side there is a certain risk, but due to the low value of the projected inflation, it is not high. Inflation on the other hand, can indirectly affect the size of the deficit and public debt. In case it goes significantly above targeted levels, during the process of adjustment of relevant interest rates an increase in interest rates on public debt may happen. On the other hand, the consumer price index largely affects the motion of the total GDP deflator, and therefore the level of nominal GDP, as the denominator share of the deficit and public debt to gross domestic product.

**Interests.** In addition to the amount and structure of public debt, factors that have an impact on interest expenditures are exchange rate and interest rates on the international and domestic markets. Given the unpredictable trends of certain variables, it is likely that more funds could be needed for the interest repayments in the future. A significant part of the public debt (and fiscal deficit if activated) are guarantees issued due to public companies financing. In the event that the companies can fulfil their obligations, these guarantees initially increase the level of public debt, but do not require additional funding. If the companies cannot meet their liabilities these guarantees are activated and additional resources are needed both for the repayment of principal and interest.

**The grey economy.** According the program of fiscal consolidation further efforts have been planned in combating tax evasion and the grey economy. If there would be no realization of the expected effects in that field or in case of further deterioration, there may be some shortfalls on the revenue side. The fight against the grey economy in particular must include the reduction in illicit trade in tobacco products, reducing the grey economy in the area of labor and employment and the continuation of good results in the field of trade in petroleum products.

**Public enterprises profit collection.** According revenue projection for the next three years considerable resources have been planned based on payment of profit made by public enterprises. On average it has been planned from 0.3% to 0.5% of GDP on this basis in the next three years. A significant source of fiscal risk lies in the potential problems that may arise in business operations of public companies, their reorganization process, solving structural problems in business activities, such as excess labor and economic sustainability of the prices of services and products.

**The unspent funds (deposits) from previous periods.** In the previous period, significant unspent funds were formed at some levels of government which are mainly transferred in approximate amounts to the next budget period, and thus not leading to distortions of the fiscal result. If, however, a decline in liquidity and shortfall in collection of current revenues occurred, accelerated spending of these funds and an increase in the fiscal deficit would be caused. Although a part of fiscal deficit generated in this way does not affect the level of public debt at the time of its creation, it has the negative impact on the level of liquidity in the future and creates to some extent a misleading picture of the state of public finances.

**Project loans.** Project loans are a key source of financing major infrastructure projects. These loans funding are included in the calculation of the fiscal result as capital expenditures to the greatest extent. Although faster withdrawal of these funds is not adverse from the standpoint of economic activity flows and can be the basis for more dynamic development in the future, it increases the expenditure side of the budget, fiscal deficit and public debt. Assessment and analysis of costs, dynamics and scope of the withdrawal of funds in the past are key factors for the assessment of justification of individual project loans planning.
Alternative Scenario of Fiscal Developments in the Period from 2015 to 2017

The following graph shows deficit share and public debt trend in GDP in accordance with the alternative macroeconomic scenario, which implies a growth rate of -3%, 0.5% and 1% in the next three years.

Graph 16. Comparison of Public Debt and Fiscal Deficit in Baseline and Alternative Scenario, in % of GDP

The basic assumption in the preparation of the fiscal scenario is that the sensitivity of the fiscal balance in relation to the growth rate is 0.4 in each year. Due to the unfavorable macroeconomic environment, one of the assumptions of alternative scenarios is an increase of the amount of activated guarantees in the amount of 0.5%, 0.25% and 0.25% of GDP over the next three years, respectively.

The growth of public debt is a consequence of the effects that the macro-fiscal scenario has on fiscal result and also direct effects on the amount of nominal GDP in each year. In the case of this or similar scenarios, or the realization of other downside risks to the achievement of the planned fiscal result, additional measures will be taken in the context of fiscal consolidation on the revenue and expenditure side.

IV. STRUCTURAL REFORMS IN THE PERIOD FROM 2015 TO 2017

Credible medium-term plan of structural reforms, together with measures of fiscal consolidation, is a key condition for (1) achieving stabilization of public finances and reducing the fiscal deficit and public debt to a sustainable level, (2) a stronger launch of economic activity based on an increase in investments, exports and employment. With the help of these measures, planned fiscal and structural adjustment will be implemented creating
a more permanent basis for more rapid economic growth, an increase in employment and advancement of standards.

1. Obstacles to Economic Growth and Structural Reforms Plan

In times of economic crisis the structural weaknesses of the Serbian economy came to the fore, as well as internal and external macroeconomic imbalances. The medium-term plan of structural reforms, together with measures of fiscal consolidation, is a key condition for starting economic growth based primarily on increasing investments, exports and employment. The greatest structural obstacles to economic growth are:
- excessive influence of the state and under-developed private sector;
- administrative barriers and regulatory constraints to business;
- low levels of investment and productivity;
- the lack of competition in some sectors of the economy;
- underdeveloped infrastructure;
- a large share of the informal economy.

In order to remove obstacles to economic growth, the economic policy of the Republic of Serbia will be devoted to, among other things, the implementation of structural reforms, in the medium term, which will be aimed at their complete elimination.

Implementation of reforms in the public sector aims to reduce the role of the state sector in the economy and increase its effectiveness in achieving the general interests of society. This provides greater fiscal adjustment, primarily on the expenditure side, through lower deficits and reducing the need for borrowing. Particular importance is given to the reduction in the number of companies under state control, reduction in the scope of consumer state-controlled prices, reduction in state aid, as well as reduction in costs of all parts of the public sector.

A key role in strengthening the private sector is played by the improvement of the business and investment climate so that the costs and risks of doing business and investing in Serbia could be reduced, completion of the process of restructuring state-owned enterprises, acceleration of the establishment of new private enterprises and more efficient implementation of bankruptcy process. Also, better protection of competition is necessary, encouragement of faster development of small and medium sized enterprises and entrepreneurship and continuation of elimination of inflexible labor market conditions.

Administrative and regulatory barriers at national and local level impose unnecessary costs for doing business and reduce legal certainty. Therefore, it is necessary to continue the "regulatory guillotine", simplifying administrative procedures, improving financial discipline, facilitating the exit from the market, simplifying and shortening the procedures for obtaining building permits, land expropriation acceleration as obstacle in the implementation of infrastructure projects.

Increasing competition means that monopolies are adequately regulated and the capacity of the Commission for protection of competition is strengthened and state subsidies to various sectors are reduced. Competition strengthening involves the gradual liberalization of regulated prices, the reduction in state aid in the form of subsidies, tax incentives, favourable loans, guarantees and transition to horizontal forms of government assistance.

Both the state and problems in the field of transport, energy, telecommunications and information technology are limiting faster economic growth. The removal of these barriers requires significant resources for building infrastructure and rolling stock in the field of transport, infrastructure and capacity in the field of energy, particularly renewable energy and infrastructure for all kinds of electronic services. Given the high level of public debt and a large number of projects applying for public funding, it will be necessary to improve the
methodology for the evaluation and selection of priority projects and consider various alternative (non-credit) ways of financing the implementation of certain infrastructure projects.

Given the high share of the grey economy in the Republic of Serbia, it is necessary to continue the systematic fight against the grey economy, through the improvement of tax administration and tax fraud detection, reduction in the number of tax procedures and their simplification, better control of taxpayers, more efficient control and collection of taxes, cross control of assets and income, better work of inspection services.

2. The Main Areas of Structural Reforms

With the aim of strengthening the private sector, the improvement of the business and investment climate will be provided so that the costs and risks of doing business and investing in Serbia could be reduced, as well as the completion of the process of restructuring state-owned enterprises. Better protection of competition will also be provided as well as the encouragement of faster development of small and medium-sized enterprises and entrepreneurship and the elimination of inflexible labor market conditions and more efficient implementation of bankruptcy process. Special attention will be paid to structural reforms that encourage the strengthening of the capacity of the economy for increasing production and efficiency, export and employment, which will result in improving the competitiveness of the economy.

2.1. Structural Reforms that Improve the Business Environment

A comprehensive program for supporting investments, job openings and private sector development will be developed so that the competitiveness and business environment of the Republic of Serbia could be improved. The program will ensure that the policies supporting the growth are well coordinated and targeted. Specific actions will focus on the following areas:

- The Ministry of Economy will in the future carry out activities in support of the implementation of the Strategy for small and medium-sized enterprises and entrepreneurs for the period from 2015 to 2020 and the reforms envisaged in the framework of the six pillars of the Strategy: (1) Improving the business environment, (2) Improving access to funding sources, (3) Continued development of human resources, (4) Strengthening the sustainability and competitiveness of small and medium-sized enterprises and entrepreneurship (5) Improving access to new markets and (6) Development and promotion of entrepreneurial spirit and encouraging entrepreneurship of women, the young and social entrepreneurship.

An action plan for improving the business environment for small and medium-sized enterprises will be implemented based on the Strategy;

- A new investment law will be adopted that will replace and expand the scope of the Law on foreign investments by inclusion of domestic investments. The law will regulate the business of the Board for quick responses within the Ministry of Economy in order to facilitate effective coordination of issuing permits necessary for investments, with the aim of further improving the business environment, the efficiency of public authority holders in the treatment process and elimination of obstacles to the successful implementation of the investments;

- With the aim of encouraging investments, a framework that regulates the conversion of land use into proprietary rights will be adopted;
- Plans for investments promotion program rationalization will be developed, in particular the Development fund and agencies that deliver programs of investment incentives and export’s financing (Agency for export insurance and financing - AOIFI and the Agency for foreign investments and export promotion of the Republic of Serbia - SIEPA);
- Efforts will be put into strengthening the innovation capacity through improving the work of the Innovation fund and the reform of research institutions funding;
- Financial discipline promotion will be continued, which is a prerequisite for the effective suppression of the grey economy. In this regard, measures will be activated by the government at all levels for the settlement of arrears;
- Continuation of tax reform improvement of tax legislation will be ensured that will have the greatest effects on increasing investments, export and employment;
- Tax Administration capacity improvement will be continued, with the aim of getting prepared for connecting with the European information systems within the EU accession process;
- The regulations guillotine process will be intensified based on a precise action plan that will be adopted.

Reform of the Construction Permits Issuance System

With the entry into force of the Law on Amendments to the Law on planning and construction, conditions were created for a different arrangement of space, primarily through faster and more transparent preparation of spatial and urban planning. The amendments to the Act prescribe the introduction of a unified procedure for issuing construction permits. It is estimated that this will lead to a significant increase in the number of issued construction permits in the future.

Based on the report of the World Bank "Doing Business Report 2015" the Republic of Serbia has taken 186th place out of 189 places in terms of the length of waiting for a construction permit. Amendments to the Law on Planning and Construction should improve the position of the Republic of Serbia on this basis by minimum of 70 places, based on what a higher inflow of foreign investments can be expected.

The amendments to the Act and the introduction of a unified procedure in the construction permit process have created the opportunity for obtaining all necessary documentation in one place, in a transparent manner and in a short time. The Republic Geodetic Authority has been included in the process of unified procedure for the issuance of a construction permit, which will lead to shortening of the scheduled time for registration of property rights on buildings construction from average 45 to 20 days. Application of the unified procedure will lead to a fall in properties prices, particularly in the area of residential properties.

Transport Infrastructure Improvement

Investments in transport infrastructure by different modes of transport and priorities have been defined in the document Transport Master Plan for the period until 2027, which was developed in cooperation with the EU. The main objective is to improve the quality of network, so that the transport network of the Republic of Serbia could be integrated into the trans-European transport network.

Efforts will be made into the development of logistics centers, regional and local character in multimodal corridors 10 and 7 in large economic regional hubs and their gravitational zones with the aim of developing transport infrastructure. The project of building the first logistics center in Belgrade has been launched, in the center of which
intermodal terminal is located, which will allow the reduction of logistics costs share in the product price.

Activities are ongoing on amending the two systemic valid laws: the Law on Railways and the Law on Safety and Interoperability of the Railways. Amendments to the Law on Railways will contribute to improving the efficiency of the railway system of the Republic of Serbia, its integration into the market of transport services, as well as the integration of Serbian railways in the EU railway system. By aligning with the Directive 2012/34 / EC of the European Parliament and with the Council establishing a single European railway area, conditions have been improved for the emergence of multiple rail carriers and control of the railway infrastructure, which will lead to the development of competition and increase the quality of transport. Amendments to the Law on Safety and Interoperability of the Railways are expected to increase the safety of all participants in railway traffic. In 2015, the adoption of the Law on Ski Lifts is envisaged and the Law on Transport Agreements in Railway Traffic. The adoption of the law on ski lifts for the first time enables determining the responsibility of legal entities and individuals in the field of ski lifts, opening markets related to the construction and performance of ski lift public transport services through concessions. By the law on transport agreements in railway traffic, conditions for the development of competitiveness of the transport market will be provided. The basic objective of this law is to increase the overall efficiency of transport and the introduction of the principle of free access, which implies the same conditions for all users and operators.

By adopting the Strategy of development of water transport of the Republic of Serbia from 2015 until 2025 and amendments to the Law on navigation and inland waters, conditions will be created for significant investments in the sector of water transport in the next 5 years. The Strategy for Development of Air Transport of the Republic of Serbia from 2015 until 2025 and Airspace Management Master Plan are planned to be developed. Conditions will be created for the strategic partnership in the construction of airport infrastructure as well as for the expansion of airspace control services. The following is expected: the market expansion, a better offer of competitive environment, a favorable environment for the development of other airlines, as well as the development of other services in the field of air transport.

2.2. Financial Stability

The amendments to the legal provisions related to the solving the issue of troubled banks will enable quicker intervention in case of deterioration of bank solvency and will enable the use of instruments such as bail-in, or conversion of obligations to the unsecured creditors, which will reduce the costs of the restructuring of vulnerable systemically important banks, if necessary. These changes are in line with the EU - Bank Resolution and Recovery Directive.

Activities on the privatization of the state and social capital in financial institutions (banks and insurance companies) will continue to ensure better corporate governance and sustainable business.

Improving the legal framework concerning the valuation of collateral, primarily real estate and Mortgage Law, which will provide a more realistic estimate of the value of assets and capital of banks as well as faster realization of collateral. These changes should result in the reduction or elimination of the use of public funds for the maintenance of financial stability.

After already implemented activities to stabilize the operation of the Agency for Deposit Insurance, as one of the most important factors of maintaining and improving the stability of the financial system, the amendments to the regulatory framework of the deposit
insurance system are in procedure. The main goal of these changes is to improve the organization and efficiency of the Agency, in order to more efficiently implement bankruptcy and liquidation proceedings of banks and insurance companies.

The Law on Bankruptcy has been improved, which improved the process of settlement of creditors, including banks, through the process of reorganization or bankruptcy of the debtor. This is expected to increase the collection of non-performing loans, and thus improve performance of banks.

In cooperation with other state institutions, the barriers to solving the problem of non-performing loans shall be determined and corrected if they exist. This should enable a more rapid process of resolving non-performing loans through the sale of such loans, or specialized investors through the process of restructuring loans, whether within the voluntary reorganization or extrajudicial financial restructuring.

NBS has planned or has already started several actions aimed at stabilizing the financial system, most important of which is improving the framework for defining systemically important banks. Other options for quickly resolving the status of non-performing loans are considered.

NBS plans numerous activities aimed at stabilizing the financial system. In the course of 2015, the assessment of the quality of banking sector assets (AQR), will be conducted, which will contribute to a better quality assessment of the financial position of that sector. Creating a database of mortgaged real estate taken as collateral for loans is also a significant project implemented by the NBS. The development of this database will allow a better assessment of the value of the collateral at the banking sector level, as well as better monitoring of real estate prices, which represent one of the indicators for the assessment of systemic risk. In addition, the NBS will develop a new methodology for identifying systemically important banks which will be based on the principles of the Basel Committee and the European banking body, at the same time taking into account the national specificities. Moreover, the NBS will develop the methodology for determining the rate of the protective layer of capital for systemically important banks, which should contribute to further strengthening the stability of the financial system.

