

Serbia SCD 2020 Update: Summary

Main Development Challenges

- 1. The Systematic Country Diagnostic (SCD) Update, completed in April 2020, argues that addressing the key constraints to growth, inclusion, and sustainable development is critical for Serbia to achieve faster progress and catch up with Europe's living standards.** The pace of poverty reduction and shared prosperity in Serbia has depended on the speed and inclusiveness of economic growth since the start of the transition. While the government has advanced structural reforms, they are not sufficient to accelerate growth and convergence with the EU, as also analyzed in the 2019 Country Economic Memorandum (CEM). Major fiscal consolidation and other reforms since 2014 helped to restore macroeconomic stability, pave the way for improvement in living standards until 2019, and put Serbia in a better fiscal position to address the Covid-19 pandemic. However, Serbia's economy in 2018 was still smaller than in 1990, indicating the need for sustained and accelerated growth to catch up with comparators in the EU.
- 2. A stronger focus on the key environmental sustainability, resilience, and inclusion challenges is necessary today.** Poverty and inequality levels in Serbia are still significantly higher than in comparator countries, with disadvantaged groups and subnational regions persistently lagging behind the average population. Environmental and climate-related concerns have become more prominent. Pressing issues such as air pollution, high energy intensity, poor wastewater management, and droughts and floods continue to pose significant threats to the country's economic development and people's livelihoods. Serbia is an extremely carbon-intensive economy, with carbon dioxide emissions per GDP at about twice the average of the comparators in Central Eastern Europe and the Baltics. These issues were overshadowed by the fiscal stress and job losses back in 2014 but have now moved to the forefront of critical constraints facing Serbia. Making progress across all these areas requires stronger institutions, yet Serbia's improvements in government effectiveness and accountability have stagnated in recent years. In addition, Serbia's population is aging and declining, with significant implications for growth and shared prosperity. Increased out-migration is also contributing to the population decline. Given the low fertility rate and high out-migration, the population is expected to decline by 17 percent over 2015-2050, and the labor force could decline by up to 20 percent by 2050.
- 3. The SCD Update identifies two groups of priority areas to accelerate progress toward the twin goals of sustained poverty reduction and shared prosperity in Serbia (Table 1). The first group of priorities implies that Serbia needs to continue efforts in:**
 - ***Sustaining macroeconomic stability:*** Efforts to sustain Serbia's hard-won macroeconomic stability will be critical given continuing and new risks, related to higher domestic spending pressures, a need to increase public investments, as well as to risks from potential further shocks (including effects of a shock on NPL levels).
 - ***Fostering competitive markets and enhancing the business environment:*** Critical proximate factors for faster growth are to enable accelerated productivity growth across business sectors, to continue expanding public investments and FDI, encouraging a move to higher-value adding activities for the latter, and creating a more enabling environment for domestic private investments, including the constraints faced by SMEs. Important policy efforts include enhancing government effectiveness, regulatory quality and transparency (including property, land, logistics and trade regulations in particular) and reducing competition barriers (including public company advantages and overall SOE governance) and developing the financial sector, while maintaining appropriate monitoring and oversight. Enabling innovation and technology adoption is important for enhancing firms' productivity.

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- **Strengthening government effectiveness, efficiency, and accountability.** This is critical to overall development, including stronger and sustained growth, inclusion, and environmental sustainability; and there are also important links to managing demographic change and EU accession. Improvement in recent years has been limited and uneven. Serbia needs to improve policy coherence, public investment management (PIM), public sector efficiency and further modernization, SOE governance and regulation; strengthen transparency, accountability, and rule of law; and improve sub-national institutions, enabling dynamic cities and well governed towns and communities. Digitalization can be a useful tool for enhancing government effectiveness, efficiency, and accountability.

Table 1: Summary of SCD Update priority areas

Priority areas where continued efforts are needed	Priority areas with increasing prominence
<ul style="list-style-type: none"> • Sustaining macroeconomic stability • Fostering competitive markets and enhancing the business environment • Strengthening government effectiveness, efficiency, and accountability 	<ul style="list-style-type: none"> • Building relevant skills and providing equitable opportunities for acquiring human capital • Reducing labor market barriers and work disincentives • Addressing the challenges of rural areas and lagging regions • Addressing immediate environmental challenges to protect quality of life • Strengthening climate resilience and supporting a low-carbon transition

4. The second group of priorities places increasing prominence on promoting inclusion, environmental sustainability, and resilience through:

- **Building relevant skills and providing equitable opportunities for acquiring human capital:** Building relevant skills will contribute to higher growth and better jobs. Serbia needs to address long-standing constraints in education and training and weak efficiency and resilience in health service delivery. More equitable access to quality education and healthcare remains critical for closing gaps (including for the Roma). Increasing the coverage of financial social assistance will also help protect basic livelihoods and investment in human capital among the poor and vulnerable.
- **Reducing labor market barriers and work disincentives:** More than 45 percent of people aged 15 and above in Serbia are not working or searching for a job. Reducing the high labor tax and contribution burden (particularly for low-wage, low-skill workers and those with dependents), strengthening the effectiveness of job matching, and improving activation remain important to lower disincentives and barriers to work, including for disadvantaged groups and promoting women’s access to economic opportunities. The demographic challenges underscore the critical need to use all of Serbia’s available workers effectively.
- **Addressing the challenges of rural areas and lagging regions:** Enhancing agricultural productivity and non-farm activities and addressing specific challenges of Serbia’s lagging regions remain important for poverty reduction and inclusion. Improving local transport connectivity would help

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to facilitate mobility, market access, access to education, and job opportunities. Serbia's potential for sustainable new mining, if well-managed, can also offer economic opportunities in those remote areas.

- ***Addressing immediate environmental challenges to protect quality of life:*** Serbia urgently needs to control and reduce air pollution, the main sources of which come from energy, transport, and industry. Strengthening water quality and wastewater treatment to address the current health hazards relies on addressing the underlying investment needs, institutional capacity, and accountability in enforcing environmental standards.
- ***Strengthening climate resilience and supporting a low-carbon transition:*** A more comprehensive disaster risk management approach remains important to strengthen climate resilience, including enhanced resilience in energy and transport infrastructure and responsiveness of the health sector, and more adaptive social protection programs. Better management and cleaner use of resources would require tackling the investment and institutional constraints to transitioning toward higher energy efficiency and cleaner energy, transport, agricultural practices, as well as non-coal mining.