

**Country diagnostics are an EBRD tool to identify the main obstacles to entrepreneurship and private sector development and to help shape the Bank's strategic priorities and project selection in new country strategies. Each diagnostic informs the EBRD's policy engagement with the authorities in the country.**

**Each country diagnostic assesses the progress and challenges of the country of operations in developing a sustainable market economy.** Private sector development and entrepreneurship are at the heart of the Bank's mandate in the regions of operation of the bank, but the private sector in all EBRD countries faces a range of problems and obstacles. The diagnostic highlights the key challenges facing private companies and shows where each country stands vis-à-vis its peers in terms of six qualities of transition – competitive, well-governed, resilient, integrated, green, and inclusive – and points out the main deficiencies and gaps in each quality.

**The diagnostics draw on a range of methodologies and best practice for assessing how big different obstacles are.** Extensive use is made of in-house expertise across the EBRD, along with surveys such as the Business Environment and Enterprise Performance Survey (BEEPS) and the Life in Transition Survey (LiTS), as well as other cross-country surveys and reports from institutions such as the World Bank, World Economic Forum and OECD. For some larger countries, the diagnostics also draw on specially commissioned studies of selected issues that are critical for private sector development in the country.

**The diagnostics are led by the EBRD's Country Economics and Policy team,** drawing substantially on the expertise of sector, governance and political experts in the Economics, Policy and Governance department (EPG) and consulting widely with relevant experts across the EBRD when preparing the final product. The diagnostics are shared with the EBRD Board during the country strategy process and published during the public consultation period.

**The views expressed in the diagnostic papers are those of the authors only and not of the EBRD.**

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**European Bank**  
for Reconstruction and Development

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## **Serbia Diagnostics:**

Assessing Progress and Challenges in Developing  
a Sustainable Market Economy<sup>1</sup>

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## Executive summary

**Serbia has considerable potential for further private sector development, contributing to sustainable economic convergence.** The private sector accounts for around 70 per cent of total employment and its profitability is low compared to central and south-east European (CESEE) peers. Large and medium-sized companies often lack appropriate corporate governance, while SMEs face an unfavourable business environment.

**Private sector productivity growth is the most important driver of long-term economic growth as the working-age population is expected to shrink in the medium-term.** Economic analysis shows that in order to boost productivity Serbia should primarily focus on improving governance, applying more inclusive employment practices and enhancing the quality of infrastructure as well as energy efficiency.

**More efficient state-owned enterprises (SOEs) can also support private sector development.** Besides better-quality inputs for private users, efficiency gains would also free up a part of fiscal resources, allowing subsidies to be spent on other purposes supporting the private sector (e.g., education or health) and make the presence of SOEs less distortive in those sectors where private companies and SOEs co-exist.

**This diagnostic focuses on the ways of making the Serbian private sector more competitive and thus more supportive for economic convergence.** The paper consists of a brief overview of the Serbian private sector in regional comparison, discusses the most important corporate productivity drivers and the economic efficiency of SOEs in Serbia, and provides a general political economy and economic outlook as well as a quality-by-quality description of the main transition gaps according to the new EBRD methodology for measuring transition. This methodology assesses each country by six desirable qualities of a sustainable market economy: competitive, well-governed, resilient, integrated, green, and inclusive, and it compares them to some benchmark countries.

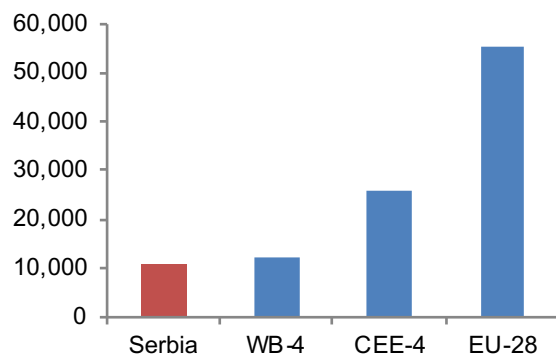
## Private sector and corporate productivity in Serbia

**Private sector development is key to ensure productivity and sustainable economic growth for Serbia.** Long-term sustainable convergence to more developed economies will require faster productivity growth, which could be facilitated in a number of ways, including technology transfers through FDI, an improved business environment for investment and SMEs, and continuous enhancement of corporate governance and management skills.



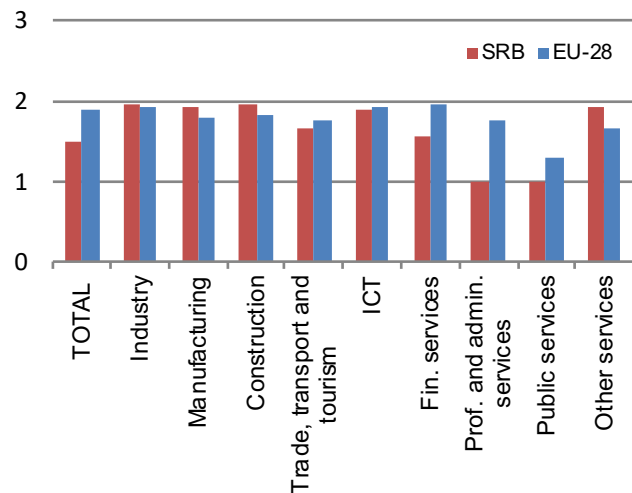
**Labour productivity in Serbia is low in regional terms.** At around €10,000, value added per employee is well below the CEE-4<sup>2</sup> and EU averages and even somewhat below the WB-4<sup>3</sup> average (Chart 1). Although Serbia’s competitiveness in manufacturing and construction is comparable to EU levels when measured by value added produced by one unit of labour cost (Chart 2), it is mainly explained by low wages rather than high productivity.

Chart 1: Value added per employee, 2014 (EUR)



Source: EUROSTAT and national authorities.

