At a Glance

- Serbia’s difficult legacy reforms are still being completed, and though serious progress has been made, the fiscal risks associated with any relapse remain high.

- Policies to stimulate entrepreneurship are being rolled out and are having an impact on employment rates. However, broader policies to enhance competitiveness in the medium and long term are needed, especially on education.

- The efficiency of social sector expenditure is the next frontier. Given current budget expenditure levels on health, education, and social protection, improved results should be expected. Functional and expenditure reviews have helped define a comprehensive reform agenda in these three areas, but political commitment is now needed to move the agenda forward.

- The World Bank program continues to support the Government in the implementation of complex structural reforms. A focus on expenditure efficiencies in the social sectors complements continued work on the business environment and infrastructure. Finally, the Bank remains the Government’s main partner on disaster risk management.

Country Context

The global financial crisis exposed the structural weaknesses in Serbia’s economic growth model and prompted the need for fiscal consolidation and an acceleration of the unfinished transition to a market economy. The rapid growth experienced by Serbia during 2001–08 was driven mainly by domestic consumption and led to significant internal and external imbalances that proved to be unsustainable.

The Government that formed following the April 2016 elections stepped up the implementation of structural reforms, broadening its focus to include a transformation of the social sector. Although the result of the recent presidential elections will necessitate a change in prime minister (given that the incumbent will become Serbia’s new president), the current emphasis on reforming the state administration, public finances, and the economy is expected to remain in place, along with pursuing the European Union (EU) accession process.

The Government’s economic reform program focuses on ensuring economic and financial stability, halting further debt accumulation, and creating an environment for economic recovery and growth to foster employment and raise living standards.

These goals will be achieved primarily through fiscal consolidation measures and an acceleration of structural reforms to remove existing bottlenecks to economic growth, including reform of state-owned enterprises (SOEs), creating the foundation for faster growth and private sector–led job creation over the medium term.
The World Bank and Serbia

The overarching goal of the World Bank Group’s (WBG) Country Partnership Framework for 2016–20 is to support Serbia in creating a competitive and inclusive economy and through this, to achieve integration into the EU.

The strategy is based on available evidence and expertise and focused on achieving the goals of reducing poverty and increasing prosperity across Serbian society in a sustainable manner.

Key areas of WBG support in Serbia include:

- restoring fiscal and macroeconomic stability
- creating conditions for accelerated private sector growth and job creation
- improving infrastructure
- strengthening public sector management and improving public service delivery to citizens

These focus areas emerged from six fundamental priorities identified by a comprehensive Systematic Country Diagnostic that examined the key challenges constraining growth and impeding greater shared prosperity.

The active portfolio reflects these priorities through 10 projects in the areas of transport, real estate management/business environment, competitiveness and jobs, health, flood recovery and flood protection, financial sector reform, public sector modernization, efficiency in public utilities, and early childhood education.

Key Engagement

The WBG has engaged in a multi-faceted effort to address Serbia’s complex legacy reforms, including commercial SOE reform, financial consolidation in public utilities and public transport companies, and the need for more efficient and competent core public administration.

More than four years of intensive dialogue and technical advice, combined with the use of policy-based and results-based lending, have started to yield important and increasingly impressive results. This has included the SOE Reform Development Policy Lending (DPL) series, the Deposit Insurance Strengthening Project, the Jobs and Competitiveness Project, the Program for Results in support of Public Administration Modernization and Optimization, and the Public Enterprise and Public Utilities DPL.

As a result of these efforts, the number of commercial SOEs, which posed both high fiscal costs and distortions in the economic arena, has been lowered to a still difficult but nevertheless manageable portfolio; public utilities are returning to financial health with gradually improving services; and the size and cost of public administration have been reduced.

Next generation reforms will focus on improving the performance of public service delivery, corporatizing public utilities, and resolving the remaining large commercial SOEs, while attention will gradually shift to promoting economic initiative, entrepreneurship, and innovation.

<table>
<thead>
<tr>
<th>WORLD BANK PORTFOLIO</th>
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<tbody>
<tr>
<td>No. of Projects: 10</td>
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<tr>
<td>IBRD Lending: $1.635 Billion</td>
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<tr>
<td>EU Trust Funds: 3 (€4.3 Million)</td>
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The Grabovnica-Grdelica stretch on Corridor X, the biggest international road through Serbia
**Recent Economic Developments**

The Serbian economy benefited from a recovery of consumption (up 1.1%) and exports (up 11.9% year-on-year [y-o-y]) in 2016. As a result, real GDP growth is estimated at 2.8% (y-o-y). Unlike in previous periods, in both 2015 and 2016, private investment provided particular support to growth, which could have been even stronger if not for a recent increase in imports (6.8% in real terms).

