

**Belgrade Stock Exchange
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Recent Economic Developments: 2015

- Economy returned to growth in Q2 (1%) after 5 quarters of decline and continued to grow in Q3 (estimated growth at 2%, y/y)
- Growth would have been even higher if not for a significant decrease in agriculture output (almost 10% in H1).
- Unemployment down (17.9% in Q2, compared to 20.9% in the same quarter 2014), informal economy is not the main buffer any more, rather formal jobs increased.
- Significant reduction in fiscal deficit through September (reached 1.3% of GDP). There was a strong growth of revenues (6.4%) and a smaller decline in expenditures (2.1%) over the first nine months.

Medium-term Outlook

- Growth is projected at 0.8% in 2015 and accelerates in 2016 and 2017 to 1.8 and 2.2% respectively.
- Inflation will remain low and within the NBS target band ($4 \pm 1.5\%$) over the next two years
- As foreign demand for Serbian exports continues to grow, Current Account Deficit will gradually decline to around 4% of GDP by 2018.
- Budget deficit will be around 4% in 2015 and on a similar level in 2016.
- Government needs to remain committed to SOEs resolution; reform of large utilities and PAR. These are preconditions for fiscal adjustment to be sustained over the medium to long term.

2016 Budget in Focus

- 2016 budget needs to reconcile on one hand the need for more financing required for structural reforms (severance packages; clearance of arrears; etc.) and the need to reduce the fiscal deficit in order to ensure public debt sustainability.
- Under the IMF program, government confirmed its commitment to reaching both goals.
- Total public expenditures will continue to decline (by about 1 percent of GDP) with expenditure cuts across all budget items – wage bill; goods and services; pensions (except for public investments).
- Revenues as a share of GDP are also projected to decline marginally, as non-tax revenues return to levels typical for previous years.

2016 Budget and Beyond: Ideas for Additional Savings

- On revenue side the focus should be on: 1) tackling large informal sector, and 2) resolution of significant tax arrears (estimated at 6% of GDP)
- On expenditure side the focus should be on: 1) reduction of spending on goods and services (in the health sector primarily), and 2) reform of state support to economy (subsidies; activated guarantees; soft loans)
- All measures are discussed in greater detail in recently launched Public Finance Review, if implemented fully, fiscal deficit could be lower by 1-1.7% of GDP each year

Revenue measures

- Electronic filing of all taxes will become mandatory on a step-by-step basis by January 2017.
- As of today filing of tax returns for salary tax and social contributions, VAT and corporate income tax is done electronically.
- These reforms were recognized by the WBG 2016 Doing Business Report where Serbia improved its ranking on Paying taxes indicator by 22 positions.

Structural Reforms: Finalizing Privatization

- Inefficient SOEs in all sectors of the economy.
 - Fiscal cost (direct and indirect budget support, negative spillovers to utilities).
 - Adverse for business climate (distorted playing field, wrong incentives)
- After long hiatus, by the end of the year most of the PA portfolio should be resolved. However, the ~10 companies that will remain are the largest and most challenging cases.
- Government needs to keep the pressure and have a clear plan/exit strategy for resolving these as well.
- Big risk that some of these end up as a new fiscal drain, and undercut the effects of previous difficult decisions.

Structural Reforms:

Reform of Public Utilities

- Government has initiated important reforms related to financial viability, efficiency, governance and quality of service delivery
- Energy sector (EPS and Srbijagas), key challenges:
 - below cost tariffs;
 - operational inefficiency (overstaffing, low collections, high distribution losses);
 - lack of payment discipline;
 - inadequate governance;
- Transport sector (Railroads and Roads), key challenges:
 - quality of service delivery;
 - efficiency of spending on both new investments and on operations and maintenance;
 - governance and accountability for the public finances received;
 - low labor productivity, overstaffing, low railway traffic intensity.

Structural Reforms: Investment Climate

- Serbia made major progress on Doing Business, but remains below average of the region.
- Good legal framework is needed, but even more: consistent and predictable implementation.
- Some very important laws adopted recently: Labor Law, Law on Inspections, Planning and Construction Law, Law on land conversion.
- Work on improving cadaster; tax and customs administration; labor, construction and trade inspections; utility companies, etc. all ongoing
- Need to keep the momentum, and continue improving.

Corporate Financial Reporting

- New Law on Accounting and Law of Auditing were passed in July 2013 bringing legislative framework closer to EU acquis communautaire
- Enforcement needs further improvements as quality of financial reporting overall continues to lack reliability.
- Prescribed application of International Financial Reporting Standards (IFRS) and IFRS for SMEs makes financial statements of companies in Serbia internationally comparable if the standards are properly applied in practice,
- Relevance and use of financial reporting in decision making by remains at low level
- Frequency and content of reporting by the companies trading on the Belgrade stock exchange is adequate, but minimum requirements for inclusion and continued trading are not strict.

Structural Reforms:

Public Sector Reforms

- Quality-cost ratio in public sector performance is low: Serbia pays a relatively high price for mediocre to weak public services
- Structural issues in wage setting and outdated and mis-staffed organizations are key causes
- Ongoing process of wage system reform (to instill 'equal pay for equal work' as a European norm) is a step forward
- Efforts at functional analysis and review aim to identify both efficiency, effectiveness and cost saving measures, and highlight capacity constraints
- Both aspects of reform are expected to move forward significantly in 2016-2017

Finally....

- Reforms are on the right track, but need deepening and acceleration
- Serbia needs high quality public services and a strong business climate to attract the investment and jobs that will generate greater and shared prosperity
- The 2016 budget is an opportunity to make a critical step forward in this direction