2.3. Structural Reforms which Improve Labor Market

By amendments to the Labour Law a reform of labor legislation is continued by providing working conditions that correspond to the EU standards. In order to complete the harmonization of the Labour Law with EU directives and deepen the reforms in the labor market the legal framework will be provided for increasing employment, by improving the existing and introducing new flexible forms of work, by establishing the legal basis for the work through temporary employment agencies (leasing of the workforce), and institutionalization of these employers, and in accordance with the International labour organization conventions governing this area. The improvement of the legislative framework regulating collective labor relations and social dialogue at all levels is also envisaged.

In line with the overall aim of employment policy until 2020, established National Employment Strategy for the period 2011 - 2020, the implementation of activities will continue aimed at establishing an efficient, stable and sustainable trend of employment growth by 2020. In this regard, efforts will be made to improve the existing legal framework of employment policy, better implementation of the existing and introduction of new measures of active employment policy, encouraging employment in the less developed regions with the development of regional and local employment policies, improving the quality of human capital, the development of institutional capacity and reduction of duality in the labor market.
The implementation of the following activities are planned in the coming period:

- In order to improve the legislative framework and the harmonization of regulations in the area of employment with the EU regulations, the Law on Employment of Foreigners has been adopted, and the next step is its implementation. In the next period, it is planned to adopt amendments to the Law on Employment and Unemployment Insurance in order to improve its implementation in practice, as well as the creation of a legislative framework for regulating the area of social entrepreneurship in accordance with the best practices of the EU, as a mechanism for social-working inclusion of less employable persons;
- Revision of the National Employment Strategy for the period 2011 - 2020;
- Adoption and beginning of the implementation of the of Employment and social policy reforms programme;
- Improvement of the existing active employment policy measures, depending on the situation on the labor market and the results of the analysis of the impact of the measures, as well as increasing the coverage of the unemployed by active employment policy measures, with special emphasis on the category of less employable people;
- Improving the process of vocational rehabilitation and employment of persons with disabilities and the preservation and expansion of the existing network of enterprises for vocational rehabilitation and employment of persons with disabilities, as special work and social activation resources and integration in the labor market;
- Implementation of process of rationalization of the number of employees and reorganization of the National Employment Service.

2.4. Structural Reform of the Public Sector

In order to establish long-term sustainability of public finances the implementation of structural reforms of the public sector will accelerate, which are primarily related to: the reform of social services, the reform of public administration, the reform of enterprises in the restructuring, and of public enterprises and public corporations, the reform of public financial management, pension reform, the reform of the education system, the reform of the health care system and ensuring financial stability.

Social Care System Reform

The improvement of the social care system will continue in the following period in accordance with the laws of this area. To this end, the activities on Amendments to the Law on Social Protection, Family Law and Amendments to the Law on financial support to families with children have begun.

It is planned to better target the beneficiaries from these areas and to reallocate financial benefits more efficiently for the users of welfare. Planned activities include reducing administrative barriers to achieve these rights, as well as a reduction in malpractice actions regarding their exercise.

One of the long-term goals of the social care system is to continue the deinstitutionalization process which involves two parallel streams:
- continuing the transformation process of the institutions for accommodation of beneficiaries;
- development of community services which need to respond to the needs of the user.

Improving the availability, scope and quality of social care services will be achieved by:
- establishment or development of these services in local communities;
- reaching the prescribed standards through the process of licensing the professional workers and the social services providers;
- strengthening inspection services at national level and the development of control and regulatory mechanisms, monitoring and evaluation.

Improving services in the social care system will be achieved by planned regulation of the normative framework in the area of earmarked transfers by issuing a Decree on earmarked transfers. The earmarked transfers are aimed at the development of social services in the less developed and undeveloped municipalities.

Public Administration Reform

During the period of the implementation of the Public Administration Reform Strategy (2004 to 2013) the main objective related to the provision of a legal framework necessary for the operation of state administration and local self-government was largely achieved. In this sense the impending reform activities will primarily focus on the implementation of laws and other regulations and policies, with the further harmonization of the existing legislation with EU regulations.

With the Public Administration Reform Strategy, adopted in early 2014, the reform processes was extended to the entire public administration, which includes additional state bodies that perform administrative tasks and are the holders of public authority. The overall objective of the reform is to continue the improvement of public administration in accordance with the principles of the so-called European administrative space, i.e. the provision of high quality services to citizens and businesses.

Specific objectives of the Public Administration Reform Strategy, which was adopted in early 2014, refer to:
- improving the organizational and functional subsystems of public administration;
- the establishment of a harmonized public civil service system based on merit and promotion of human resources management;
- improvement of public financial management and procurement procedures;
- increasing legal safety and improvement of business environment and the quality of public services;
- strengthening transparency, ethics and accountability in the performance of public administration.

Reforms in Restructuring Companies, Public Companies and Public Corporations

In order to minimize fiscal risks in the following period comprehensive reforms of the socially-owned companies and public companies will be conducted. Priority is a significant reduction in state aid to these companies by:
- reduction of direct or indirect subsidies;
- restrictions on issuance of new guarantees;
- enhanced accountability, transparency and monitoring of operations of these companies.

It is necessary to implement the strategies of the two broad categories of state-owned companies:
- companies in the portfolio of the Privatization Agency;
- other large state-owned companies, including companies in the areas of electricity, gas, railways and roads.

The solution for companies that are in the portfolio of the Privatization Agency should be provided through privatization or liquidation, in accordance with the recently adopted Law
on Privatization. Collecting letters of interest for these companies began in August 2014 for which modalities will be found to be applied in the future. Bankruptcy proceedings will be initiated for companies with weak prospects for privatization, and appropriate social programs for employees will be provided.

One way to solve the problem is to find a strategic partner for the state-owned and public companies, and a solution will be found for specific projects through the issuance of concessions, with the aim of primarily using the generated revenues to reduce public debt, and efforts will be made, in accordance with the IMF, to contract financially viable investment projects that provide high yields.

To support the work of the telecommunications sector on strict market principles a tender for the privatization of Telekom Serbia will be launched during 2015.

The state aid—including budget subsidies, government guarantees, lending from the budget or any other forms of public support—to Zelezara Smederevo, a steel producer, will be eliminated and accumulation of arrears by this company will be prevented.

Eliminating state aid to Zelezara Smederevo and preventing accumulation of arrears by this company can be implemented by either (i) signing a Strategic Partnership Investment Agreement with a private investor for Zelezara Smederevo, or (ii) adopting a Government Decision to resolve Zelezara Smederevo in a way that eliminates state aid to this company and prevents accumulation of arrears. At the same time, the possibility of long-term partnerships for certain companies based on the model of concessions will be further investigated.

During 2015, the restructuring of large state-owned enterprises will be performed in cooperation with international financial institutions, in particular: PE "Electric Power Industry of Serbia", "Serbian Railways" JSC, PE "Srbijagas" and PE "Roads of Serbia".

1) PE "Electric Power Industry of Serbia". It is necessary to adopt and implement a corporate restructuring plan that focuses on streamlining the organizational structure and management and rationalization of the number of employees in order to avoid the need for state aid in the future. Financial restructuring plan will, among other things, contain measures aimed at improving the collection of receivables. After the restructuring process a minority private partner will be found which could further improve the sustainability of the company and provide professional management. The restructuring process will be prepared in cooperation with the World Bank and the European Bank for Reconstruction and Development (hereinafter: EBRD). Implementation of these plans will be continued in the period from 2016 to 2017.

2) PE "Srbijagas". It is necessary to restructure PE "Srbijagas" organizationally and financially. Plans for the restructuring PE "Srbijagas" include the sale of property that is not used to perform basic activities and adopting a framework for organizational restructuring by the end of December 2014. In the area of financial restructuring, which will be conducted with the support of the World Bank, the emphasis will be on improving the collection, the introduction of taxes on gas transit and solving problems with the companies that are the main source of arrears, including companies such as: HIP Azotara Fertilizer Co, HIP Petrohemija, MSK Kikinda and Železara Smederevo d.o.o. The plan will be adopted by the end of September 2015. The aim of these measures is to stop further deterioration of the financial position of PE "Srbijagas" and eliminating the need for additional state aid in line with the fiscal program.

3) "Serbian Railways" JSC. The plan of corporate and financial reorganization, which will be implemented in the future, implies organizational and statutory changes. The company will be divided, in accordance with experiences from other EU countries, to the companies in the field of passenger transport, cargo transport, a company that will deal with the infrastructure and the holding company. The changes will be accompanied by the
reorganization of management. The restructuring plan will include changes in the disposition of property, transport networks and the rationalization of the number of employees. The sector of freight traffic will not receive subsidies from the budget and will operate according to market principles starting January 2018, in accordance with the recommendations of the World Bank. Fees for the use of railway infrastructure will be introduced, as the part of the opening of the market for rail transport. The reorganization and improvement of the business plans of the remaining state-owned passenger and infrastructure companies will also be continued with the aim of strictly limiting state aid in the medium term. The whole process will work closely with the World Bank, EBRD and EU in determining optimal plans for corporate and financial restructuring.

4) PE "Roads of Serbia". It is expected that the merger of PE "Roads of Serbia" with the company "Serbian Corridors" d.o.o. will be completed by the end of March 2015, in order to leave the construction and maintenance of roads in the Republic of Serbia the responsibility of one company. The efficiency is expected to improve due to the consolidation of operations. Toll amounts will also be considered, and improving road maintenance contracts will be worked on. The goal is to save money and increase the efficiency of the system and thus reduce the need for subsidies from the budget. The options for the construction and maintenance of roads through concessions will be taken into consideration. Corporate and financial restructuring plans will be developed in collaboration with the World Bank.

Public Finance Management System Reform

The amendments to the Budget System Law will have particular importance within the public finance management system, which will improve the control system regulating the number of employees and the amount of wages in the public sector. Establishment of a central registry of employees in the public sector is in its final stage. The register includes all direct and indirect Republic of Serbia budget beneficiaries, local government, mandatory social insurance organizations, public agencies and other entities that are controlled by the state, as well as all public companies at national and local level. On the basis of the actual number of employees from the Registry and conducted analysis, the required number and structure of employees for each area of the public sector will be determined and ways of hiring and promotion system will be defined.

In 2015, the reform of salaries policy and other incomes of the employees in the public sector (state administration, autonomous provinces, local self-government units, public agencies, public services, mandatory social insurance organisations - excluding public enterprises) will be worked on, through the introduction of common salary grades, coefficients and ways of promotion and remuneration of employees.

The process of introduction of program budgeting was launched on the basis of established methodology. In the following period, the operations to further improve the budget process will intensify.

With the aim of improving the tax system and better tax collection and other duties, an enormous progress has been made in the process of transition to electronic filing of tax returns, the introduction of a single tax return for employees, as well as the single account for payment of fiscal duties paid on the income of employed persons. In parallel, activities will be focused on strengthening tax administration in order to continue its modernization and increased efficiency.

Improving the public financial management system will be achieved by improving the quality and credibility of strategic documents defining the Government’s economic and fiscal policy. This includes the introduction, development and implementation of new
methodological approaches and operational tools for analysis and projections of key macroeconomic and fiscal aggregates, as well as simulation of certain economic policies and their short-term and long-term effects. In this sense, in the following period the capacities of Sector for macroeconomic and fiscal analyses and projections will be strengthened, both in terms of increasing the number of employees and through their professional training, in order to best respond to the demands of the international environment, the conclusion of the arrangement with the IMF but also to the demands that EC set in the process of EU accession negotiations.

In order to better control budget spendings in the following period, special attention will be paid to the efficient management and control of public spending. Further strengthening of internal financial control in the public sector, i.e. the introduction of financial management and control and internal audit of the users of public funds on the central and local levels, as well as the functional improvement of the work of budget inspection are two key reform priorities in the area of public finance management.

In the following period, the process of strengthening fiscal responsibility of local governments will continue, with the aim to increase the fiscal capacity of local governments, ensure better collection of revenues, higher service quality, greater efficiency of local utilities, restrict employment and efficient spending of funds and thus reduce the need for transfers from the budget of the Republic of Serbia.

Pension System Reform

During 2014, the Law on Pension and Disability Insurance has been amended, including the following: (1) increasing the legal age of retirement for women from 60 to 65 years until 2032 (6 months per year until 2020, 2 months per year thereafter); (2) increase the minimum retirement age from 58 to 60 years by 2023, and (3) the introduction of a penalty of 4% per annum for early retirement. For the period from 2015 to 2017 the following activities are planned:

- Continued reform of the right to insurance service at an accelerated rate (the so-called accelerated pension plan). Persons working in particularly difficult and hazardous jobs or jobs that cannot be performed satisfactorily at an older age, are entitled to the insurance period at an accelerated rate (i.e. accelerated pension plan), and on that basis have the right to favorable conditions for retirement. The rights to these benefits is regulated by the Law on Pension and Disability Insurance and other regulations. For these persons an additional contribution shall be paid. The area of accelerated pensions will be reexamined, so that this issue is regulated in a unique way (one possible option is to enact a special law), with improved criteria for entitlement to benefits, and the amount of contributions and the conditions for retirement of these categories of the insured adequately and fairly assessed. The proposal is to conduct analysis of the area and prepare a proposal for amending regulations.

- Analysis of pension and disability insurance of farmers with proposed measures in order to truthfully cover farmers according to their economic status (cadastral income, etc.). The area of pension and disability insurance of farmers has already been faced with major problems (small number of insurers in relation to the number of pensioners, low collection rate, financing mainly from the state budget, low amounts of pensions, etc.). On the other hand, with this type of pension insurance, the risk of poverty among the elderly rural population is significantly reduced, and it is usually more exposed to this risk. The options for the future of this system will be examined, in order to assess its viability and in accordance with the result of the study, a proposal for amending the regulations will be drawn.
Education System Reform

The structure of expenditures for education in the Republic of Serbia is inadequate (around 80% are employees' salaries), although the total allocations for education are not small, so there is considerable scope for improving the results (coverage and quality). In accordance with the adopted strategic documents and economic situation, it is certain that the allocations for education will be aligned with the reality of budget options. The reform of the education system in the Republic of Serbia in the following period will focus on:

- The savings in expenditures, through rationalization of school network which is obsolete and does not fit existing needs, and in compliance with Strategy of Development of Education in Serbia by 2020. Consequently, the number of classes and number of teaching and non-teaching staff will be in line with the rate of student enrollment in compliance with the expert instruction for forming classes in primary and secondary schools. The actual savings will be used for increasing allocations for pre-university education, in order to improve working conditions of employees in this section of the system;

- Raising competence through the adjustment of teaching curricula with the requirements of the modern labor market. The special significance for active participation in the labor market has improvement of the quality of secondary and university public and private education, as well as synchronization of the demand for qualified workforce with the supply. In this regard, the role of government will be to encourage systematic improvement of the quality of curricula and teachers in the public school system and to significantly strengthen preventive regulatory function in private education.

Other activities that enhance the quality of the education system - the development of information systems, the introduction of half-day preschool program for a period of one school year for all children between three and five and a half years, the unique system of rewards for high school students, training teachers to use new methods and information technology, the introduction of courses, prevention of early school drop outs and others.