Chart 2: Value added per €1 of labour cost



Source: National Statistical Office, EUROSTAT and EBRD

**The private sector in Serbia accounts for around 70 per cent of total employment.** While small-scale privatisations have been mostly finished, some large SOEs are still to be privatised, or at least restructured, as they presently constitute significant fiscal risks. Large

<sup>2</sup> Czech Republic, Hungary, Poland and Slovakia

<sup>3</sup> Albania, Bosnia and Herzegovina, FYR Macedonia and Montenegro

and medium-sized companies often lack appropriate corporate governance and are frequently over-indebted<sup>4</sup> which limits their access to finance and thus their investment capacity. On the other hand, smaller companies face a number of challenges, the most important ones being the unpredictable business environment, high para-fiscal (i.e. non-tax) charges, and limited access to finance.

**The structure of the economy has remained broadly unchanged over the previous decade.** Services play a major role in the creation of value added (60 per cent), while industry and agriculture account for one-fourth and one-tenth of value added, respectively. Around half of the value added by services comes from trade, real estate and healthcare.

**Low profitability of private companies indicates potentially large efficiency gains.** The Serbian private sector (and corporate sector in general) is among the least profitable in the CESEE, with return on assets at 2.0 per cent (vs. 3.8 per cent in CESEE) and return on equity at 8.4 per cent (vs. 11.2 per cent in CESEE).

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<sup>4</sup> Long-term debt of over-indebted companies (defined as firms whose long-term debt is at least ten times higher than their EBITDA) and companies with negative EBITDA and equity stood at 25 per cent of GDP in 2015, the second highest in the CEE region.

## Corporate productivity drivers

The six transition qualities<sup>5</sup> all have a significant effect on productivity and thus on growth and income convergence in Serbia. An econometric analysis, using a large firm-level data set covering most sectors of the Serbian economy, provides estimates of the impact of changes in various exogenous factors on productivity (Table 1).<sup>6</sup> Improvements in youth inclusion and governance would support (total factor) productivity and growth the most. Better (regional) integration of infrastructure, energy efficiency and resilience (macroeconomic environment, NPLs) would also have a significant positive effect.

Table 1: *Drivers of total factor productivity*

Inclusive	Well-governed	Integrated	Green	Resilient	Competitive
Youth employment	Quality of institutions	Quality of infrastructure	Energy efficiency	Macroeconomic environment	Competition on sectoral level (HHI index)
	WB - Doing Business			NPLs	Employment and quality of education
	Corporate governance: delegation of authority				Share of intangible assets in total assets

Note: In order to assess their relative importance, all variables are separated into groups with a standardized coefficient above 0.3 (absolute value), between 0.2 and 0.3, between 0.1 and 0.2 and between 0 and 0.1. Standardized coefficients show the impact of one standard deviation change in the variable on productivity.

>0.3
0.2-0.3
0.1-0.2

Source: EBRD calculations.

**A more inclusive economy could raise productivity to a large extent.** Addressing youth unemployment (currently around 41 per cent in 2016) should be high on the agenda. Better coordination among education institutions and companies, and expanding the number of trainee and internship programmes, among other measures, could allow young people to get practical training and work experience earlier in life, thus avoiding long unemployment periods. Long-term growth and poverty alleviation would also require increasing the employability and employment of the most vulnerable groups, including young people, women, and the older and Roma population<sup>7</sup>.

**Improved governance is also key to support productivity.** Better institutions and an improved business climate would have a strong effect on productivity by providing stronger incentives for investment. Higher investments in turn can raise technological readiness and make the workforce more productive. Improving corporate governance should also be high on the agenda, both in SOEs and private companies. SOE profitability is low compared to

<sup>5</sup> See Annex 1.

<sup>6</sup> A two-step approach was applied. First, firm-level data from ORBIS were used to estimate the total factor productivity, and then, in the second step, the productivity estimates were regressed on a variety of firm-specific, macroeconomic, institutional and business environment variables by using random effects generalized least squares (GLS) model.

<sup>7</sup> For a detailed overview of the labour market in Serbia, see e.g. Social Inclusion and Poverty Reduction Unit, Government of Serbia & World Bank (2016), “Women’s Access to Economic Opportunities in Serbia”, Report 105793-YF; Dokmanovic, Mirjana (2016), “Gender Analysis for Serbia”, Letter of Contract N°2016/377481; World Bank (2015), “Gender at a Glance: Serbia” Report No. 100423.

CEE peer countries, suggesting that more professional management and a reduction in political interference could bring significantly more efficiency. The lack of appropriate division between ownership and management at private companies also creates inefficiencies, especially once an expanding company reaches a certain size.

**For Serbia, as an open economy, transport infrastructure and regional connections are very important.** Despite improvements in recent years, transport and energy connectivity to neighbouring countries and within the country still requires major improvements.

**Transitioning to a more energy efficient economy is also needed.** Energy and carbon intensity in the country is high as a consequence of heavy use of coal as well as low energy efficiency in industry and buildings. Improving energy efficiency can result in lower energy costs and emissions, while raising the share of renewables can cut emissions and contribute to more resilience by reducing the dominance of coal-fired energy generation.

**Despite recent improvements, the macroeconomic environment is still a significant hindrance to productivity and growth.** While the fiscal deficit has reached low levels, its sustainability still depends on several reforms (SOE restructuring, public sector right-sizing and efficiency improvements) that are needed to put the still high level of public debt on a sustainable path.