Looking across the sectors of the economy, growth in 2016 was broad based. Agricultural output increased by 8.3% y-o-y in real terms in 2016, and value added in industry increased by 3.6% and in services by 2.2% compared to 2015.

The improved economic performance was reflected in the labor market, with employment rates exceeding those from before 2009. Both the activity and the employment rates, at 52.3 and 45.5% in the fourth quarter of 2016, respectively, have increased over the past two years. The unemployment rate fell to 13% in the fourth quarter, the lowest level since 2008.

In 2016, real wages increased by 2.6% (y-o-y) after declining for three consecutive years. However, almost a third of the increase in employment came from the informal sector. Youth unemployment dropped but remains high at 31.2%.

Since employment and labor income are critical to the welfare of the poor and vulnerable, poverty (measured using the regional line of US$5/day 2005 purchasing power parity [PPP]) is estimated to have declined from 14.9% in 2014 to 13.6% in 2016. The recovery in agriculture output in 2016 is likely to have had positive impacts on rural poverty, but it is estimated that poverty has not returned to its lowest level, which was seen in 2008.

Fiscal consolidation continues successfully, and in 2016, the general government budget deficit reached 1.4% of GDP compared to 6.6% in 2014.

Public debt declined to around 74% of GDP by year-end.

Inflation averaged 1.2% in 2016, well below the central bank target band, due to a still relatively weak domestic demand. Low inflation in 2016, and in particular a decrease in food prices (thanks to the good agriculture season), helped protect purchasing power.

The current account deficit (CAD) shrank by 13% in euro terms in 2016. This came as a result of an improved trade balance (down 12.9%) and despite lower remittances (a drop of 9.4% y-o-y). Foreign direct investment (FDI) reached 5.5% of GDP. The dinar fell slightly (1.5%) against the euro in 2016.

**Economic Outlook**

Growth is projected to accelerate from 2.8% in 2016 to about 4% over the medium term. An increase in consumption is expected to be the main driver of growth, with investment also gaining in importance.

The ongoing fiscal consolidation program aims for the fiscal deficit to decline to around 1% of GDP over the medium term, which should bring public debt as a share of GDP to below 70% by 2019. With domestic demand recovering gradually, inflation is set to return to the target band in 2017. External balances are projected to improve, with the CAD below 4% of GDP over the medium term.

With economic growth and improvements in the labor market, poverty is expected to continue its gradual decline. Poverty measured at the US$5/day poverty line is estimated to decline to 12.8% in 2017 and 11.9% in 2018.
Project Spotlight

New equipment improves radiation therapy for people with cancer.

In 2014, total health spending in Serbia accounted for about 10% of GDP. The fact that Serbia spent almost twice as much per capita on health as comparable countries but had similar health outcomes indicated that there was a need to increase the efficiency and the quality of the country’s public health care system.

This was critical for Serbia, given the fiscal constraints and increasing demands for health care from an aging population. To address some of the systemic deficiencies in the health sector and build on the support under a previous project, the Second Serbia Health Project, with US$40 million in funding, supports the improvement of public health care financing and efficient purchasing of pharmaceuticals and medical devices.

With the centralized procurement of drugs, introduced in 2014 for hospitals and primary health care centers and in 2015 for public pharmacies, the Health Insurance Fund (HIF) saved €25 million in 2014 and €41 million in 2015. This provides a greater availability of prescription drugs and significantly lowers the out-of-pocket expense of drugs for the insured, which particularly benefits the lower-income population who cannot opt out of the public health care system.

The Project also supports reforms in health care financing that will strengthen the transparency and efficiency of HIF financing in public hospitals through the introduction of the diagnosis-related group (DRG) payment system. In primary health care, the introduction of quality indicators and performance-based payment for health care providers aims to improve the efficiency and quality of health care.

One of the major health issues in Serbia is the prevalence of malignant diseases (cancers). Procurement of six linear accelerators under this Project will enable the country to attain international standards in terms of the availability of radiotherapy. The distribution of equipment will increase the equity and quality of cancer treatment for citizens throughout the country and reduce the long waiting lists for radiotherapy.