Health Care System Reform

In accordance with the adopted strategic documents and systematic laws in the field of health care, the reforms will continue ensuring the increase of efficiency of the health system, increasing the financial sustainability of health care, improving health of the population and increasing the quality of health care. These goals can be achieved by redirecting from curative to preventive medicine and improving the system of accreditation and certification of health care institutions, with the establishment of the system of mandatory certification of minimum standards (e.g. patient safety).

As part of fiscal consolidation rationalization of the health system will be conducted primarily through the reduction of non-medical staff, rationalization of the number of hospital beds, improving mechanisms for the selection of priorities in terms of procurement of new equipment and better control of expenses for medical services. This will increase the efficiency of health care institutions, provide evaluation of their actual effects and increase the quality of health care. Significant savings on this basis are expected and reduction of corruption in the health sector.

The planned structural reforms in health care, in the period from 2015 to 2017 are:

- Improving laws and by legal acts as planned to reform the health system of the Republic of Serbia by adoption of a strategic document - the Development Plan which defines the policies of health care and health insurance.
- Improving the quality of health care for sustainable health system - strengthening primary or secondary and tertiary health care with an emphasis on the introduction of new, highly developed medical technology in order to meet the EU standards. Also, it is necessary to improve the existing and create new centers for the treatment of patients with malignant diseases which are increasing in the world and in our country.

- Improving health care financing through the introduction of a system for the establishment of the National Health Accounts (hereinafter: NHA) - which provides reliable information about the financial resources allocated to health care and their use for each individual. NHA is the instrument for clear monitoring of the money flow through the health system of the country, increasing the efficiency of health services and equitable distribution of available resources in the health system of the Republic of Serbia.

- Computerization of the health system, which consists of linking 335 health institutions into a single information system regardless of the health care level.

- Improving personnel base from the Plan network of health care institutions and establishment of a base for private practice.

- Defining the role of the private sector in providing health services to the population.

V. REALISATION OF ECONOMIC POLICY GUIDELINES

In 2014, reforms that aim to reduce risks and costs have been conducted, in order to create a business environment that will foster increased employment and investments. The reforms are implemented in accordance with the recommendations of the Ministerial dialogue between the Ministers of Economy and Finance of EU member states and candidate countries. Specifically, in accordance with the evaluation of Ministers, the Republic of Serbia was invited to: strengthen the fiscal consolidation and reform the pension system and public administration; continue to strengthen public financial management; work to resolve the problematic loans; establish anti-inflation credibility; adopt the necessary legislation, stated in the Pre-Accession Economic Programme for 2014, and to complete the restructuring of state-owned companies; improve the business environment and support the development of the private sector and facilitate the process of issuing building permits; increase the flexibility of the labor market and reduce rigidities through increasing duration of employment under the contract, limiting severance payments only on the number of years of employment with the current employer in the case of layoffs, as well as to simplify accounting procedures for payroll and benefits.

Fiscal consolidation measures on the expenditure side were adopted in 2014. Estimated fiscal adjustment mostly relates to the reduction of expenditures for public sector employees, reducing pensions, subsidies and other forms of direct and indirect forms of assistance to state and public enterprises. Also, Law on Amendments to the Law on Pension and Disability Insurance envisages a gradual increase in the age of retirement for women. In accordance with the provisions of consolidation earlier decision on the prohibition of employment in the public sector is extended, the subsidies for land exceeding 20 ha are abolished, and it is planned to introduce a uniform system of pay grades in the public sector. In order to improve the management of public finances the Central Register of employees in the public sector was introduced, and the Budget Law for 2015 was introduced in the process of program budgeting.

Amendments to the Labor Law continued the reform of labor legislation, providing working conditions that correspond to EU standards. The law was adopted in order to increase the flexibility of the labor market in the Republic of Serbia and to simplify the procedures of hiring and firing workers. Amendments to the law have allowed changes in the ways of calculating severance pay due to termination of employment on the grounds of
redundancy, in which only the time spent in employment with the employer is taken into account when the employee is entitled to severance pay. In addition, the conditions for extended application of collective agreements have become stricter and the fixed-term contracts are extended from one to two years.

The Law on Privatization and the Law on Amendments to the Law on Bankruptcy regulates the end of the process of restructuring state-owned companies, and during 2015, in cooperation with international financial institutions the restructuring of large state-owned companies will be carried out, in particular: PE "Electric Power Industry of Serbia", "Serbian Railways" JSC, PE "Srbijagas" and PE "Roads of Serbia". In this way the operations of these companies will improve, especially in state-owned companies that operate with losses, the scope of state aid in the future will be reduced and the management of these enterprises will improve. The Law on Amendments to the Law on Bankruptcy introduced clearer rules that aim to accelerate the bankruptcy proceedings and better protection of creditors of the debtor and ensuring complete transparency of bankruptcy proceedings.

The Law on Amendments to the Law on planning and construction shortens the procedures and simplifies the process of issuing building permits. These laws will significantly improve the business environment and support the development of the private sector.

The Law on Amendments to the Law on Corporate Income Tax enables the submission of electronic applications for income taxes, including income tax withholding, thus achieving the compliance with their obligations and deadlines for submitting the above applications that are prescribed by the law governing the tax procedure and tax administration.

The process of introducing electronic filing of tax returns and uniform application of the tax in order to have all taxes and contributions on salaries of employees showed on one application and paid on one account has been finished.

**MEDIUM TERM SECTOR REFORM MEASURES OF ECONOMIC POLICY**

**3.1. PHYSICAL CAPITAL**

3.1.1. **Priority measure:** Improving transport infrastructure and services in the pan-European transport corridors and the transport network in Southeast Europe

In order to develop transport infrastructure, the focus will be on the development of logistics centers of regional and local character in multimodal corridors 10 and 7, in large economic regional hubs and their gravitational zones. Construction of the first intermodal logistics center in Belgrade, will allow for the reduction of the share of logistics costs in the product price. Combining the public company "Roads of Serbia" with “Corridors of Serbia” will lead to a single company that will be responsible for the construction and maintenance of roads in Serbia.

Amendments to two systemic current laws: the Law on Railways and the Law on Safety and Interoperability of the Railways will contribute to improving the efficiency of the railway system of the Republic of Serbia, its integration into the market of transport services,
as well as the integration of the Serbian railways in the railway system of the European Union.

In the coming period, the implementation of the plan of corporate and financial reorganization of the public company "Serbian railways" Ltd. will also begin.

In 2015, the adoption of the Law on Ski Lifts and the Law on Transport Agreements in Railway Traffic is envisaged, which will allow for an increase in overall transport efficiency and introduce the principle of free access.

The adoption of the Strategy for the development of water transport of the Republic of Serbia from 2015 to 2025 and the amendment of the Act on navigation and inland waters will contribute to creating the conditions for significant investment in the water transport sector in the next five years, while the preparation of the Strategy for the development of air transport in the Republic of Serbia from 2015 to 2025 and the Master Plan for airspace management will provide conditions for the conclusion of strategic partnerships in the construction of airport infrastructure and service expansion for airspace control.

3.1.1.1 The implementation of the sectoral measure

These priority measures will be implemented through a combination of investments, reorganization programs, adoption and implementation of strategic documents, and administrative and legislative activities.

3.1.1.2 Relation of the sectoral measure with the (national) strategic guidelines

The EC Progress Report for 2014 notes that some progress has been made in the area of transport policy, particularly in road and rail transport, inland waterways and air transport and at the same time the report draws attention to the fact that it is necessary to further strengthen administrative capacity, particularly for enforcement and inspection while market access in rail transport has yet to be realized.

3.1.1.3 Contribution of the priority measure towards the achievement of the objectives of national economic policy

Investment in transport infrastructure for different modes of transport and priorities are defined in the document Transport Master Plan until 2027, which was developed in cooperation with the EU. The main objective is to improve the quality of the network, in order to integrate the transport network of Serbia into the trans-European transport network. The concrete activities and indicators are presented in the Action Plan for implementing the programme of the Government.

3.1.1.4 Current state of preparation / implementation
In order to develop transport infrastructure, the development of logistics centers of regional and local character in multimodal corridors 10 and 7 and in large economic regional hubs and their gravitational zones will be conducted. The project for the construction of the first logistics center in Belgrade has been launched. An intermodal terminal is located in the heart of this logistics center. Activities are also ongoing on amending two current systemic laws: the Law on Railways and the Law on Safety and interoperability of the railways.

3.1.1.5 The corresponding sectoral indicator

Number of developed logistics centers of regional and local character on the multimodal corridors 10 and 7, in large economic regional hubs and their gravitational zones. Amendments to the Law on Railways and the Law on Safety and Interoperability of the Railways adopted.


Amendments to the Law on Navigation and Inland Waters adopted.

3.1.1.6 The dynamics of implementation (including the progress made so far and the next steps)

By aligning with Council Directive 2012/34/E3 on establishing a single European railway area, conditions have been improved for the emergence of multiple rail carriers and control of the railway infrastructure, which will lead to the emergence of competition and increase the quality of transport.

In 2015, the adoption of the Law on ski lifts and the Law on transport agreements in railway traffic is envisaged. The basic objective of this law is to increase the overall efficiency of transport and the introduction of the principle of free access, which means the same conditions for all users and operators.

Other planned activities include the adoption of the Strategy for the development of water transport of the Republic of Serbia from 2015 to 2025, the amendment of the Act on navigation and inland waters, developing the Strategy for the development of air traffic of the Republic of Serbia from 2015 until 2025 and developing a Master Plan for airspace management.

It is expected that the merger of the public company "Roads of Serbia" with “Corridors of Serbia” will be completed by the end of March 2015, which will result in a single company responsible for the construction and maintenance of roads in Serbia. Pricing of tolls will also be reconsidered and work on improving road maintenance contracts will be
done. In addition, options for the construction and maintenance of roads through concessions will be considered. Plans for corporate and financial restructuring will be developed in collaboration with the World Bank.

The plan for corporate and financial reorganization of "Serbian Railways", which will be implemented in the future, implies organizational and statutory changes. The company will be divided in accordance with experiences from other EU countries into companies in the field of passenger transport, cargo transport, a company that will deal with the infrastructure and the holding company. These changes will be accompanied by the reorganization of the management.

The restructuring plan will include changes in the disposition of property, transport networks and the rationalization of the number of employees.

3.1.1.7 Description of the degree to which measures contribute to the objectives of the strategy "Southeast Europe 2020"

This priority measure will in a direct and indirect way contribute to the achievement of strategic objectives in the field of the sustainable development dimension I of the Southeast Europe 2020 Strategy, which relates to transport, and will do so by improving relations between rail and water transport and through the introduction of free access in the area of rail transport.

The measure will also contribute to further improvement of air traffic and cooperation in the region as well as the implementation of the JSPA initiative.

3.1.1.8 Potential challenges and / or risks in the implementation

- Lack of project documentation and problems with the expropriation of land can slow or undermine the implementation of infrastructure projects.
- Restrictions of the transport network (speed limits, lines with one railroad track, non-electrified railway lines, UIC-C standard, and others)
- Some standards are not easily achievable in the Republic of Serbia.

3.1.1.9 The budgetary implications, including funds received from the IPA:

Consolidation of the public company "Roads of Serbia" aims to achieve cost savings and increased efficiency of the system, and reduce the need for budget transfers.

The implementation of the Plan of corporate and financial reorganization of the "Serbian Railways" will mean that the freight transport sector will no longer receive subsidies from the budget and will operate according to market principles.
Fees for the use of railway infrastructure will be introduced, as part of the opening of the market for rail transport.

3.1.10 Description anticipated effects of measures, including the expected time of their implementation

The project of building the first logistics center in Belgrade, in the center of which is the intermodal terminal, will allow for the reduction of the share of logistics costs in product prices.

Amendments to the Law on Railways will improve the efficiency of the railway system of the Republic of Serbia, its integration into the market of transport services, as well as the integration of Serbian Railways in the railway system of the European Union.

The adoption of the Law on transport agreements in railway traffic will create conditions for the development of competition in the transport market.

The adoption of the Strategy for the development of water transport of the Republic of Serbia from 2015 to 2025 and the amendment of the Act on navigation and inland waters, will create conditions for significant investment in the sector of water transport in the next 5 years.

Drafting and implementation of the Strategy for Development of Air Transport of the Republic of Serbia from 2015 until 2025 and the Master Plan for airspace management will create the conditions for a strategic partnership in the construction of airport infrastructure and service expansion in airspace control.

Market expansion is expected, better market offers due to a competitive environment, a favourable environment for the development of other airlines, as well as the development of other services in the field of air transport.

Gains from improved efficiency due to the consolidation of PE "Roads of Serbia" are also expected.

The implementation of the Plan of corporate and financial reorganization of the "Serbian Railways" will include a continuation of the reorganization and improvement of the business plans of the remaining state-owned passenger and infrastructure companies with the aim of strictly limiting state aid in the medium term.

3.1.2. Priority measure: Ensuring environmental sustainability through proper management of natural resources and reducing pollution

The development and improvement of waste management systems;
Improving water management (water supply and waste water management);
Improving air quality by reducing harmful emissions.

3.1.2.1 The implementation of the sectoral measure

This priority measure will be implemented through a combination of investments, reorganization program, adoption and implementation strategies, and administrative and legislative activities.

3.1.2.2 Relation sectoral measures with the (national) strategic guidelines:

The EC Progress Report for 2014 states that there has been modest progress in the areas of environment and climate change. Strategic planning, capacity building and increased investment in connection with the strategic priorities for further harmonization with EU policies in the areas of environment, climate policy and civil protection are needed. In May 2014, a plan of priority investments was developed. The ongoing efforts to strengthen inspection and enforcement should be accompanied by the removal of inconsistencies and shortcomings in the legislation that prevent effective implementation. An effective and sustainable funding system for environment and climate policy is needed. By the first quarter of 2015, the government should propose their planned contributions to the Climate Agreement for 2015.

3.1.2.3 Contributions of the priority measure to the achievement of the objectives of national economic policy:

The Republic of Serbia intends to implement a series of measures to improve the quality of the environment. This includes ensuring that drinking water in rural areas meets the quality standards of the EU Directive on drinking water, extension of centralized water supply to selected rural areas with the worst water quality, improving the quality of water in streams by reducing the discharge of untreated industrial and municipal wastewater expansion of the sewage system so that it covers 65% of the population by 2019 and the provision of wastewater treatment in settlements with a significant impact on receiving waters, particularly in sensitive areas.

Another goal is to introduce the separation and processing of hazardous waste from households and industry, as well as other special waste sources, by providing a regional municipal waste management center in each region in accordance with the EU Directive on landfills. This also includes encouraging recycling, closure and reclamation of existing landfills and waste disposals that do not meet the necessary requirements.

Targets are set in order to improve air quality by reducing emissions from the energy sector, industry and transport, establishment of ambient air quality in accordance with EU directives, particularly with activities in settlements which exceed the limit values, strengthening the institutional and administrative capacity in the area of air quality and climate change.
3.1.2.4 Current state of preparation / implementation

The directives on the assessment of environmental impact and strategic assessment of environmental impacts are fully transposed into national legislation and implemented; the Directive on public participation was fully transposed in 2008 and implemented; transposition of the Directive on freedom of access to information on the environment will be completed by the Law on Ratification of the Protocol on Pollutant Release and Transfer Registers of pollutants to the Convention on Access to Information, Public Participation in Decision-making and Access to Justice in Environmental Matters, in October 2011. Systematic transfer of liability in the field of environment did not begin, however, by comparing domestic legislation with the Directive, it was found that about 60% of the directive has been transposed. According to the NPAA, the transposition and the implementation plan will be completed by the end of 2014.