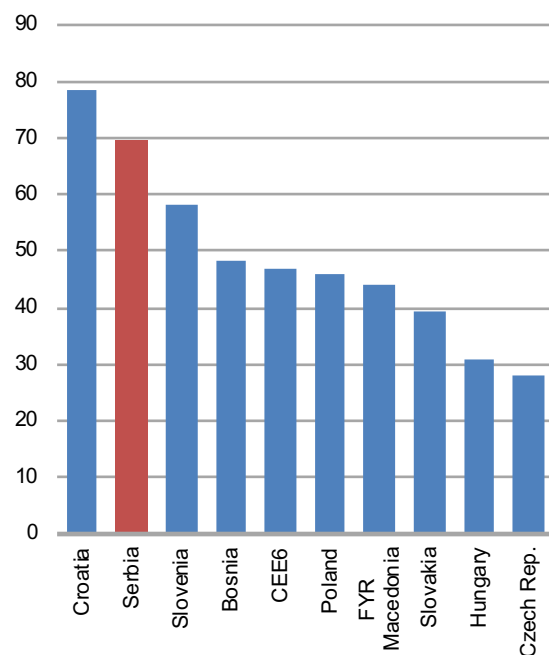
## Economic efficiency of SOEs

**SOEs are an important part of the Serbian economy.** In 2015 Serbia stood out in the Western Balkans/Central Eastern European region with one of the highest shares of SOE assets in GDP at around 70 per cent (Chart 3). Although half of the assets are concentrated in the energy sector, public enterprises are also present in many other sectors, including the mining, transport (road, railway and air transport companies), manufacturing (e.g., chemicals, pharmaceuticals, furniture), communications (telecom, newspapers, TV and radio stations) and agriculture (including forestry).

**Weak SOE performance is a considerable burden on public finances and a source of important fiscal risks.** The financial performance of Serbian SOEs is low by regional standards. At 18 per cent of GDP, revenues of Serbian SOEs are somewhat below the regional average, and their profitability is low or negative in most sectors. The average ROA in 2012-2015 was barely positive and among the lowest in the region (Chart 4). That might be an important reason why subsidies from the state budget, at two per cent of GDP, are significantly higher than in the EU (1.3 per cent). Furthermore, Serbian SOEs face serious problems in collecting their claims and paying their dues – in both cases the average number of days (over 100) is twice as high as in the CEE peers – thus creating pockets of illiquidity in the economy.

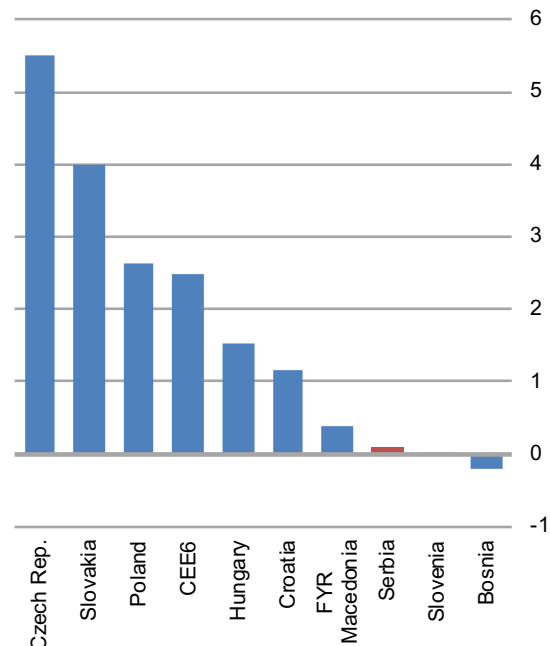
**Restructuring of large SOEs, particularly in the sectors of mining, energy and transport, is supported by the IMF, World Bank and EBRD.** Serbian SOEs are often burdened with excess employment and high debt. In most sectors, the cost of employees accounts for a much higher share of revenues than in other CEE countries, and three Serbian SOEs are among the top 10 overleveraged firms in Serbia. However, SOE restructuring has been running somewhat behind schedule.

**Chart 3: Assets of SOEs<sup>8</sup>**  
(share in GDP, 2015)



Source: EBRD calculation based on ORBIS BVD.

**Chart 4: ROA of SOEs**  
(weighted averages, 2012-2015)



Source: EBRD calculation based on ORBIS BVD.

<sup>8</sup> Financial sector not included.

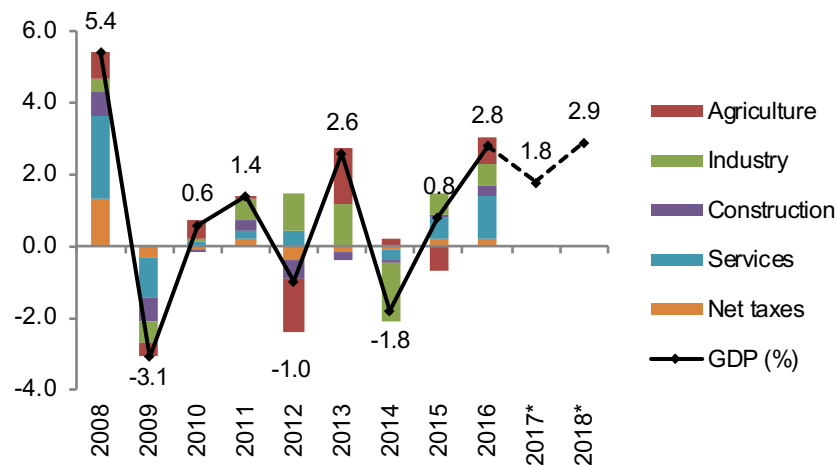


## Macroeconomic performance and outlook

**Economic growth started to recover in recent years after stagnating between 2009 and 2014.** Severe flood damage in May 2014 damaged the energy and mining sectors in particular and caused GDP to decline by 1.8 per cent, but the country returned to growth in 2015 (0.8 per cent), rising to 2.8 per cent in 2016. Growth in the past two years was driven by investment and exports amid stronger external demand and an improved investment environment, but was also helped by supply-side factors – relatively low oil prices and interest rates, the recovery of the mining and energy sectors in 2015, and a very good agricultural season in 2016.

**Medium-term growth prospects are dependent on the implementation of structural reforms.** The economy is expected to slow down the growth to 1.8 per cent in 2017 due to a severe drought hitting the agriculture sector and difficulties in mining and electricity generation, and to pick up to 2.9 per cent in 2018. Exports and consumption should be the main growth drivers, while the contribution of investment will stay positive but somewhat lower than in the past two years. With an investment-to-GDP ratio below 20 per cent, the investment gap is still sizable compared to other countries at a similar level of development. An acceleration of medium-term growth would need further business environment reforms and SOE restructuring, as well as resolving the issues of NPLs and corporate over-indebtedness, which are both high even by regional standards.