What is noticeable is some progress in transposing the INSPIRE Directive (considered to be 18% transposed, full transposition is planned for 2020). In the EC Progress Report for 2012, it was pointed out that there has been some progress in horizontal legislation through adopting the National Strategy for Sustainable Use of Natural Resources in 2012, the National Strategy for approximation in the field environmental protection in 2011, and by confirming the Register on the Release and Transfer of pollutants of the United Nations Economic Commission for Europe.

3.1.2.5 The corresponding sectoral indicator

- Expansion of the sewerage system so that it covers 65% of the population by 2019
- Index of water quality in the Republic of Serbia
- The share of the population serviced by the water supply.
- The share of treated waste water among total discharged wastewater.
- Households equipped with a system for waste collection.
- The share of municipal waste delivered to the landfill matched against the total municipal waste.
- Index of air quality SAQI_11
- The annual change in the amount of selected pollutants emitted into the air (SO2, Knox, PM10)

3.1.2.6 The dynamics of implementation (including the progress made so far and the next steps)

The total amount of waste produced by households increased from 1.73 million tons in 2007 to 2.71 million tons in 2011. The collection rate from households increased from 60% to 72%. So far nine landfills that meet the requirements of the EU have been constructed and put into operation, while the rest of the waste is disposed of in landfills without prior treatment into disposal sites which often operate without valid permits and are not equipped with systems for collecting leachate, appropriate foil and systems collect landfill gas. A large
portion of municipal waste also goes to dumps. There are over 3,500 dumps in the Republic of Serbia. The existing level of recycling and reuse of waste is not sufficient. It is estimated that the rate of recycling in RS has increased by 10%-15% compared to the period before the adoption of the Law on Waste Management and all by-laws arising from that Law.

Next steps will include the development of project documentation and implementation of investment projects to support the establishment of regional waste management systems and other priority infrastructure projects including the preparation, implementation, coordination and supervision of such projects. Priority investments will be focused on the establishment of regional waste management systems, including the establishment of new landfills and infrastructure, the closure of non-compliant landfills, improving the system for collecting and sorting waste (trucks, containers, recycling yards, flows to the secondary separation, transfer stations), providing location composting of biodegradable waste. This measure will also include appropriate studies, development planning and other documents required to ensure the sustainability of such investment projects. Activities will focus on the implementation of the Landfill Directive and other EU requirements that require high costs.

Wastewater facilities exist in 21 municipalities (out of 219 registered in the areas of the Republic of Serbia); even the largest cities in the Republic of Serbia (Belgrade, Nis and Novi Sad) discharge their wastewater into water recipients without treatment. As a result, individual locations in the Republic of Serbia (e.g., the Backa Grand Canal, Palic and Ludosko lakes, waste water channel in Pancevo) are extremely polluted with unprocessed industrial and municipal wastewater. Transposition of EU directives in water and waste water areas is still limited, and can be considered to be in progress. The best results were achieved in the transposition of the Water Framework Directive (80% of harmonization of legislation reported); Directive on drinking water (76%); as well as the Floods Directive (70%). Legislation on limit values of emission for water pollutants and deadlines for its implementation (as well as the parameters for ecological and chemical status of surface water and chemical groundwater quantitative status) are fully aligned. However, there is still work left to advance the transposition of EU requirements in terms of urban waste water, nitrates, and the Directive on bathing water. When talking about the further transposition of EU requirements in terms of water quality standards and the Groundwater Directive, it should be said that not much work is left for the transposition of EU requirements. The water quality standards (EQS for water) are regulated in our legislation through the Regulation on limit values of pollutants in surface and ground waters and sediments, and deadlines for achieving them ("Official Gazette of RS", No. 52/12), which has transposed the provisions of a large number of EU directives regulating this area.

Support will be provided for the expansion and optimization of public water supply networks and facilities for water treatment, construction and improvement of the system for the collection of municipal waste water (sewage network), as well as plants for wastewater treatment. Activities will include the development of project documentation and implementation of investment projects which are related to directives on drinking water and wastewater utilities, and other identified priority needs. Municipalities will be given support
for project preparation, implementation, coordination and monitoring, and other functions related to the management of investment projects.

The monitoring and assessment of air quality is fully operational through the implementation of the Law on Air Protection ("Fig. Gl. RS" No.36 / 09 and 10/13), which is linked to the EU Directive 2008/50, (DIRECTIVE 2008/50/EC on ambient air quality and cleaner air for Europe), and accompanying regulations which achieve harmonization of national and EU practices. Transposition of EU directives in the sector of air is either completed, or it is in advanced stages, except in the case of the Directive on the reduction of sulphur content of certain liquid fuels, for which the degree of compliance is extremely low (6%). The majority (95%) of the new Directive on ambient air quality has already been transferred in 2009 (Law on Air Protection), and compliance with the remaining provisions of the directive will be achieved through amendments to the existing regulations.

Activities will include the identification of measures to reduce air pollution hot spots, help in the process of issuing requests for integrated permits, and identification of priority investment projects for pollution reduction. Activities will also contribute to the development of project documentation and implementation of priority investment projects.

In accordance with the Law on Environmental Protection and the National Environmental Protection Programme (whose implementation is achieved and provides planning and environmental protection management) the adoption of a five-year Action Plan for implementation of the National Programme of Environmental Protection is expected.

3.1.2.7. Description of the degree to which the measure contributes to the objectives of the strategy "Southeast Europe 2020"

This measure will in a direct and indirect way contribute to the achievement of strategic objectives in the field of sustainable development in the dimension J of the SEE2020 strategy which is related to environment, and to opening markets in the field of environment for private sector participation in infrastructure financing.

3.1.2.8. Potential challenges and / or risks in the implementation

Despite the fact that over the past few years national regulations and a revised strategy for waste management have been developed and defined, the provision of sufficiently developed and equipped systems for collecting waste remains one of the most important challenges that the sector faces.

The implementation of the Landfill Directive requires significant investment in order to establish or improve landfills. Other challenges include the enforcement of the requirements for packaging waste in terms of standards in the preparation of the packaging and specific targets for recycling and recovery of packaging waste, as well as legislation in the field of electrical and electronic waste.
3.1.2.9. Budgetary implications, including funds received from the IPA

The implementation of the Landfill Directive requires significant investment in order to establish or improve landfills. Substantial investment programs for waste water management and improvement of drinking water quality are also needed. According to estimates by the National Strategy for approximation in the field of environmental protection, the sub-sectors of water and waste management alone require about 4 billion EUR investment to meet EU requirements.

The most important source of funding for the sector of environment and climate change is the state budget revenues from taxes. A current estimate of expenditure from the budget of the Republic, AP Vojvodina and cities and municipalities for environment is 0.3% of GDP. In the period 2007-2012 275 million EUR was allocated through all forms of development assistance. The peak absorption was achieved in 2011 with 46.62 million EUR. According to the National Program of Environmental Protection, expenditures for environmental protection should reach 1.2% of GDP by 2014 and 2.4% of GDP by 2019. The dissolution of the Fund for Environmental Protection and a significant reduction in the Budget Fund for Water of the Republic of Serbia has made investments in environment more complex.

The Republic of Serbia still faces numerous challenges in terms of water quality. Although the concentration index of BOD5 in surface waters indicate that the ion concentration of ammonia, nitrate and orthophosphate is generally within acceptable limits, among the samples of water in the basin of the Vojvodina 43% were categorized as 'very bad' and 'bad' water quality. Key sources of pollution are unprocessed industrial and municipal wastewater, drainage water from agriculture, leachate from landfills, as well as pollution related to river navigation and operation of power plants. About 67% of the total wastewater discharged comes from households and 19% from industry. While growing, the percentage of households connected to the public sewerage network is still small: only 36% in Central Serbia and 23% in Vojvodina. The rest of the resulting waste water goes into septic tanks or directly into the groundwater. Problems of waste water are even more alarming in industry and mining. Require substantial investment programs for waste water management and improvement of drinking water quality. The implementation of the Water Framework Directive requires serious preparatory work and a strong institutional basis. The challenges include the implementation of the Nitrates Directive, in particular the definition of vulnerable zones and establishing action plans which will be implemented by farmers.

Challenges relating to air quality include reducing emissions from stationary sources such as power plants and local district heating, adjusting the oil refineries to meet the EU standards, control of emissions of volatile organic compounds resulting from the storage and distribution of petrol, strengthening institutions for monitoring and collecting data, addressing the increasing levels of pollution due to traffic in cities.
3.1.2.10. Description anticipated effects of the measure, including the expected time of its implementation

This measure will provide support for the implementation of the practice of sustainable use of natural resources, recovery of polluted sites and reducing the harmful impacts of the industry.

Innovative waste management solutions will contribute to reducing the amount of waste, increasing the rate of collection and recycling, establishing priority components of the regional waste management system, including the development of new landfills and infrastructure, the closure and reclamation of non-compliant sites, the establishment of plants for the processing of hazardous waste, creating a system for collection and processing of specific waste sources. Access to clean drinking water for households will be provided through the expansion and optimization of public water supply networks and facilities for water treatment, construction and improvement of the system for the collection of municipal waste water (sewage network), as well as through wastewater treatment facilities.

3.1.3. Priority measure: Ensuring energy security, energy market development and overall transition to a sustainable energy

Key priorities for energy development of the Republic of Serbia in the coming period and in accordance with the country’s obligations under the Energy Community Treaty, the Energy Strategy of the Energy Community and EU policy in the field of energy, refer to the following:

- Ensuring energy security and the provision of safe, high-quality energy supply and energy sources and the establishment of conditions for reliable and safe operations and sustainable development of energy systems and the energy sector in general.
- The development of the energy market based on the principles of competition, transparency and free initiatives of energy companies, ensuring the protection of consumers of energy and energy sources, development of the electricity and natural gas markets and their connection with the single market of the EU, better connecting the energy system of the Republic of Serbia with the energy systems of other countries.
- The transition to sustainable energy through the implementation of measures for energy efficiency, renewable energy and protecting the environment and reducing the impact on climate change. Development of Energy in the Republic of Serbia should be such that its effects on the environment are minimized.

3.1.3.1 The main objectives and relevance for competitiveness and growth

The EU Progress Report for 2014 states that additional efforts are required for the electricity price to clearly reflect costs and that there is an urgent need to make a decision on the model of separation of Srbijagas, in accordance with the EU acquis.
The Government of the Republic of Serbia on 25 December 2014 passed a Conclusion accepting the Baseline restructuring of JP "Srbijagas" Novi Sad. Also, it is necessary to strengthen the administrative capacity in the field of energy and the independence of the regulator in the field of energy and to make greater efforts towards renewable energy sources and energy efficiency in all sectors.

The main priorities of energy development of the Republic of Serbia are based on the Energy Act, which specifically defines the objectives of energy policy ("Official Gazette of RS", No. 145/2014), Article 3, as well as the obligations and activities arising from the Energy Community Treaty.

Increased competitiveness in the market through the implementation of the third energy package, improved energy efficiency in all sectors of energy, including consumption and simplifying the procedures for obtaining permits will contribute to removing the barriers to entry into the market of energy.

The measure is aimed at providing support in the development of energy markets; intensifying exploration of energy resources; the construction of new power plants or upgrading and modernization of existing ones; rationalization of energy consumption and the overall increase in energy efficiency; intensive use of renewable energy sources, where the promotion of renewable energy sources should also be included in the energy plans of cities and local communities as part of the local energy strategy; reorganization and restructuring of companies in the energy sector; further harmonization of existing legislation with EU standards, through mutual harmonization and development of national regulations, increased security of energy supply and energy through the availability of reserves of oil, petroleum products and natural gas, using transparent mechanisms based on the principle of solidarity.

The measure will lead to improvements in the energy sector, the achievement of national strategic objectives in the field of energy and the objectives of European integration, in accordance with EU policy in the field of energy and the objectives of the Energy Strategy of the Energy Community adopted at the Ministerial Council in October 2012, and the National Strategy for Sustainable Development.

The measure will contribute to the implementation of the existing legislative framework in the field of energy efficiency, to its further improvement and providing incentives for energy efficiency improvements.

3.1.3.2 Description of the measure

This sectoral measure will be implemented through a series of institutional, legal, project, financial activities and measures for each area of energy: electricity, renewable energy, oil and oil products, natural gas, thermal energy, coal, and energy efficiency.

Ensuring energy security or the provision of safe, high-quality energy supply and energy commodities and the establishment of conditions for reliable and safe operations and sustainable development of energy systems and the energy sector in general.

The development of the energy market based on the principles of competition, transparency and free initiatives of energy companies, ensuring the protection of consumers of energy and energy sources, the development of the electricity and natural gas markets and their connection with the single market of the EU, intensifying connections between the energy system of the Republic of Serbia with the energy systems of other countries.
The transition to sustainable energy through the implementation of energy efficiency measures, renewable energy, protecting the environment and reducing the impact on climate change. Development of the Energy sector of the Republic of Serbia should be such that its effects on the environment are minimized.

Key indicators:

- Annual percentage of adopted bylaws for the implementation of the Energy Act and the efficient use of energy
- Work of the energy sector in accordance with the provisions of the "third package"
- The number of days for which reserves of oil and oil derivatives have been provided,
- Increase in storage capacity (base value - 0, 2016 - 6%, in 2017 - 18%, 2018 - 38%)
- The amount of oil in reserves of petroleum products
- Installed capacity for electricity generation
- New interconnection power lines
- Net dependence on energy imports (percent of total primary energy supply)
- The available capacity to transport gas
- The share of renewable energy in final energy consumption (%)
- ENS (% of electricity not supplied due to shut downs in the total electricity supplied)
- The degree of implementation of the Action Plan for Energy Efficiency

3.1.3.3 The legal / administrative acts that need to be developed, adopted or implemented

- Energy Law ("Official Gazette of RS", No. 145/2014);
- Treaty on establishing the Energy Community
- Law on Commodity Reserves ("Off. Gazette of RS", No. 104/13)

3.1.3.4 The dynamics of the progress made in the last 12 months

In January 2014, the Energy Strategy of the Republic of Serbia until 2025 with projections until 2030 was adopted by the Government. However, due to the establishment of the new government in April 2014, it was necessary to repeat the procedure for the adoption of this document. It is expected that soon the adoption of the Energy Development Strategy of the Republic of Serbia until 2025 with projections to 2030 by the Government will be completed and then it will be adopted by the National Assembly. Upon adoption of the new Energy Strategy, the Strategy Implementation Programme will be prepared, which will further define projects, activities and measures to be undertaken for a period of 6 years.

The legal framework of the Republic of Serbia for the formation and maintenance of required reserves of oil consists of the Law on Commodity Reserves ("Off. Gazette of RS", No. 104/13), which in a separate chapter regulates the formation and use of mandatory reserves of oil and oil derivatives in the event of disruptions in energy supply and energy and is also referenced in the Energy Law ("Official Gazette of RS" 145/14).

The Government of the Republic of Serbia, at the proposal of the Ministry of Mining and Energy, adopted the Decree on the amount, method of calculation, payment and disposal fee for the formation of mandatory reserves of oil and oil derivatives ("Official Gazette of
RS”, No. 108/14) and the Regulation on the methodology of data collection and processing and the calculation of average daily net imports, the average daily consumption and the amount of required reserves of oil and oil derivatives (“Official Gazette of RS”, No. 108/14), which has now better regulated the conditions for the collection of fees for the formation and maintenance of required reserves of oil and oil derivatives, in accordance with the planned structure and amount of required reserves, the necessary financial resources for procurement and storage, consumption of petroleum products in the previous calendar year and the period of time for the formation of mandatory reserves.