**Chart 5: Decomposition of GDP growth by sector**  
(in percentage points)



\* EBRD's November 2017 projection.

Source: National statistical office.

## Political economy

**Serbia began the transition later than most other Western Balkans countries. It has been catching up steadily since the removal from power of Slobodan Milosevic in 2000.** Nevertheless, some elements of the ex-Yugoslav legacy, including the continuing hold by the state on the main economic assets and the system of trading seats on the boards of key state-owned companies between political parties, have persisted for many years. Major structural reforms were delayed by successive governments, regardless of the strength of their democratic credentials.

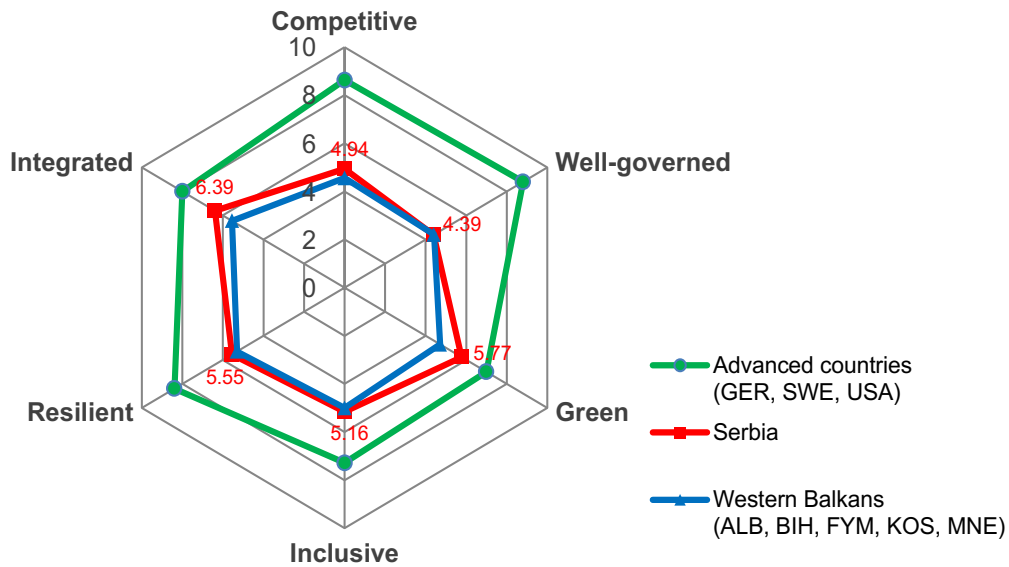
The strong position enjoyed by the current governing Serbian Progressive Party (SNS) at both national and local level since 2012, further reinforced after its victories in early general elections in 2014 and 2016, has created **political momentum for an ambitious modernisation and reform programme**. Over the last few years, the Serbian parliament has adopted a package of reform bills, including labour and pension laws, and laws on privatisation and bankruptcy essential for the restructuring and privatisation of more than 500 public companies. Although the results of subsequent early privatisations have been uneven, this process is ongoing, accompanied by the reform of governance and efforts to strengthen the rule of law and the business environment. Further success in these areas will be particularly important for long-term growth prospects. Given the multitude of challenges facing Serbia, pursuing conclusive reforms requires not only strong political will and public support but efficient governance as well.

**The reform process is supported by continuing EU approximation.** Serbia obtained the status of EU candidate country in 2012 and formally opened EU accession negotiations on 21 January 2014. However, the accession negotiations only started in earnest at the end of 2015. So far, Serbia has opened 12 chapters of the EU accession negotiations, including the critical rule of law chapters 23 and 24.

## Qualities of a sustainable market economy

Serbia faces major gaps in all six transition qualities.<sup>9</sup> The largest gaps relate to the competitive, well-governed and resilient qualities (Chart 6).

Chart 6: ATQ scores – Serbia



Source: EBRD estimates.

Note: The level of development within each of the qualities is measured from 1 to 10, with 1 meaning little or no progress and 10 representing the global frontier.

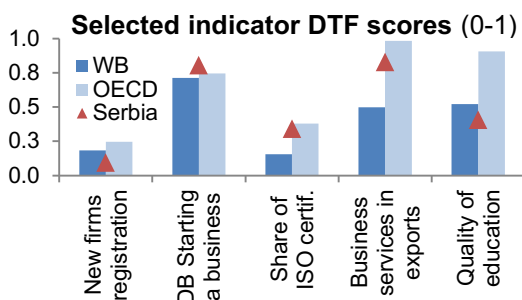
<sup>9</sup> For a brief overview of characteristics of transition qualities see Annex 1.

**Competitive [ATQ = 4.94]**

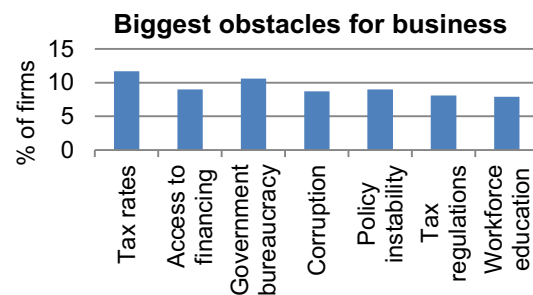
**The competitiveness of the Serbian economy is comparable to other Western Balkans countries and lags behind EU standards.** Despite being among the top ten reformers in the World Bank Ease of Doing Business report in 2016, many structural issues remain to be addressed. The economy is still severely constrained by weak institutions, an inefficient public sector, high corporate indebtedness and skills mismatches. The EC considers Serbia to be moderately prepared to cope with competitive pressure and market forces within the EU.

- **Privatisation/restructuring of large SOEs has lagged behind.** Serbia’s power, telecommunication and energy sectors remain largely under state control. Viewed as a source of contingent fiscal risks, they are currently being restructured. Enforcement of competition rules on public companies is often ineffective. Weak competition generally exists in the retail and energy distribution sector, as well as in public procurement-dominated sectors.
- **SMEs face major obstacles to doing business.** Most SMEs are concentrated in the trade, services, manufacturing and technology sectors and contribute to 60 per cent of employment and 50 per cent of value added. Challenges include an unpredictable business environment, high levels of para-fiscal charges, and difficult and costly access to finance.
- **Tax rates, access to financing and inefficient government bureaucracy** are seen as the most problematic factors for doing business in Serbia, followed by **corruption** which is also seen as a severe obstacle to private sector development according to BEEPS V.
- **Investment, at under 20 per cent of GDP, is still below the level needed for long-term convergence.** Government subsidies support foreign direct investment in several industries, including the automotive industry which dominates exports.
- **Competitiveness is also negatively affected by skills mismatches** as levels of education and training do not fully match the needs of the private sector. Consequently, unemployment is high (especially long-term and youth unemployment), leading to skills deterioration, further skills mismatches and an ongoing brain drain. Recent amendments to the labour law have increased labour market flexibility, but social contribution payments remain relatively high.

43<sup>rd</sup> out of 190 countries in ease of doing business (World Bank, 2018)  
 78<sup>th</sup> out of 137 countries in Global Competitiveness Index (World Economic Forum, 2017-2018)  
 42<sup>nd</sup> out of 141 economies in Economic Complexity Index (Observatory of Economic Complexity, 2015)  
 65<sup>th</sup> out of 128 countries in Global Innovation Index (Cornell University, INSEAD and WIPO, 2016)  
 76<sup>th</sup> out of 160 countries in Logistics Performance Index (World Bank, 2016)  
 Ranked around median among EBRD CoOs on overall competitiveness (13 indicators)



Source: World Bank, WEF, ISO and EBRD's calculations



Source: WEF's Global Competitiveness Index 2017-2018

**Well-governed** [ATQ = 4.39]

**Serbia performs poorly on many aspects of public governance.** The country scores particularly low in the area of property rights protection, government effectiveness, and regulatory burden. There is insufficient transparency on the state’s subsidy policy and on government policymaking in general, as evidenced by the practice of important laws being approved by emergency procedure, without proper consultations with interested parties. Secondary legislation is usually adopted with delays. Businesses bear a costly administrative and financial burden of numerous fiscal and para-fiscal charges at both state and local government level.

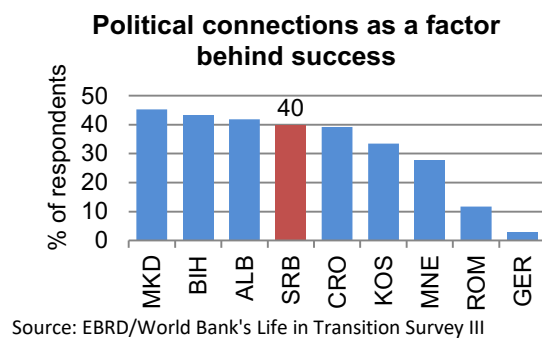
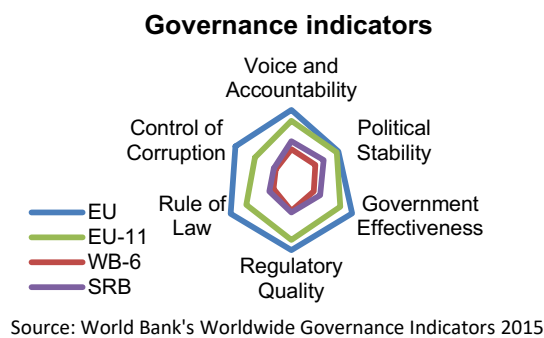
- **Support for democracy and the market economy**, at between 30 and 40 per cent, is lower in Serbia than in the SEE region as a whole (LiTS III).
- With regard to the **rule of law**, the country is judged by the EC to be at “some level of preparation” (the second lowest on a five-point scale) with regard to functioning of the judiciary as well as the fight against corruption and organised crime. Despite constitutional guarantees on independence, there is still some political influence over the judiciary. Enforcement of contracts is lengthy.
- **Corruption** remains prevalent in many areas, posing a serious problem. Public enterprises are particularly vulnerable to corruption, according to the EC.
- **Political connections** are seen by many people as key to success in life, according to the LiTS III, with 42 per cent of respondents (the fourth highest among all countries) seeing this factor as more important than effort and hard work, or intelligence and skills.
- The **corporate governance framework** needs to be strengthened. The EBRD’s assessment of corporate governance in Serbia highlights a problem with stakeholders and institutions, which score 2 on a scale from 1 (worst) to 5 (best), and points to several critical issues in the structure and functioning of boards, and internal control.<sup>10</sup> Also, the ethical behaviour of firms is often below acceptable standards.

72<sup>nd</sup> out of 176 countries in Corruption Perceptions Index (Transparency International, 2016)

Less than half of Serbian respondents think there are free elections, and law and order. (LiTS III, 2016)

Only around one third of Serbian respondents think there is a fair justice system and an independent press. (LiTS III, 2016)

The average female Board representation within the largest listed companies is around 20 per cent<sup>7</sup> vs. 30 per cent minimum in EU countries from 2015



<sup>10</sup> See “Corporate Governance in Transition Economies: Serbia Country Report”, prepared by Gian Piero Cigna, Pavle Djuric, Yaryna Kobel and Alina Sigheartau, EBRD, March 2017.