In the period before 2014, the following activities of relevance for this measure were carried out:

In the period from 16.08.2013. until 11 October 2013, a public consultation on the draft of the new Energy Strategy of the Republic of Serbia until 2025 with projections to 2030 was held, and a report on the public consultation was prepared. In this period, there were 6 major public debates in Belgrade, Nis, Kragujevac and Novi Sad. The final public hearing was held for representatives of the European Delegation, the Energy Community will and the diplomatic corps. The text of the draft Strategy was submitted to the opinion of the relevant ministries, as well as to the Secretariat for Public Legislation and the European Integration Office.

In accordance with the strategic assessment of environmental impact, it is necessary before submitting a new Energy Strategy to the Government for approval, to prepare and document an environmental impact assessment for the Strategy. The Report on the Strategy’s Environmental Impact Assessment was prepared on the basis of the Decision on strategic assessment of the impact of the Energy Development Strategy of the Republic of Serbia until 2025 with projections to 2030 on the environment, which is issued by the Ministry of Energy, Development and Environmental Protection (No. 312-01-00731 / 2013-04, from 11.06.2013. the). This document is also presented to the public and public consultations were organized in the period from 30/10/2013. until 25/11/2013. The report was submitted for the opinions of all relevant institutions as well as neighboring countries.

In 2010, the Government of the Republic of Serbia adopted the first national action plan for energy efficiency for the period 2010 - 2012 (1. APEE), which established indicative targets for this period in the amount of 1.5% of final energy consumption calculated in relation to the the base year 2008 (0,1254Mtoe) ie. target of at least 9% saving in final energy consumption in the 9th year of implementation (until 2018). In 2013, the government adopted a second national action plan for energy efficiency for the period 2013 - 2015 (APEE), which in this period proposes savings at the level of 3.5% of final energy consumption. In 2013 the Law on the efficient use of energy was also adopted and it introduced instruments that should lead to energy savings in accordance with the APEE, and to fulfilling the obligations under the Energy Community in terms of implementation of the relevant directives, whose obligation at the time of adoption were in force in the Energy Community. Given that the EU regulation on energy efficiency is constantly improving / expanding in the coming period, serious efforts will be needed for alignment with the new EU acquis in this area or meeting new obligations under the Energy Community.
In June 2013, the National Action Plan for renewable energy sources of the Republic of Serbia was adopted. This document sets out the objectives for the use of renewable energy sources by 2020, and the way to achieve these objectives.

European Union Directive 119/2009 imposes an obligation on Member States to maintain minimum reserves of crude oil and oil derivatives that are used in case of supply disruption, and bearing in mind their high import dependence. Member States shall ensure that the reserves that will be available in the event of a crisis based on transparent mechanisms and the principle of solidarity. In order to create and maintain the required reserves of oil Member States may establish non-profit bodies (Central Stockholding Body) and shall establish procedures for the supply in case of any disruption in supply.

Law on ratification of the treaty on establishing the Energy Community between the European Community and the Republic of Albania, Bulgaria, Bosnia and Herzegovina, Croatia, the former Yugoslav Republic of Macedonia, Montenegro, Romania, Serbia and the United Nations Interim Administration Mission in Kosovo in accordance with resolution 1244 United Nations Security Council (“Official Gazette of RS”, No. 62/06) (hereinafter: Contract) has the Republic of Serbia making a commitment to harmonize its legislation with the requirements of the EU directives relating to energy, which will enable the full participation of countries in South East Europe in the internal energy market of the European Union.

At the fifth meeting of the Council of Ministers which was held on 11 December 2008, decision was 2008/03/MC-ENC on the extension of the Treaty on the oil field was made. One of the most important issues in this area is to establish a system of mandatory oil reserves in accordance with Directive 2009/119/EC which imposes the obligation of Member States to hold minimum reserves of oil and / or petroleum derivatives.

At a meeting of the Ministerial Council of the Energy Community, which was held on October 18 in Budva, the Decision on the implementation of Directive 119/2009 EC was adopted with contracting parties undertaking to establish mandatory reserves of oil and / or petroleum derivatives no later than January 1st of 2023.

3.1.3.5 The dynamics of the forthcoming steps (2015-2017)

The energy market in the Republic of Serbia will see a complete integration into the single pan-European energy market, whereby the institutional and regulatory framework of the Republic of Serbia needs to be fully aligned to allow investment, economic development, energy security and social stability.

In the next period, the implementation and monitoring of energy policy defined in the main strategic documents defined in the Law on Energy is foreseen: the Energy Development Strategy of the Republic of Serbia until 2025 with projections to 2030, Strategy implementation programme, Energy Balance of the Republic of Serbia, the National Action Plan for Energy efficiency and the National action plan for renewable energy.

Also in the coming period, the preparation of bylaws in accordance with the Energy Law and technical regulations in electricity is foreseen.

The next step will also be to prepare the missing technical/project documentation in accordance with national legislation and relevant international and EU standards, as well as support for building an open infrastructure for public access and provision of equipment and the creation of conditions for the establishment and operation of emergency oil reserves.
Further steps include the implementation of the Law on efficient use of energy and its further advancement towards regulation of the European union as well as the implementation of relevant action plans, for which it is necessary to provide substantial financial support from donors, international financial institutions, the Budget Fund for the promotion of energy efficiency and the use of the ECCO financing model.

The national action plan for renewable energy sources of the Republic of Serbia ("Official Gazette of RS", No. 53/13).

3.1.3.6 Description of the degree to which the measure contributes to the objectives of the Energy Community

This priority measure will in a direct and indirect way contribute to the achievement of strategic objectives in the field of energy security, energy market development and sustainable growth, both in terms of implementation of activities aimed at increasing energy efficiency, the attainment of at least 9% savings in final energy consumption, ensuring the realization of renewable energy sources from 27% in gross final energy consumption by 2020, as well as improvement of environmental conditions in all areas of energy, providing conditions that would encourage investment in energy facilities, development and rehabilitation of national infrastructure (storage capacity), increasing the number of days for which reserves of oil and oil derivatives are provided.

3.1.3.7 The main challenges / risks in implementing measures

- Weak institutional framework and insufficient human resources for the implementation of public policy and strategic planning in the energy sector.
- Low collection rates, which leads to large debts to public enterprises and suppliers of energy and fuels.
- Low energy efficiency in all sectors of the energy industry (production and distribution of electricity and heat, district heating, existing buildings, industry, transport).
- Lack of permanent funding sources as well as revolving mechanism for financing projects in the field of energy efficiency
- High energy and carbon intensity of the economy
- The technological obsolescence of existing and lack of new power capacity,
- The inefficiency of public enterprises in the sector,
- The legacy of destroyed, devastated natural space and excessive pollution of water, air and soil caused by power generation;
- The low level of use of technologies for low emissions of harmful substances in all parts of the energy cycle;
- The underdevelopment or insufficient development of internal and regional markets for electricity and natural gas;
- Lack of strategy for economic and social development of the country;
- Long-lasting and complex procedure of obtaining approvals and permits.
Significant financial resources are required to implement energy policies. The draft Energy Strategy of the Republic of Serbia until 2025 with projections to 2030 estimates the required funding for the period up to 2020, 2025 and 2030 for the implementation of activities for each area of energy: electricity, heat, renewable energy, oil natural gas, coal, energy efficiency. The Program for implementation, which will be prepared after the adoption of the new Energy Strategy, defines in detail the projects, measures and activities as well as the necessary financial resources for a period of six years. The amount of funds needed for coordinating the operation of large combustion plants within the Public Enterprise "Electric Power Industry of Serbia" with air emission limit values has been estimated in a document called the Energy Community Study of the need for modernization of large combustion plants. The study states that the financial resources necessary for coordinating the operation of large combustion plants within the Public Enterprise "Electric Power Industry of Serbia" with the limit values according to the Large Combustion Plants Directive 2001/80/EC are about 650 million, and with the limits set under the Directive on Industrial Emissions 2010/75/EC these investments amounted to 700 million euros.

Creating and maintaining mandatory reserves of oil and oil derivatives will not have a negative reflection on the expenditure side of the budget of the Republic of Serbia, given that the funds for these purposes are collected on the basis of fees imposed for the formation and maintenance of required reserves of oil and oil derivatives, which represents revenues into the budget.

In conjunction with the planned resources within IPA funds, we highlight the planned activities defined in the sector planning document (SPD Sector Planning Document-): Activity 1.1.4 - Supply and Technical assistance concerning the optimal management of networks and mandatory oil stocks and support to the Central Stockholding Entity (electric grid, gas and oil) (2015) and Activity 2.1.6 - oil and oil derivatives storage (2016).

To achieve the objectives in terms of energy efficiency also requires significant financial resources. To achieve the above goals in the building sector, the public sector should provide an investment of around 50 million EUR per year, on average, which would generate annual savings of about 80GWh. In addition to the funds to be provided for the implementation of measures in the public sector, given that the average repayment period for measures in the building sector is about ten years, it is necessary to provide the means to encourage the population to implement these measures. It is obvious that in addition to the support of donors and international financial institutions a steady source of revenue for the budget fund for the promotion of energy efficiency should be provided, and all the funds would not be a one-time benefit but should be used on a revolving basis.
3.2.1.9 Description of the anticipated effects of the measure, including the expected time of their realization

The measure will contribute to the integration of national energy markets in the integrated European energy market, increasing security of energy supply and energy, as well as the achievement of the objectives in the field of energy efficiency and renewable energy resources and environmental protection, which arise from decisions of the Ministerial Council adopted on the basis of the Energy Community Treaty. This will enable the Serbian energy sector to be established at the market and economically efficient to the extent that generates its own development, but also represents a generator and a secure basis for development of the country.

The measure will contribute to increasing the security of energy supply in the Republic of Serbia through the establishment of procedures in case of supply disruption and mechanisms based on the principle of solidarity between the Member States of the European Union and the Energy Community. The measure will contribute to achieving the objectives from the Action Plan for improving energy efficiency, with the degree of implementation of the measures largely dependant on the resources provided. Achieving these goals directly affects the competitiveness of industry, increasing standard of citizens, reduce costs in the budget of public users, as well as the reduction of the negative impacts of the energy sector on the environment.

3.2. HUMAN CAPITAL

A prerequisite for the further development of human capital is adequate functioning of the health care system, as well as the social welfare system, because it guarantees the necessary safety and protection of investment in the process of acquiring education and improvement of qualifications. Therefore, the implementation of the measures envisaged in NERP will be carried out in close coordination with the Employment and social reform programme (ESRP) and social policies and measures which this document envisages.

Education is a key element in the development of human capital and the most important question regarding the education system in the Republic of Serbia is its relevance.

The general conclusion is that the education system does not prepare students adequately for the world of work. It does not respond sufficiently to the needs of the economy and does not provide enough opportunities for professional development of employees in order to improve their skills and improve employment opportunities.

The basic orientation of the Strategy for Development of Education in Serbia, which was adopted in 2012 is that the circumstances that exist in the environment of the Republic of Serbia, especially in the European Union, clearly indicate that the Republic of Serbia needs a very methodical, organized and high quality development of the education system because it
is one of the key conditions for the development of the Republic of Serbia towards a knowledge-based society capable of providing good employment of the population.

**3.2.1 Priority measure:** Development of a National Qualifications Framework in order to raise competences

In order to implement this measure a series of activities will be carried out aimed at adapting the teaching and study programs to the requirements of the modern labor market, the adoption of the Law on the National Qualifications Framework, developing an action plan for the development of the national qualifications framework, the adoption of the Law on regulated professions, the formation of sectoral councils and harmonization of the different types of qualifications at all levels of education with the needs of the economy and the labor market

**3.2.1.1 The main objectives and relevance for competitiveness and growth**

The EU Progress Report on the Republic of Serbia for 2014 concluded that it is necessary to make significant efforts to improve the quality and efficiency of the education system. Implementation of the strategy of education should improve the quality of education. The reform of the vocational education system, which currently does not meet the needs of the labor market, is an important priority and little progress has been made. There is a need to rationalize the number of vocational schools and to establish a network of educational profiles that are more relevant to the labor market.

**3.2.1.2 Description of the measures**

The introduction of the National Qualifications Framework in Serbia (NQFS) for lifelong learning supports the development of a modern, relevant and flexible education system. The NQFS should enable the adjustment of education to the needs of the economy and allow for mobility and progression of the individual through the education system. Application of the NQFS provides access to qualifications that are recognized by the job market; quality in the process of obtaining a diploma or certificate; increased number of persons who acquire qualifications through formal education and the process of recognition of prior learning; support to the development of human resources at the macro and micro level. However, the establishment of an NQFS will require fundamental changes in the education system in the sense of creating a system for the recognition of prior learning (recognition of non-formal and informal learning), system qualification and accreditation of loan providers for educational services. Also, the system of quality assurance is an integral part of the NQFS and applies to all segments of education, the development process of qualification, development of educational programs in accordance with the standards of qualifications, quality assurance in the process of qualification and assessment of achievements - standardized exams for the qualification. In the absence of an operational and functional National Qualifications Framework, as well as a quality assurance system, there is
very little incentive for the development of facilities in the system of education and training outside the formal education system (adult education).

The measure will be implemented through the following activities:
1. Development and adoption of an integrated NQFS, the draft Law on Integrated NQFS, as well as the report on referencing the NFQS at European Qualifications Framework (EQF) (Indicator - Adoption of an integrated NQFS)
2. Drafting of the draft law on regulated professions (Indicator - The draft law on regulated professions)
3. The formation of sectoral bodies (Indicator - Number of established sectoral bodies)
4. Development of sectoral qualifications standards in accordance with the needs of the labor market (Indicator - Number of developed qualifications standards)
5. Development of educations programs for established qualification standards (indicator -% of educational programs based on qualification standards)

3.2.1.3 The legal / administrative acts that need to developed, adopted or implemented

1. Law on the Basis of the Education System (Official Gazette of RS, Nos. 72/09, 52/11, 55/13);
2. Law on Higher Education (RS Official Gazette no. 76/05, 100/07, 97/08, 44/10, 93/12, 89/13, 99/2014);
3. Law on Adult Education (Official Gazette of RS no. 55/13).

3.2.1.4 The dynamics of the progress made in the last 12 months

The NQFS for levels I-V in secondary vocational education (formal and informal) and levels VI to VIII in higher education has been developed, thus creating conditions for establishing a unique National Qualifications Framework, which will include both formal and informal education, as well as the establishment of the system of recognizing the previous education.

A professional team has been formed to create an integrated NQFS and to prepare NQFS for referencing at EQF (December 2014).
A working group was formed for drafting the law on regulated professions (January 2015).

3.2.1.5 The dynamics of the forthcoming steps (2015-2017)

- December 2015 – integrated NQFS adopted and in December 2016 NQFS referenced at EQF
- December 2016 - NQFS referenced
- December 2015 - 4 sector councils formed and in 2017 all sectoral councils formed
- December 2015 - Number of developed qualifications standards.
- December 2015 -% of educational programs in accordance with the qualification standards.

3.2.1.6 Assessment of the contribution to the national action plan for implementation of the strategy SEE 2020

This priority measure will directly and indirectly contribute to the achievement of strategic objectives in the field of smart growth in dimension D, which refers to the quality of education with a focus on qualifications and mobility.

3.2.1.7 The main challenges / risks in implementing measures

- Lack of financial resources
- Insufficient human resources
- Insufficiently developed links between education, employment and economic development and innovation policy, as well as industrial restructuring
- The delay in the formation of the Sectoral Councils

3.2.1.8 Budgetary implications / defined including funds from IPA

IPA 12 - 3.6 million EUR, out of which 1 mil Euro for technical assistance, while the rest of the funds are earmarked for supply of equipment for secondary vocational schools.

3.2.1.9 Description of the anticipated effects of the measure, including the expected time of their realization

Compliance of the educational offer to the needs of the labor market and Economy – 2020.