**Resilient** [ATQ = 5.55]

The Serbian economy has undergone various internal and external shocks in recent years, which have slowed down economic convergence considerably. Macroeconomic stability has improved, however, thanks to the recent fiscal consolidation and narrowing of external imbalances. The economy is increasingly open to trade and relatively diversified, but dependent on the performance of its main trading partner, the euro area. Since the global crisis, export growth has outpaced imports, supporting the recovery. Financial stability has been preserved throughout the past decade, but NPLs and corporate indebtedness have reached a high level, even by regional standards. Agriculture is an important sector and food security is not an issue for Serbia.

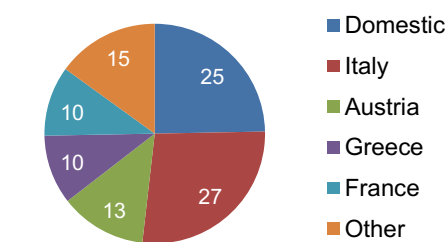
- A **3-year precautionary arrangement with the IMF**, signed in February 2015, is based on three pillars: restoring public finances' health, increasing the resilience of the financial sector, and implementing structural reforms. The results of fiscal consolidation have been good so far, but public debt is still high and is sensitive not only to euro but also to US dollar movements. Important fiscal risks stem from large, unreformed state-owned enterprises.
- The **banking sector** is highly capitalised and liquid, but also highly euroised. NPLs are declining but in September 2017 still significant at 12 per cent of total loans. Basel III rules are being implemented.
- **Reliance on foreign currency borrowing is high**, making unhedged borrowers, especially households, strongly exposed to foreign exchange risk. Central bank interventions are frequent in the foreign exchange market but reserves remain high, at around 30 per cent of GDP.
- Private sector credit stands at 44 per cent of GDP, implying **moderate banking penetration**. Non-banking financial services such as leasing, factoring and insurance are at an early stage of development. Capital markets are also underdeveloped.
- Serbia is **vulnerable to climate change shocks** as witnessed by the major floods in 2014, which caused damages of €1.7 billion, or 5 per cent of GDP. Floods also highlighted the **vulnerability of the country's energy system**, which relies heavily on coal from open-pit mines in electricity generation.

Public debt was at 72.9 per cent of GDP at end-2016, with 40 per cent denominated in euros and one third in US dollars.

The headline/AQR-adjusted capital adequacy ratio, with the unprovisioned NPLs deducted,<sup>1</sup> is 18.0<sup>2</sup> and 16.9<sup>3</sup> per cent, respectively.

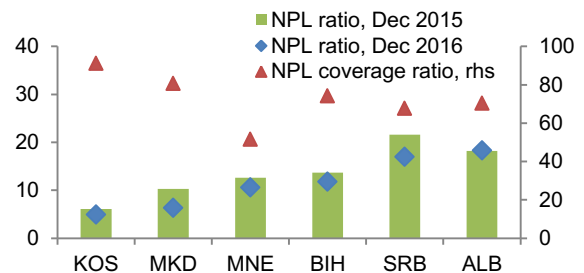
Energy imports make about 10 per cent of total imports and are dominated by oil and gas.

**Ownership of bank assets**



Source: National bank of Serbia

**Non-performing loans (%)**



Source: Vienna Initiative

<sup>11</sup> Capital adequacy ratio \* (1 – Net NPLs/Capital).

<sup>12</sup> Capital adequacy ratio \* (1 – ((Net NPLs/Capital) \* (AQR adjusted NPL ratio/NPL ratio))).

**Integrated** [ATQ = 6.39]

**The promotion of cross-border integration is at the heart of long-term economic development in Serbia and the rest of the Western Balkans.** The EU is the country's main trading partner (accounting for over 60 per cent of total exports and imports of goods), and also the main source of FDI. For most goods Serbia has tariff-free access to a market of over 1 billion people (EU, neighbouring CEFTA countries, EFTA members, Belarus, Kazakhstan, Russia, Turkey and USA). However, the country is not yet a member of the WTO.

- The country's **trade openness**<sup>13</sup> is below the CEE-4 average but above the Western Balkan average at 105 per cent of GDP, and is rising. A further increase would be helped by the reduction of non-tariff barriers.
- **Future WTO membership** is dependent on the adoption of a law on genetically modified organisms and completion of market access negotiations with a number of WTO members.
- **The FDI stock per capita** (€3,600) is above the Western Balkan average, but there is room to have more. Investment could be attracted through business environment improvements and better transport and energy infrastructure.
- The quality of **transport infrastructure** is ranked by the World Economic Forum as lower in Serbia than in most other WB countries, with poor scores in all four categories (rail, road, water and air). Improvements are needed in the areas of traffic management, maintenance, and road safety.
- **Cross-border energy integration** has progressed in recent years. An electricity interconnection between Romania and Serbia should be operational by the end of 2017 and preparations for building a gas interconnector between Serbia and Bulgaria have started. In 2016, Serbia set up the South Eastern European Power Exchange to develop a power market with its neighbours. A 'Roadmap for a regional electricity market for the Western Balkan 6' has been agreed.
- **Most trade and investment is related to EU countries but the role of China** and some other countries is increasing. China has expressed an interest in investing in Serbia's road infrastructure, railways and the energy sector as part of its Belt and Road Initiative.

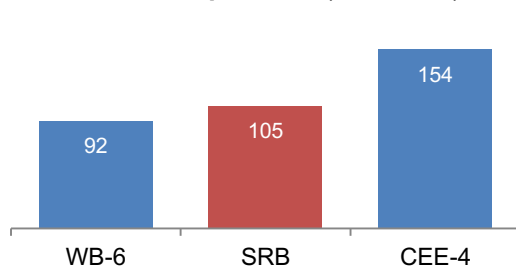
Serbia has become an EU candidate country in March 2012.