Establishing an NQFS will require substantial changes to the system of education in terms of creating a system for the recognition of prior learning (recognition of non-formal and informal learning), system for qualification and accreditation of providers. Also, the system of quality assurance is an integral part of the NQFS and applies to all segments of education, the development process of qualification, development of educational programs in accordance with the standards of qualifications, quality assurance in the process of qualification and assessment of achievements - standardized exams for the qualification.

3.2.2 Priority measure: Improving the efficiency of managing the education system

This priority measure will be implemented through the development of information systems at all levels of education, school network optimization, the development of financing models in education, reform of secondary education, the introduction of half-day preschool program for a period of one school year for all children between three and five and a half years and training teachers to use new methods and information technologies (eg, introduction courses, prevention of early school leaving, etc.).
3.2.2.1 The main objectives and relevance for competitiveness and growth

The Progress Report on the Republic of Serbia in the European integration process in 2014 concluded that it is necessary to make significant efforts to improve the quality and efficiency of the education system. Education Development Strategy to 2020 and the Action Plan for the implementation of this strategy are designed, among other activities that are in line with the sectoral measure.

This priority measure will contribute to the achievement of the national economic policy through two aspects: the triple jump rationalization of the education system and the harmonization of the education system to the real needs of the economy and society.

3.2.2.2 Description of the measure

The measure will be implemented through a combination of legislative and administrative activities. The Strategy for Development of Statistics in Education and Science will define the legal framework for the implementation of a unified information system in education. During the year 2015 registries of institutions and employees in education will be developed as the basis for an information system. The new Law on Higher Education will regulate the funding of universities and colleges with the aim of encouraging the development of study programs aligned with the needs of the labor market, raising the quality of teaching and encouraging the mobility of teachers and students. Analysis of the needs of local governments and criteria for making the school network will be done after a reorganization of the school network in order to conform to the demographic situation and the needs of society for certain educational profiles.

The measure will be implemented through the following activities:

1. Development and implementation of a unified information system in education (UISE)
   1.1 Development of registers of preschools, kindergarten teachers and children. (Indicator - Number of realized registers)
   1.2 Development of registers of elementary schools, teachers, students. (Indicator - Number of realized registers)
   1.3 Development of registers of secondary schools, teachers, students. (Indicator - Number of realized registers)
   1.4 Development of registers for higher education. (Indicator - Number of realized registers)
2. Development of a model of financing of higher education
3. Optimization of the school network
3.2.2.3 The legal/administrative acts that need to be developed adopted or implemented

1. Law on the Basis of the Education System (Official Gazette of RS, Nos. 72/09, 52/11, 55/13)
2. Law on Higher Education (RS Official Gazette no. 76/05, 100/07, 97/08, 44/10, 93/12, 89/13, 99/2014)
3. Indicators for monitoring the situation in Education (NPS 2011)
4. Guidelines for promoting the role of information and communication technologies in education (NPS 2013)

3.2.2.4 The dynamics of the progress made in the last 12 months

1. The Working Group on drafting strategy for development of statistics in Education and Science (July 2014)
2. The Working Group on implementation of the guidelines of ICT in education
3. The registry of staff in higher education institutions - FinV (January 2015)
4. Piloting infoVOB system at 7 universities (November 2014)

3.2.2.5 The dynamics of the forthcoming steps (2015-2017)

- 1 Jul 2015 - The Strategy of development of statistics in Education and Science adopted
- 2 September 2015 - Developed a register of institutions and teachers for all levels of education
- 3 Jun 2016 - Developed a unique information system in pre-university education
- December 4, 2015 - Determining the cost of studying at HEIs and science
- December 4, 2015 - The new Law on Higher Education
- 5 Jun 2016 - Made analysis of the needs of local governments in a number of schools
- 6 December 2017 - The network of schools aligned with the real needs

3.2.2.6 Assessment of the contribution to the national action plan for implementation of the strategy SEE 2020

The priority measure will directly and indirectly contribute to the achievement of strategic objectives in the field of smart growth in dimension D which relates to better alignment of the education system to the needs of the economy and the labor market (D.4).

3.2.2.7 The main challenges/risks in implementing measures

In addition to the potential problems of a financial nature or problems due to lack of human resources in the implementation of these measures there is a risk of inertia in the field of higher education especially due to the high degree of autonomy. Further optimization of the school network can cause certain trade union resistance.
3.2.2.8 **Budgetary implications / defined including funds from the IPA**

In addition to the funds planned for this activity in the budget of the Republic of Serbia, part of the proceeds will be used from the already approved loans, as well as potential donors. Some activities will be implemented through two TEMPUS project: FINHED (budget 919,000 EUR) and Rhodes (budget 787,000 EUR).

3.2.2.9 **Description of the anticipated effects of the measure, including the expected time of their realization**

This measure is aimed at raising the efficiency of the education system and the harmonization of educational enrolment policy to the needs of the labour market in order to ensure the long-term planning prerequisites for economic development and recovery. Rationalization of the education system through the school network optimization and change of financing higher education will reduce the costs which will allow the overflow to go into investing in priorities even more encouraging economic growth.

Efficient education system - 2020. The unique information system in education (all levels of education) - 2017.

3.2.3 **Priority measure**: Adopting a new strategic and legislative framework for research and innovation

3.2.3.1 **The main objectives and relevance for competitiveness and growth**

Progress Report on the Republic of Serbia in the European integration process in 2014 emphasizes that in the field of science and research some progress has been accomplished. Additional efforts are needed, especially to increase the capacity at the national level through higher investment in research and development, both by the public and the private sector.

The proposed sectoral priority measure will contribute to the increase in the capacity for innovation through the adoption of strategic and legislative documents, reform of the system of financing of research institutions and increasing investments in research and development.

3.2.3.2 **Description of the measure**

The measure will be implemented by adopting the strategy "Research for Innovation 2020", an appropriate action plan, a roadmap for the development of scientific research infrastructure, the Law on Scientific Research, the Law on Innovation, changing the financing model of public research organisations, as well as the adoption of the Rulebook on the evaluation of scientific research.
3.2.3.3 The legal / administrative acts that need to be developed adopted or implemented

1. Law on Scientific and Research Activities (Official Gazette of RS no. 110/05, 50/06, 18/10)
2. Law on Innovation Activities (Official Gazette of RS no. 110/05, 18/10, 55/13)
3. Strategy for Scientific and Technological Development of the Republic of Serbia from 2010 to 2015 (Official Gazette of RS no. 13/10),
4. Action plan for the implementation of the Strategy of Scientific and Technological Development of the Republic of Serbia for the period from 2014 to 2015 (Fig. gl. RS no. 11/2014).

3.2.3.4 The dynamics of the progress made in the last 12 months

1. Working group for drafting the Law on Scientific Research, the Law on Innovation, and the Regulations on the evaluation of scientific research was formed in January 2015;
2. Working group for drafting the Strategy "Research for Innovation 2020" and the corresponding Action Plan was also formed;

3.2.3.5 The dynamics of the forthcoming steps (2015-2017)

1. Jun 2015 - adopted documents;
2. December 2015 - adopted strategy;
3. December 2016 - defined roadmap for the development of scientific research infrastructure.

3.2.3.6 Assessment of the contribution to the national action plan for implementation of the strategy SEE 2020

Sectoral measure will directly and indirectly contribute to the realization of two strategic objectives in the field of smart growth in the dimension E: research, development and innovation, as follows:
- The establishment of the Fund of excellence in research, through measures to strengthen operative research capacity and promote research excellence;
- Introduction of programs for technology transfer by stimulating industrial-academic collaboration, and research devoted to commercialization.

3.2.3.7 The main challenges / risks in implementing measure

- The level of public funding of scientific research sector is low compared to international standards (Lisbon objectives);
- outcomes of applied research and development achieved in scientific research organizations are not suitable for commercialization;
- fragmented and unsuccessful national system of innovation;
- brain drain of researchers to better-funded R & D organizations outside Serbia.

3.2.3.8 Budgetary implications / defined including funds from the IPA

The adoption of the Strategy "Research for Innovation 2020", an appropriate action plan and roadmap for the development of scientific and research infrastructure will be implemented with the use of the instrument for pre-accession IPA 2013 in the amount of 0.74 million EUR.

The remaining activities necessary for the implementation of sectoral measure do not require additional resources.

3.2.3.9 Description of the anticipated effects of the measure, including the expected time of their realization

This measure is aimed at long-term increase in the quality of research and development in scientific research organizations. To achieve this goal it is necessary to invest in infrastructure for research and development, including the development of centers of excellence and investment in human capital development, including the reintegration of researchers from the Serbian diaspora in national programs. To achieve this, the first step is a new strategic and legal framework regulating scientific research.

Increased quality of scientific research will lead to greater and more efficient technology transfer from research institutions to the economy, with favorable effects on productivity and employment. For this it is necessary to improve the legal framework regulating the innovation activity.

3.3. BETTER INDUSTRY STRUCTURE

One of the main drivers of economic development of the Serbian economy and structural adjustment of the industry in the coming period will be the sector of micro, small and medium enterprises and entrepreneurs. This sector generates about two thirds of employment and turnover, 54.1% of GVA and accounts for 43.2% of the exports of the non-financial sector. It is estimated that in 2013 SMEs and entrepreneurs (SMEE), which makes 99.8% of the total number of entrepreneurs participated with about 34% of the GDP of the Republic of Serbia.

SMEEs are operating under conditions in which the entire Serbian economy is still characterized by a slow economic recovery after several years of recession-induced by the global economic crisis. Challenges to the further development of the private enterprise sector still exist in the domain of an insufficiently supportive business environment, grey economy and the fall in domestic demand. SMEE’s have a significant problem of liquidity and access to affordable sources of funding, without which they cannot achieve the necessary improvement of competitiveness and productivity.
Framework measures to promote the development of the SMEE sector in the period up to 2020 is defined in the strategy to support the development of small and medium-sized enterprises, entrepreneurship and competitiveness for the period 2015 to 2020, whose official adoption by the Government of the Republic of Serbia is expected in early 2015. The strategy has fully respected the recommendations of the Small Business Act of the European Union, and is organized through six pillars:

1. Improving the business environment;
2. Improving access to finance;
3. Continuous development of human resources;
4. Enhancing the sustainability and competitiveness of SMEs;
5. Improving access to new markets;
6. Development and promotion of entrepreneurial spirit and encourage entrepreneurship of women, youth and social entrepreneurship.

Implementation of the strategy will be based on annual action plans, which will include measures in all six pillars of the strategy. In the first period of implementation, special attention will be focused on improving the business environment (included under pillar 3.4) and to improve access to finance for SMEEs.

3.3.1 Priority measure: Improving access to finance for SME’s and entrepreneurs (SMEE)

This measure represents the implementation of priority actions in the second pillar of the Strategy to support the development of small and medium-sized enterprises, entrepreneurship and competitiveness for the period 2015 to 2020 in the period up to 2017. The measure covers the most important actions within the three priorities of the second pillar strategy, which relate to improving the quality of the banking sector offers for SMEs, the development of new financial instruments and improving the ability of SMEs to access different sources of funding.

3.3.1.1 The main objectives and relevance for competitiveness and growth

The Progress Report on the Republic of Serbia in the European integration process in 2014 concluded that Serbia should improve the business environment and support the development of the private sector, important sectors of the economy require further restructuring and liberalization, as well as the urgent need to resolve the issue of restructuring of large state companies. The Small Business Act of the European Union emphasizes the need to improve access to financing for SMEs.

The Republic of Serbia in the Global Competitiveness Report of the World Economic Forum for 2014-2015 is ranked on the 98th place out of 144 countries in terms of availability of financial services, 110th in terms of their accessibility and even in the 121st and 132nd place in relation to access to credit and availability of entrepreneurial capital. These estimates
are worse than the placement of most neighbouring countries and show a the long-term trend. In various surveys of entrepreneurs, the problem of access to finance remains at the top of the obstacles to doing business.

3.3.1.2 Description of the measure

These priority measures will be carried out through a number of related activities.

The most important activity is related to the improvement of credit support to the banking sector for SMEs refering to the continued implementation of favourable credit, financed from foreign sources, with the guarantee of the Republic of Serbia, which is realized through commercial banks. In this way, SMEs will provide access to long-term loans under more favourable conditions. The most important line of credit in this context is "Apex Loan for SMEs and other priorities III / A". On the victims, because the loans from the apex and directed primarily at medium and larger small businesses, the second activity relates to the implementation of a program of support for the purchase of equipment for small businesses. Through a combination of its own participation, grants and soft loans to commercial banks that will participate in the program, it will be easier for small businesses to invest in equipment.

The second set of activities relating to the development of new financial instruments, as a supplement or alternative to bank financing. The beginning of this long-term activity is an analysis of the need for establishing alternative of financial instruments with proposed investment strategy, which will be prepared by the European Investment Bank during 2015. Continuation of activities will be carried out in accordance with the recommendations of investment strategies, for what has already requested assistance from the IPA package for the next period.

Activities on the demand side, ie improving the ability of SMEs to access different sources of financing, will be conducted in cooperation with the National Agency for Regional Development and the Serbian Chamber of Commerce, which is a long-term committed to develop information services and counselling to SMEs and which established a special portal to finance SMEs. Through the technical assistance component of the regional project WB EDIF will be developed a new program of training in readiness for investment companies.

In addition to these major activities, which are included in the priority measure, the company and additional activities related to the promotion of the public financial institutions supporting SMEs (Development and AOFI), creating a legal framework for non-deposit microfinance institutions and venture capital funds, the continued implementation of other lines of credit secured by state guarantees or grants, and implemented by commercial banks, support for greater use of guarantee schemes financed from EU sources, such as WB EDIF and Cosmo, the improvement of the enforcement procedure and regulations pertaining to the lien, in order to create conditions for the reduction of risk and interest rates of banks and other complementary activities.
3.3.1.3 The legal/administrative acts that need to be developed, adopted or implemented

The Framework Agreement "Apex Loan for SMEs and other priorities III / A" is signed, for 150 million euros. It is expected that in the future to negotiate a loan for another 150 million euros.

A draft program of support to small businesses for the purchase of equipment had been developed and funds in the amount of RSD 200 million in the budget for 2015 have been provided. The program will begin with the realization after being approved by the Government.

In early 2015, a financial agreement for IPA 2014 is expected to be signed in the framework of which EUR 150 000 is provided for this purpose followed by the signing of the agreement between the the EIB and the European Union Delegation in Serbia and the start of the study. To establish financial instruments 15 million EUR has been requested within the Sectoral planning document for the competitiveness of the sector for the period 2015-2017.

3.3.1.4 The dynamics of the progress made in the last 12 months

The Framework Agreement between the Republic of Serbia and the European Investment Bank regulating the activities of the EIB in the RS was signed on 11 May 2009. Bearing in mind the approved loans from financial contracts where the Republic of Serbia was the borrower, up to now the EIB has approved four APEKS credit lines for SMEs primarily in the amount of 500 million euros. Financial contract for a new "Apex Loan for SMEs and other priorities III / A" between the Republic of Serbia and the European Investment Bank and the National Bank of Serbia, was signed on 30 December 2013 for an amount of 150 million euros.

The program of support to small businesses for the purchase of equipment is not implemented in 2014 due to lack of funds, but it was piloted in 2013.

In the past 12 months the program of activities relating to the preparation of studies related to financial instruments has been finalised.

With the support of USAID, the Serbian Chamber of Commerce has developed a portal dedicated to financing for SMEs, which is regularly updated and supplemented.