23<sup>rd</sup> out of 190 countries on trading across borders (World Bank Doing Business 2018)

76<sup>th</sup> out of 160 countries on International Logistics Performance Index (World Bank, 2016)

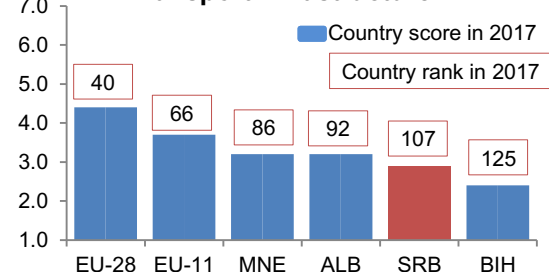
39<sup>th</sup> out of 138 countries on mobile broadband subscriptions/ 100 persons (World Economic Forum, 2016)

**Trade openness** (% of GDP)



Source: World Bank's World Development Indicators

**Transport infrastructure**



Source: WEF's Global Competitiveness Report 2017-2018

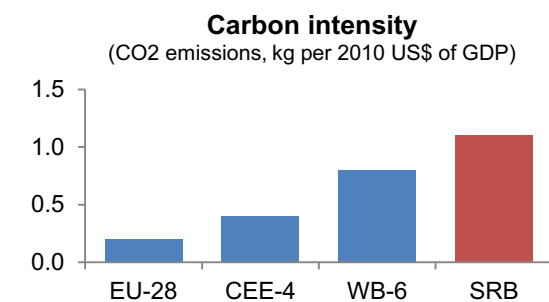
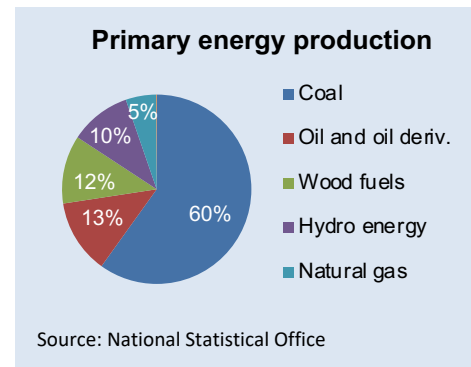
<sup>13</sup> (Exports + Imports of goods and services)/GDP.



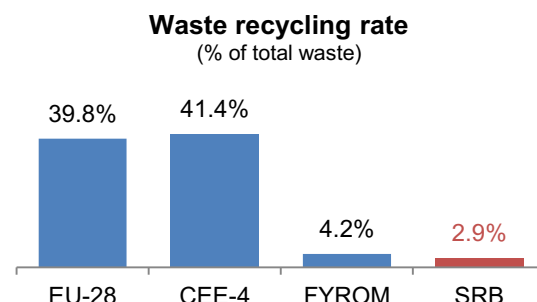
**Green [ATQ = 5.77]**

**Energy and carbon intensity in Serbia is high** as a consequence of intensive use of coal in electricity production and heating, outdated energy infrastructure, high energy losses in transformation, transmission and distribution, and low energy efficiency among end-users. Poor air quality, mainly due to coal power generation, is a concern, especially in urban areas, and Serbia is in the top five among 41 European countries in terms of the PM2.5 concentration. Despite that, the country's Energy Strategy envisages the construction of a further 700 MW of coal-fired thermal energy units by 2025.

- **Serbia has set a goal of 27 per cent of total energy consumption from renewables by 2020** (up from around 15 per cent in 2014<sup>14</sup>). A higher share of renewables would support the country's efforts to diversify away from coal and oil, and significantly decarbonise the economy. The most important renewable energy resource is hydropower with an estimated potential at around 25,000 GWh<sup>15</sup> annually, from which less than half is used.<sup>16</sup> There is also significant potential for energy generation from biomass.
- **Energy efficiency measures in residential buildings can result in the highest emissions savings.** In 2014, the residential sector accounted for 34 per cent of final energy consumption (vs 24 per cent in the EU). There is also a significant energy-saving potential in public sector buildings (27 per cent in healthcare and 24 per cent in education).
- **There is significant potential for waste recycling, as Serbia recycles less than 3 per cent of its total waste** (vs. around 40 per cent in the EU). While Serbia's alignment with the EU's principal directives on waste management is good, improvements in implementation are needed, with operation and performance of recycling firms negatively affected by unpredictable public financing.
- **Only 10-11 per cent of the population is connected to wastewater treatment** and it is by far the most underdeveloped sub-sector of water infrastructure in Serbia.
- The country should step up preparations to address **vulnerability to adverse impacts of climate change**, such as flooding, which caused damages estimated at 5 per cent of GDP in 2014. These should focus on planning and investments in vulnerable sectors.



Source: World Bank's World Development Indicators



Source: Eurostat

<sup>14</sup> Eurostat<sup>15</sup> *Energy Sector Development Strategy of the Republic of Serbia for the period by 2025 with projections by 2030*<sup>16</sup> International Energy Agency



**Inclusive** [ATQ = 5.16]

**Youth inactivity and skills mismatches and gender inequality, constitute major inclusion challenges in Serbia.** Besides young people and women, other vulnerable groups are the elderly and the Roma population. The widespread incompatibility of skills supplied and demanded in the labour market imposes significant costs on firms, limiting productivity, innovation and product development, and increasing recruitment and training costs.

- **The activity rate is significantly higher for men (60 per cent) than for women (43 per cent).** Females face difficulties in entering the labour market, and are less likely to be employed full-time or have flexible working hours. According to the *Gender Equality Index 2016*, Serbia is lagging behind the EU in overall gender equality, with the largest gaps in the areas of work and money. The gender employment gap is most pronounced among older workers (55–64 years), at 18.7 percentage points. Also, the Roma and population in rural areas tend to have larger gender educational gaps.
- **The likelihood of unemployment of young people (15-24) is almost three times the rate in the adult population (25-54).** The youth unemployment rate stands at 35 per cent. Unemployment is higher among young women than among young men (40 vs 32 per cent).
- **The education system does not ensure that young people acquire skills required by employers.** VET programmes are concentrated in fields such as business administration, health and law whereas officially registered vacancies are predominantly within the subsectors of manufacturing, leaving a strong demand for technical and engineering skills unmet. Even among the higher education graduates, the unemployment rate is much higher in Serbia than in EU (15.0 vs 5.6 per cent).
- **According to BEEPS V, 37 per cent of firms reported an inadequately educated workforce as an obstacle to current operations.** Only a minority of businesses (38 per cent) addresses skills mismatch through formal in-company training programmes.
- **Scarcity of work-based learning opportunities forces many young people into self-employment, but the environment for young entrepreneurs is not favourable.** Young people have limited access both to the resources needed to establish their own businesses (20 per cent) and to training (31 per cent).<sup>17</sup>