3.3.1.5 The dynamics of the forthcoming steps (2015-2017)

2015

- Uptake and implementation of the first tranche of the new APEX loan in the amount of EUR 150 million
- Implementation of programs to support small businesses for the purchase of equipment
- Preparation of the study that analyses the need for establishing alternative financial instruments with proposed investment strategies
- Preparation of investment readiness programs, the choice of an institution that will administer it and start of mentoring work
- Regularly updated portal for access to financing and implementation of workshops and training in accordance with the annual plan

2016

- Negotiations and uptake of APEX loan for an additional 150 million euros.
- The new annual cycle of the program of support for the purchase of equipment for small businesses
- Completion of the study and the initial implementation of the project of establishing financial instruments, in accordance with the investment strategy
- Completion of mentoring work and start implementing investment readiness programs for businesses
- Regularly updated portal for access to financing and implementation of workshops and training in accordance with the annual plan

2017

- New cycle of implementation of the program of support for the purchase of equipment for small businesses
- Continued implementation of the project of establishing financial instruments, in accordance with the investment strategy
- Implementation of investment readiness programs for businesses
- Regularly updated portal for access to financing and implementation of workshops and training in accordance with the annual plan

3.3.1.6 Assessment of the contribution to the national action plan for implementation of the strategy SEE 2020

This priority measure will directly and indirectly contribute to the achievement of strategic objectives in the field of sustainable growth in the section K - competitiveness.

3.3.1.7 The main challenges / risks in implementing measures

- Lack of funding, especially if the necessary funds from IPA for financial instruments are not granted
- Lack of cooperation and coordination of public authorities, organizations and bodies

3.3.1.8 Budgetary implications / defined including funds from the IPA
Measures planned for implementation in this field will be financed from the budget of the Republic of Serbia, donor funds, primarily through the Instrument for Pre-accession assistance of the European Union and international financial institutions in accordance with budgetary constraints, as well as funds from the budget of the Chamber of Commerce of Serbia.

Anticipated funding sources already reflected within the means of point 3.3.1.3

3.3.1.9 Description of the anticipated effects of the measure, including the expected time of their implementation

In 2015:

1. Realized budget support to small businesses for the purchase of equipment in cooperation with banks
2. Establishing a dialogue between the public and private sectors on increasing the volume of lending to SMEs
3. Activities conducted on the development of the capital market mechanisms, and to ensure alternative methods of facilitating access to financing and capital
4. Favourable financing conditions for SMEs;
5. The development of capital markets for access to alternative sources of funding

In 2016:

6. Conducted needs analysis to establish the alternative of financial instruments with a proposal Investment Strategy 2015-2016
7. Performed assessment of the market for financial instruments and investment needs assessment for the programming period 2014-2020 year;
8. The proposed investment strategy so that financial products offered to suit the needs of the market;
10. Portal established as the national economy PKS point with an overview of all available public, private and EU funding sources
11. Updated information on the website of the Entrepreneurial portal NARD Portal economy and PKS.
12. System of the regular submission of information Serbian Chamber of Commerce by the public, private and EU funding sources in order to have regular updates Portal economy PKS;
13. Conducted a national campaign to inform SMEs about the Portal economy PKS.

3.4. GOOD BUSINESS ENVIRONMENT

A reliable, predictable and clear legal and administrative framework for doing business that provides legal certainty and makes no unnecessary barriers to business is of
paramount importance for economic development, because it directly affects competitiveness, levels of investment and the dynamics of economic development.

### 3.4.1 Priority measure: The introduction of more efficient procedures for investments in construction and real estate management

#### 3.4.1.1 The main objectives and relevance for competitiveness and growth

The Annual Progress Report of the EC for Serbia for 2014 in the field of meeting the economic criteria noted that: "to enter the market continues to be difficult due to lengthy and costly procedures for obtaining various types of special permits and all major parafiscal costs. This is especially true for a building permit. The issue of conversion rights to use the property right is still not resolved, which further prevents any potential investment. Problems with construction permits should be resolved soon through Amendments to the Law on Planning and Construction. Bureaucracy, quasi-fiscal costs and difficulties in obtaining building permits remained the main obstacles to a more dynamic start-up and business expansion. It is necessary to make further efforts in the implementation of planned reforms in this area.

When it comes to sectoral policies we need to invest special efforts to improve the process of issuing building permits, in order to influence that the construction sector is more dynamic and to improve the business environment in general. New law to facilitate the issuance of building permits has yet to be adopted."

Priority regulatory reform in the Republic of Serbia is linked to urgent legislative changes that largely affect the business environment. One of the key measures is to actively implement the Law on Amending the Law on Planning and Construction and the timely adoption of bylaws and harmonization of all the "sectoral" regulations governing this area, with the aim of reducing and efficient procedures for issuing building permits.

#### 3.4.1.2 Description of the measure

This measure is one of the priority measures Dimensions 1 - Establish an enabling regulatory framework in line with the needs and capabilities of SMEs, under Pillar 1 - Improving the business environment Strategy to support the development of small and medium-sized enterprises, entrepreneurship and competitiveness. The measure will be implemented through the following legislative and administrative activities:

1. Full implementation of the adopted Law on Amendments to the Law on Planning and Construction

The amendments to the Act and the introduction of a unified procedure in the permitting process created the opportunity to obtain all necessary documentation in one place, in a transparent manner and in a short time. In the process unified procedure for the issuance of a building permit is included and the Republic Geodetic Authority, which will lead to a
shortening of the scheduled time for registration of property rights on the basis of the
collection of buildings with an average 45 to 20 days. Progress will be monitored on the
basis of the following parameters: duration of the procedure for obtaining construction and
use permits and registering property rights shortened for at least 100 days; The rationalization
of taxes and charges through their reduction and abolition; Reducing the number of
procedures to no more than 11 (currently 16).

2. Adoption of Amendments to the Law on State Survey and Cadastre

The planned sanctions for non-compliance with the deadline of 30 days provided for by
the Law on General Administrative Procedure Act ("Off. Gazette of the Republic of Serbia",
No. 33/1997, 31/2001, 30/2010), in which the competent administrative authorities, including
the Republic Geodetic Authority, must perform registration in the Real Estate Cadastre by
duly received the request.

3. Establishment of the Central Records unified procedure for issuing construction
permits in accordance with the Law on Amendments to the Law on Planning and
Construction

Central Records will be established within the Business Registers Agency.

4. Reconciliation of sectoral legislation with the legislative framework for regulating the
area of planning and construction to optimize the licensing process related to the
construction and issued by public companies and other bodies.

Progress will be monitored on the basis of the following indicators:
- compliance regulations relating to the issuance of building permits issued by
public companies and other bodies;
- Redefining the role of public companies and other bodies involved in licensing
procedures in the process of construction;
- The level of optimization procedures.

5. Edit the property-legal relations on construction land and the necessary space and
urban planning

This activity should provide an accurate accounting of the situation in terms of coverage
of the territory corresponding to spatial and urban plans and prepare an action plan that
specifies the dynamics of development and adoption of insufficient planning documents in
cooperation with the Ministry of Civil Engineering, Transport and Infrastructure, Ministry of
State Administration and Local Government, the Ministry of Finance of the Republic
Geodetic Authority, the Standing conference of Towns and Municipalities and other
competent authorities.

6. Reform legislation which provides for the payment of compensation for land
This activity should lead to the establishment of clear criteria for determining the contribution of the construction land.


The amended Regulations prescribe the obligation of registration of pre-emption in the real estate to be clearly noted this right and uniformly applied in all units and cadastre which will enable the registration of the lease without restrictions.

8. Shorten the time required to enrol mortgage on the property, as well as to remove it

This activity involves simplifying and shortening administrative procedures for the registration and cancellation of the mortgage through the training of staff in the local Real on the implementation of administrative procedures.

3.4.1.3 The legal / administrative acts that need to be developed, adopted or implemented

1. Strategy to support the development of small and medium-sized enterprises, entrepreneurship and competitiveness (2015-2020) and the Action Plan;
3. Law on Amendments to the Law on State Survey and Cadastre

3.4.1.4 The dynamics of the progress made in the last 12 months

A World Bank report on doing business in the Republic of Serbia for 2013 and 2014: The Republic of Serbia in terms of the time required to obtain construction permits is ranked 182 place (out of 185 countries) in both analysed years. With regard to registration of immovable property is ranked 41st (2013) and No. 44 (2014).


3.4.1.5 The dynamics of the forthcoming steps (2015-2017)

2015

- Full implementation of the Law on planning and construction by 1 March 2015.
- Fourth quarter. The implementation plan will be developed for 2016 with projections for 2017 on the basis of quarterly and annual reports on the implementation and updating of indicators

2016

- Fourth quarter 2016 will be drafted implementation plan for 2017 with projections for 2018 on the basis of quarterly and annual reports on the implementation; shall update the indicators and analyse the need for revision (midterm external evaluation)

2017

- Fourth quarter: 2017 adoption of the amendment shall be audited Strategy (if applicable) and develop implementation plan for 2017 with projections for 2018, based on the quarterly and annual reports on the implementation and updating of indicators

3.4.1.6 Assessment of the contribution to the national action plan for implementation of the strategy SEE 2020

This priority measure will directly and indirectly contribute to the achievement of strategic objectives in the field of sustainable growth in the dimension K, relating to the implementation of regional activities to support the development of SMEs, including the grouping of links SDI-MSP, as well as coordinated efforts to improve business integrity.

3.4.1.7 The main challenges / risks in implementing measures

The most significant risks identified are lack of funding and lack of cooperation and coordination of public authorities, organizations and bodies. A measure intended to alleviate the risks related to the cooperation of the competent state bodies and organizations is the establishment of the Council for small and medium enterprises, entrepreneurship and competitiveness, as well as occasional working bodies of the Government, whose members are representatives of ministries and other bodies and organizations.

3.4.1.8 Budgetary implications / defined including funds from the IPA

- Funds for the implementation of activities under this priority measures are provided in the budget of the Republic of Serbia, as follows: 01 Revenue from the budget, the section 36; Function 410; Program 1102
- With the support of USAID BEP BEP business and GIZ project
- Since 2016, support for the implementation of activities under this measure will be provided through the project "Development of the Private Sector" IPA 2013
3.4.1.9 *Description of the anticipated effects of the measure, including the expected time of their implementation*

1. Amendments to the Act and the introduction of a unified procedure in the permitting process created the opportunity to obtain all necessary documentation in one place, in a transparent manner and in a short time. In the process unified procedure for the issuance of a building permit is included and the Republic Geodetic Authority, which will lead to a shortening of the scheduled time for registration of property rights on the basis of the construction of buildings with an average 45 to 20 days.

2. Establishing a central register established under the Business Registers Agency until 2016.

3. The harmonized regulations relating to the issuance of building permits issued by public companies and other bodies;

4. Redefined the role of public companies and other bodies involved in licensing procedures in the process of building

5. Determining the exact situation in terms of coverage of the territory corresponding to spatial and urban plans and prepare an action plan that specifies the dynamics of development and adoption of insufficient planning documents.

6. Establishing clear criteria for determining the contribution of the construction land.

7. Revised Regulations prescribe the obligation of registration of pre-emption in the real estate to be clearly noted this right and uniformly applied in all units and cadastre which will enable the registration of the lease without restrictions.

8. Simplify and shorten the administrative procedures for the registration and cancellation of the mortgage.
### Table 1: REPORTING TABLE ON SECTORAL STRUCTURAL REFORM MEASURES

<table>
<thead>
<tr>
<th>Recommendation / country-specific policy guidance (1)</th>
<th>Number and title of the measure and the sector (2)</th>
<th>Description of main measures of direct relevance to support competitiveness and growth, and to address country-specific policy guidance (if applicable)</th>
<th>Legal/Administrative instruments (3)</th>
<th>Timetable on progress achieved in the last 12 months (4)</th>
<th>Timetable on upcoming steps (up to three years) (5)</th>
<th>Estimated contribution to SEE2020 national action plan (6)</th>
<th>Specific challenges/risks in implementing the measures (7)</th>
<th>Link to SEE2020 targets</th>
<th>Challenges/Risks (8)</th>
<th>Budgetary implications/including committed IPA funds (9)</th>
<th>Qualitative elements (10)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Treaty establishing the Energy Community (Official Gazette of RS”, No. 62/06)</td>
<td>3.1.3 Priority measure: Ensuring energy security, energy market development and overall transition towards a sustainable energy / ENERGY (area - PHYSICAL CAPITAL)</td>
<td>The measure is aimed at providing support for: the development of energy markets; more intensive exploration of energy resources; the construction of new energy capacities and revitalization and modernization of the existing ones; rationalization of energy consumption and the overall increase in energy efficiency; intensive use of renewable energy.</td>
<td>Ensuring energy security and the security of safe, high-quality energy supply and energy and the establishment of conditions for reliable and safe operation and sustainable development of energy systems and energy sector in general. The development of the energy market based on the principles of competition, transparency and free initiative of energy companies, ensuring the protection of energy Law “Official Gazette of RS”, No. 145/2014); Treaty establishing the Energy Community Law on Buffer Stock (“Off. Gazette of RS”, No. 104/13)</td>
<td>In January 2014, the Energy Strategy of the Republic of Serbia until 2025 with projections to 2030 was approved by the Government. However, due to the establishment of the new Government in April 2014, it was necessary to repeat the procedure for the adoption of this document. It is expected that the Energy Development in the next period follows the implementation and monitoring of energy policy defined the main strategic documents of the Law on Energy: Energy Development Strategy of the Republic of Serbia until 2025 with projections to 2030, Program of realization of the Strategy, Energy Balance of the Republic of Serbia and the National Action Plans for Priority will measure the direct and indirect way contribute to the achievement of strategic objectives in the field of energy security, energy market development and sustainable growth, both in terms of implementation of activities aimed at increasing energy efficiency, and attainment of at least 9% savings in final energy</td>
<td>Weak institutional framework for the implementation of public policies and strategic planning in the energy sector.</td>
<td>Low collection rate, which leads to large debts to public enterprises and suppliers of energy and fuels.</td>
<td>Low energy efficiency in all sectors of the energy industry production and distribution of electricity, district heating, etc.</td>
<td>Significant financial resources are needed to implement energy policies. The draft Energy Strategy of the Republic of Serbia until 2025 with projections to 2030 estimates required funding for the period 2020, 2025 and 2030 for the implementation of activities for each area of energy: electricity, heat, etc.</td>
<td>The measure will contribute to the integration of national energy markets in the integrated European energy market, increasing security of energy supply and energy, as well as achieve the goals in the area of energy security, energy and the protection of the environment, arising from the decisions of Ministerial Council adopted on the basis of the Energy Community Treaty. This will enable the...</td>
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consumers of energy and energy sources, the development of the electricity and natural gas market and their connection with the single EU energy market, more intensive connection of the energy system of the Republic of Serbia with the energy systems of other countries. The transition towards sustainable energy through the implementation of energy efficiency measures, usage of renewable energy, protection of environment and reduction of impact on climate change. Development of energy of the Republic of Serbia should be such that its effects on the environment are minimized.

The legal basis of the Republic of Serbia for the formation and maintenance of mandatory reserves of oil is the Law on Buffer Stock ("Official Gazette of RS", No. 104/13), which in a separate chapter regulates the formation and use of mandatory reserves of oil and oil derivatives in the event of disruptions in energy supply and energy. The National action plan for using renewable energy resources of the Republic of Serbia ("Official Gazette of the Republic of Serbia No. 104/13), which regulates, inter alia, participation of renewable energy sources of 27% in gross final energy consumption in 2020, as well as improvement of environmental conditions in all areas of energy. Providing conditions that would encourage investment in energy facilities. The measure will increase security of energy supply in the Republic of Serbia through the establishment of procedures in case of supply disruption and mechanisms based on the principle of solidarity between the Member States of the EU and the Energy Community. Development and rehabilitation of national infrastructure (storage capacity), increasing the number of days for which the reserves of oil and oil derivatives have heating, existing buildings, industry, transport).