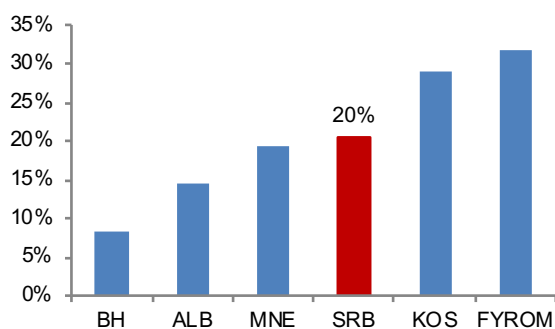
Activity rate (15-64) was 65.6 per cent (vs. 72.9 per cent in EU) in 2016.

Employment rate is substantially lower among women than men (48 vs 62 per cent; RZS, 2016).

Gender pay gap is 11.7 per cent (UN ECE, 2013).

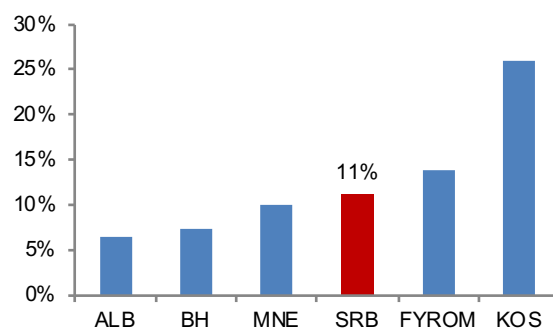
Only 30 per cent of Roma population is expected to complete postsecondary education vs almost 70 per cent of non-Roma (World Bank, 2015).

**Young people having access to finance to start and grow a business**



Source: Gallup World Poll

**Inadequately educated workforce is a major or severe obstacle to current operations**



Source: EBRD BEEPS V

<sup>17</sup> Gallup World Poll 2013-2016.

## Annex 1: Characterising qualities of sustainable market economy

In establishing the provisional ATQ scores the following characteristics under each of the qualities were considered.

1) **Competitive** – The assessment of economic competitiveness draws on the existing assessments of transition challenges relating to market structures that support competition and incentives for sound decision making (including measures of openness, business skills and the business environment). It also takes account of the capacity of firms to add value and innovate (including measures of access to appropriate infrastructure and resources).

2) **Well-governed** – The assessment of the extent to which an economy is well-governed builds on the existing EBRD assessments of corporate governance for private enterprises, complemented by a measure of integrity and business standards in that regard. In addition, the assessment incorporates measures of the quality of public governance, the integrity and control of corruption and the rule of law based on the available external sources such as, for instance, the World Governance Indicators compiled by the World Bank.

3) **Integrated** – The assessment of economic integration takes into account both cross-border and domestic connectivity aspects. It uses measures of openness to trade and investment, as well as balance of payment aspects. In addition, it looks at the quality of cross-border and domestic infrastructure, including considerations of cost and service provision. Measures of the quality of energy and ICT infrastructure are also included as important pillars of a modern market economy.

4) **Resilient** – The assessment of challenges in the area of stability and economic resilience take into account two dimensions of stability. With regard to financial stability, it draws on existing assessments of transition challenges in financial sectors. Given the importance of the banking sector vis-à-vis other financing sources, most indicators relate to the health and adequate regulation of the banking sector. However, other sources such as stock markets are also taken into account. The second component is energy sector resilience which mainly looks at domestic and cross-border connectivity but also takes into account legal and regulatory considerations in the electricity and gas markets.

5) **Green** – The assessment of challenges in the area of green economy builds on the assessment done for the sustainable resource initiative (SRI). It uses some of the existing indicator, for example, relating to carbon intensity or the extent of renewable energy in the energy mix. It also continues to look at pricing and the legal or policy framework. Furthermore, the assessment takes into account measures of climate mitigation and adaptation as well as environmental outcome indicators such as air pollution, waste generation and biodiversity.

6) **Inclusive** – The assessment of inclusion challenges is closely aligned with the existing methodology for assessing transition gaps in the areas of inclusion and equality of opportunity, with particular reference to gender gaps, regional gaps, and gaps in terms of opportunities for young people.

## Abbreviations

<b>ATQ</b>	Assessment of transition qualities
<b>BEEPS</b>	Business Environment and Enterprise Performance Survey
<b>CEE</b>	Central and Eastern Europe
<b>CESEE</b>	Central, Eastern and Southeastern Europe
<b>CEFTA</b>	Central European Free Trade Agreement
<b>CoO</b>	Country of operation
<b>DTF</b>	Distance to frontier
<b>EBITDA</b>	Earnings before interest, tax, depreciation and amortization
<b>EC</b>	European Commission
<b>EFTA</b>	European Free Trade Agreement
<b>EU</b>	European Union
<b>FDI</b>	Foreign direct investment
<b>GDP</b>	Gross domestic product
<b>ILO</b>	International Labour Organization
<b>IMF</b>	International Monetary Fund
<b>LiTS</b>	Life in Transition Survey
<b>NPL</b>	Non-performing loan
<b>ROA</b>	Return on assets
<b>RZS</b>	National statistical office of the Republic of Serbia
<b>SMEs</b>	Small and medium-sized enterprises
<b>SOE</b>	State-owned enterprise
<b>USA</b>	United States of America
<b>VET</b>	Vocational education and training
<b>WB</b>	Western Balkans
<b>WEF</b>	World Economic Forum
<b>WTO</b>	World Trade Organization