High energy and carbon intensity of the economy

Technological obsolescence of existing and lack of new energy capacities, inefficiency of public enterprises in the energy sector

The legacy of a destroyed, devastated natural space and excessive pollution of water, air and soil pollution caused by power generation;

The low level of use of technologies with low emissions of harmful substances in all parts of the energy cycle;

Underdevelopment and insufficient development of internal and regional markets for electricity and natural gas;

Lack of strategy for economic and social development of the country;

Long and complex procedure of

renewable energy, oil, natural gas, coal, energy efficiency Program for implementation of the Strategy, which will be prepared after the adoption of the new Energy Strategy, defines in detail the projects, measures and activities as well as the necessary funding for the period of 6 years. For the formation and maintenance of required reserves of oil and oil derivatives.

Negative reflection on the expenditure side of the budget of RS is not planned, considering that funds are collected for this purpose on the basis of fees imposed for the formation and maintenance of required reserves of oil and oil derivatives, which represents the revenue budget. In connection with the planned resources within
RS Government, at the proposal of the Ministry of Mining and Energy, adopted the Decree on the amount, method of calculation, payment and disposition of fee for the formation of mandatory reserves of oil and oil derivatives ("Official Gazette of RS", No. 108/14) and the Decree on the methodology of data collection and processing and the calculation of average daily net imports, the average daily consumption and the amount of required reserves of oil and oil derivatives ("Official Gazette of RS", No. 108/14), by which the conditions for the collection of fees for the formation and maintenance of mandatory reserves of oil and oil derivatives are more closely regulated, in accordance with the planned structure and RS", No. 53/13) been provided; obtaining approvals and permits.

Reports on the implementation of the National Action Plan for the use of renewable energy sources of the Republic of Serbia which is submitted to Energy Community every other year.

Lower levels of investment in production facilities that use renewable energy resources in relation to the anticipated National Action Plan.

Obtaining IPA funds, we recommend Activity 1.1.4 - Supply and Technical assistance concerning the optimal management of networks and mandatory oil stocks and support to the Central Stockholding Entity (electric grid, gas and oil) (2015) and Activity 2.1.6 - oil and oil products storage (2016).
<table>
<thead>
<tr>
<th>Improve the quality and efficiency of the education system.</th>
<th>HUMAN CAPITAL</th>
<th>amount of mandatory reserves, the necessary financial resources for procurement and storage, consumption of petroleum products in the previous calendar year and the period of time for the formation of mandatory reserves. Report on the implementation of the National Action Plan for the use of renewable energy resources of the Republic of Serbia (&quot;Official Gazette of RS&quot;, No. 8/15)</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.2.1 Priority measures: Development of a National Qualifications Framework in order to raise the competences</td>
<td>1. Development and adoption of integrated NQF and proposals for the draft law on integrated NQF (Indicator - Adoption of an integrated document NQF)</td>
<td>1. Law on the Basis of the Education System (Official Gazette of RS, No. 72/09, 52/11, 55/13), the Law on Higher Education (RS Official Gazette no. 76/05, 100/07, 97/08, 44/10, 93/12, 89/13, 99/2014)</td>
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<td>2. Drafting of the draft law on regulated professions (Indicator - The draft law on regulated professions)</td>
<td>3. Law on</td>
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<td>3. The formation of sectoral higher</td>
<td>1. Formed team for making integrated NQF and prepare proposals for the draft law on NQF-in (December 2014)</td>
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<td>2. The Working Group on drafting the regulated professions established (January 2015)</td>
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<td>1 December 2015 - adopted document on integrated NQF. December 2016 - adopted Law on NQF</td>
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<td>3 December 2015 - formed four sectoral councils. 2017 - formed all sectoral councils.</td>
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<td>Priority measure will directly and indirectly contribute to the achievement of strategic objectives in the field of smart growth in the dimension D, which refers to the increase of quality with a focus on qualifications and mobility.</td>
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<tr>
<td></td>
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<td>- Lack of financial resources</td>
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<td>- Insufficient human resources</td>
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<td>- Insufficiently developed links between education, employment and economic development and innovation policy, as well as industrial restructuring</td>
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<td>- The delay in the formation of the Sectoral Councils</td>
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<td>- IPA 12 – 3,6 million EUR</td>
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<td>- Compliance educational offer to the needs of the labor market and the economy - 2020</td>
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</tbody>
</table>
| Improve the quality and efficiency of the education system. | HUMAN CAPITAL | 3.2.2 Priority measure: improving the efficiency and management of the education system | 1. Development and implementation of a unified information system in education (UISE)  
1.1 Development registers of preschools, kindergarten teachers, children. (Indicator - Number of realized registers)  
1.2. Development of registers of elementary schools, teachers, students. (Indicator - Number of realized registers)  
1.3. Development of 1. Law on the Basis of the Education System (Official Gazette of RS, Nos. 72/09, 52/11, 55/13)  
2. Law on Higher Education (RS Official Gazette no. 76/05, 100/07, 97/08, 44/10, 93/12, 89/13, 99/2014)  
2. The Working Group on implementation of the guidelines of ICT in education  
3. Reported the registry of staff in higher education institutions 1 Jul 2015 – Adopted Strategy of development of statistics in Education and Science  
2 September 2015 - Developed register of institutions and teachers for all levels of education  
3 Jun 2016 - Developed a unique information system in pre-university education  
December 4, 2015 - Determining the cost of studying at Priority measure will directly and indirectly contribute to the achievement of strategic objectives in the field of smart growth in the dimension D, which refers to the increase of quality with a focus on qualifications and mobility  
113.2.2 | - Lack of financial resources  
- Insufficient human resources  
- The resistance of the university community to change the model of financing due to the excessive autonomy  
- TEMPUS project FINHED (919,000 EUR)  
- TEMPUS project RHODES (787,000 EUR)  
- Use of funds from approved credit lines  
- Using funds from potential donations  
- A more efficient system of education - 2020  
- Single information system in education (all levels of education) - 2017 |
<table>
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<tr>
<th>Improve the quality of research, increase the capacity for innovation and achieve more efficient technology transfer from research institutions to the economy, with more favorable effects on productivity and employment</th>
<th><strong>HUMAN CAPITAL</strong></th>
<th><strong>Priority measure</strong></th>
<th><strong>Sectoral measure</strong></th>
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<tr>
<td><strong>3.2.3</strong></td>
<td><strong>Established Working group for drafting the Law on Scientific Research, the Law on Innovation, and the Decree on the evaluation of scientific research</strong></td>
<td>1. Established Working groups for drafting the Law on Scientific Research, the Law on Innovation, and the Decree on the evaluation of scientific research (January 2015)</td>
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<td><strong>2. Innovation Activities Act (Official Gazette of RS no. 110/05, 18/10)</strong></td>
<td>2. Innovation Activities Act (Official Gazette of RS no. 110/05, 18/10)</td>
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<td><strong>4. Action plan for the implementation</strong></td>
<td>4. Action plan for the implementation</td>
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<td><strong>1. Law on Scientific Research, the Law on Innovation, and Decree on the evaluation of scientific research (Official Gazette of RS no. 110/05, 50/06, 18/10)</strong></td>
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<td><strong>2. Strategy “Research for Innovation 2020” and the corresponding action plan; change of the model of financing science and research and development institutions and 3. defining the roadmap of development of scientific research infrastructure</strong></td>
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<td><strong>3. The situation in education (NPS 2011)</strong></td>
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<td><strong>4. Guidelines for promoting the role of information technology in education (NPS 2013)</strong></td>
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<td><strong>FINVO (January 2015)</strong></td>
<td>4. FINVO (January 2015)</td>
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<td><strong>4. Piloting infoVOB system at 7 universities (November 2014)</strong></td>
<td>4. Piloting infoVOB system at 7 universities (November 2014)</td>
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<td></td>
<td><strong>HEIs and fields December 4, 2015 - The new Law on Higher Education 5 Jun 2016 - The new Law on Higher Education 5 Jun 2016 - The prepared analysis of the needs of local governments in a number of schools 5 December 2017 - The network of schools aligned with the real needs</strong></td>
<td>5. The network of schools aligned with the real needs</td>
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<td><strong>6 December 2017 - The new Law on Higher Education</strong></td>
<td>6. The new Law on Higher Education</td>
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<td><strong>IPA 2013 – 0.74 million EUR</strong></td>
<td>6. IPA 2013 – 0.74 million EUR</td>
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<tr>
<td>1. The level of public funding of scientific research sector is low compared to international standards (Lisbon objectives)</td>
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<td>2. The outcomes of applied research and development achieved in scientific research organizations are not suitable for commercialization</td>
<td>2. The outcomes of applied research and development achieved in scientific research organizations are not suitable for commercialization</td>
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<td>3. Fragmented and unsuccessful national system of innovation</td>
<td>3. Fragmented and unsuccessful national system of innovation</td>
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<td>4. The brain drain of researchers to better-funded R &amp; D organizations outside Serbia</td>
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IPA 2013 – 0.74 million EUR
of the Strategy of Scientific and Technological Development of the Republic of Serbia for the period from 2014 to 2015 (Fig. gl. RS no. 11/2014)
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<tr>
<th>Page</th>
<th>Section</th>
<th>Content</th>
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<tbody>
<tr>
<td>1</td>
<td>1.1</td>
<td>One of the main drivers of economic development of the Serbian economy is structural adjustment of the industry in the coming period, which will be a sector of micro, small and medium enterprises and entrepreneurs. This sector generates about two-thirds of employment and turnover, 54.1% of GVA and accounts for 43.2% of the exports of the non-financial sector. It is estimated that in 2013 SMEs, which makes 99.8% of the total number of entrepreneurs participated with about 34% of the GDP of the Republic of Serbia.</td>
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<td>1</td>
<td>1.2</td>
<td>The most important activity related to the improvement of credit support to the banking sector for SMEs refers to the continued implementation of favorable credit, financed from foreign sources, with the guarantee of the Republic of Serbia, which is realized through commercial banks. In this way, SMEs will provide access to long-term loans under more favorable conditions. Indicator: Business loans for SMEs in EUR. Availability of indicator: June / July of the current year for the previous year. The National Bank of Serbia provides this indicator according to the OECD methodology for Financing SMEs and Entrepreneurs 2014: OECD Indicators System. The goal for 2015 - mitigate the negative trend of reduction of bank lending to SMEs.</td>
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<tr>
<td>1</td>
<td>1.3</td>
<td>Strategy to support the development of small and medium-sized enterprises, entrepreneurship and competitiveness (2015-2020) and the Action Plan: Bearing in mind the approved loans from financial contracts where the Republic of Serbia was the borrower, up to now by the EIB approved four APEKS credit line for SMEs primarily in the amount of 500 million euros. Financial contract for a new &quot;APEX Loan for SMEs and other priorities III/IV&quot; was signed on 30 December 2013 for an amount of 150 million euros. The program of support to small businesses for the purchase of equipment was implemented in 2014 due to lack of funds, but it was piloted in 2013. In the past 12 months finalized the program of activities relating to the implementation of studies related financial instruments. With the support of USAID, Serbian Chamber of Commerce has developed a portal dedicated to financing for SMEs, which are regularly updated and supplemented.</td>
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<tr>
<td>1</td>
<td>1.4</td>
<td>Disbursement and implementation of the first tranche of the new APEX loan in the amount of EUR 150 million implementation of programs to support small businesses for the purchase of equipment. Preparation of the study analyzes the need for establishing alternative financial instruments with proposed investment strategies. Preparation of investment readiness programs, the choice of an institution that will administer it and start mentoring work. Regularly updated portal access to financing and implementation of workshops and training in accordance with the annual plan.</td>
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<tr>
<td>1</td>
<td>1.5</td>
<td>Priority measure will directly and indirectly contribute to the achievement of strategic objectives in the field of sustainable growth in the dimension K, relating to the implementation of regional activities to support the development of SMEs, including the grouping of links SDI-MSP, as well as coordinated efforts to improve business integrity. The most significant risks identified are lack of funding, especially if they are not granted the necessary funds from IPA for financial instruments and the lack of cooperation and coordination of public authorities, organizations and bodies.</td>
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<tr>
<td>1</td>
<td>1.6</td>
<td>Funds for the implementation of activities under this priority measure are provided in the budget of the Republic of Serbia and 01 Income from the section 20 Chapter 20.0 Program 1504 Function 410 Strad 0004 Ecc. Classification 411. In early 2015, expected to sign a financial agreement for IPA 2014 in the framework of which is provided for this purpose EUR 150 000 followed by the signing of the agreement between the Delegate of the EIB and the European Union Delegation in Serbia and the start of the study. To establish financial instruments requested 15 million EUR within the Sectoral planning document for the competitiveness of the sector for the period 2015-2017. With the support USAID BEP BEP business budget Serbian Chamber of Commerce.</td>
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<tr>
<td>2</td>
<td>2.1</td>
<td>Analysis of the need for establishing alternative financial instruments with a proposal of Investment Strategy 2015-2016.</td>
</tr>
<tr>
<td>2</td>
<td>2.2</td>
<td>Prepared estimate of the market for financial instruments and investment needs assessment for the period 2015-2016.</td>
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<td>2. Law on Amendments to the Law on Planning and Construction (&quot;Off. Gazette of RS&quot;, No. 132/2014);</td>
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2015.
2. Full implementation of the Law on planning and construction of 1 March 2015.
3. IV quarter. The implementation plan will be developed for 2016 with projections for 2017 on the basis of quarterly and annual reports on the implementation and updating of indicators.
4. 2016 Fourth quarter 2016 will be drafted implementation plan for 2017 with projections for 2018 on the basis of quarterly and annual reports on the implementation and updating of indicators.

Priority measures will directly and indirectly contribute to the achievement of strategic objectives in the field of sustainable growth in the dimension K, relating to the implementation of regional activities to support the development of SMEs, including the grouping of links SDI-MSP, as well as coordinated efforts to improve business integrity.

The most significant risks identified are lack of funding and lack of cooperation and coordination of public authorities, organizations and bodies.

Funds for the implementation of activities under this priority measures are provided in the budget of the Republic of Serbia, as follows:
1. Revenue from the budget, the section 36; Function 410; Program 1102; -With The support USAID BEP BEP business and GIZ project -From 2016 Support for the implementation of activities under this measure will be provided through the project "Development of the Private Sector" IPA 2013.

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9. The reform legislation which provides for the payment of compensation for land
10. Amendment of the Rules on the development and maintenance of real estate cadastre
11. Shorten the time required to enroll mortgage on the property, as well as to clean

annual reports on the implementation; shall update the indicators and analyze the need for revision ( midterm external evaluation)

2017
Fourth quarter:
2017 adopting the amendment shall be audited Strategy (if applicable) and develop implementation plan for 2017 with projections for 2018, based on the quarterly and annual reports on the implementation and updating of indicators

2. Establishing a central register established under the Business Registers Agency until 2016
3. The harmonized regulations relating to the issuance of building permits issued by public companies and other bodies;
4. redefined the role of public companies and other bodies involved in licensing procedures in the process of building
5. Determining the exact situation in terms of coverage of the territory corresponding to spatial and urban plans and prepare an action plan
that specifies the dynamics of development and adoption of insufficient planning documents.

6. Establishing clear criteria for determining the contribution of the construction land.

7. Revised Regulations prescribe the obligation of registration of pre-emption in the real estate to be clearly noted this right and uniformly applied in all units and cadastre which will enable the registration of the lease without restrictions.

8. Simplify and shorten the administrative procedures for the
| registration and cancellation of the mortgage |