Republic of Serbia
FISCAL COUNCIL

FISCAL TRENDS IN 2016, CONSOLIDATION AND REFORM 2016-2020

Summary

The new Government faces great challenges - continued fiscal deficit decrease, reform of public enterprises and completion of the privatisation of state-owned enterprises. The fiscal trends in the previous year and a half, since the fiscal consolidation started, can be rated as satisfactory, as the state deficit has been permanently decreased by over a billion Euros (over 3 pp of GDP). In addition, 2015 saw the beginning of economic activity recovery, now gradually accelerating in 2016 - additionally improving the state of public finances. However, Serbian public finances are far from solid and the road to their complete recovery will be a long one. The greatest fiscal problem Serbia faces is the exaggerated public debt, which will amount to about 26 bn Euros at the end of 2016 (almost 78% of GDP). For a permanent recovery of public finances, the public debt would have to drop to well below 60% of GDP. The enormous public debt increase (from the end of 2008 to mid-2016) occurred through two main channels: 1) the government had to borrow heavily to finance the high fiscal deficit - the gap between the much larger budget expenditures (pensions, salaries, subsidies etc.) and the budget revenues; 2) the government assisted unsuccessful operation of large public and state-owned enterprises (Srbijagas, Železnice, EPS, RTB Bor, Galenika, earlier Železara, banks) - by providing direct aid and writing off tax and other debts, but also by guaranteeing for a large proportion of their accumulating debt (which, by definition, is included in public debt). The majority of these guaranteed loans are now being repaid from the state budget, on behalf of these companies. Hence, to achieve a necessary public debt decrease, compared to GDP, the new Government will have to continue to decrease the fiscal deficit, reform the operation of public enterprises and complete the privatisation of state-owned enterprises, which are all major challenges. In addition, the new Government would have to support the economic recovery that has already begun through its policies (including the fiscal policy as a major factor). This recovery is based on sound economic grounds, but it is still vulnerable and heavily reliant on good economic and fiscal policies that would support it.

The ultimate fiscal objective of the new Government should be a decrease of the state deficit to 0.5% of GDP by 2019. At the beginning of its mandate, the Government should come out with solid and credible medium-term fiscal framework that would lead to a significant reduction of the public debt as a share in the GDP. The Fiscal Council believes that a good overall goal for the new Government would be to decrease general government deficit to the level of 0.5% of GDP by 2019.

- **This would provide an obvious relief from excessive share of public debt in the GDP.** Public debt amounting to 78% of GDP is unsustainable for a country like Serbia, even though the dangers of a public debt crisis are not imminent at the moment. However, any external shock (such as the one from 2008) that would catch Serbian public finances with the public debt at the current level would lead

into a public debt crisis. This is why the public debt must be decreased, to return Serbian public finances into safer waters. Fiscal deficit decrease is necessary for a strong and credible public debt decrease. If the general government deficit were to be reduced to 0.5% of GDP by 2019, the share of public debt in GDP would be decreased by about 2.5 pp per year. At that rate, Serbia would be able to decrease the public debt to about 70% of GDP by 2020 and slightly below 60% of GDP by 2025. With a more moderate fiscal objective, it would be impossible to reduce the public debt below 60% of GDP even in the long term. For example, with a deficit of 1.5% of GDP, the public debt would most likely fail to reach 60% even by 2030.

- **Non-productive expenditures for interests would be greatly decreased**. Serbia will spend about 1.2 bn Euros (3.5% of GDP) in 2016 on interests, which makes it one of the countries with highest expenditures for this purpose. A deficit decrease to 0.5% of GDP by 2019 would decrease the interest expenditures in 2020 to 3.2% of GDP, freeing about 150 m Euros per year to be used for more productive purposes (e.g. increasing the scope of social assistance).
- **Deficit decrease is achievable and can be reached through structural improvements of public finances.** Relatively high budget expenditures for public sector salaries, pensions and subsidies (including the pay off of guaranteed debt of state-owned enterprises) and insufficient public revenue collection (extensive grey economy) are the reasons behind the current unsustainably high fiscal deficit. The fiscal deficit could be cut to 0.5 % of GDP just by resolving these issues, i.e. by implementing economically sound measures: Tax Administration reform, restructuring of public enterprises and resolution of structural imbalances in the budget. If all of this was consistently implemented, not only would the fiscal deficit reach the targeted level of 0.5% GDP by 2019, it would simultaneously free up some fiscal space to increase public investments, which, at the moment, are insufficient.
- **Economic growth would be given an efficient boost.** Ensuring macroeconomic stability (reaching and maintaining a low fiscal deficit) has a positive effect on economic growth. In addition, the aforementioned reforms (public and state-owned enterprises, Tax Administration) and structural improvements to public finances (increase in public investments) also encourage growth. Relevant research emphasizes the effects of high quality education and healthcare reform on growth, which is why we believe that the reform of these sectors should find its way onto the Government's list of priorities.
- **EU rules prescribe a targeted medium-term deficit of 0.5% of GDP for members with debt comparable to Serbia's.** The Treaty on Stability, Coordination and Governance – TSCG - prescribes that EU member states cannot have, as their medium-term budget objective, a structural fiscal deficit exceeding 0.5% of GDP if the share of public debt in the GDP exceeds 60%. Signatories have undertaken to integrate these provisions and rules into their national legislation (with emphasis on the Constitution). In the process of EU accession, Serbia should certainly accept these rules and, since the share of its public debt in its GDP greatly exceeds 60% of GDP, the appropriate medium-term objective would be a deficit of 0.5% of GDP.

Permanent deficit to be realized in 2016 is 3-3.5% of GDP (instead of the planned 4% of GDP), however, the exceptional fiscal result in the first half of the year is, in part, temporary. The Fiscal Council has analyzed, in detail, the possible deficit in 2016 (see chapter "Fiscal Deficit in 2016"), to see, *inter alia*, what kind of savings need to be implemented in the medium term to achieve the target deficit of 0.5% of GDP. The public expenditure and revenue flows from the beginning of this year indicate that the fiscal deficit in 2016 could amount to a relatively low 2.5% of GDP, but this assessment is relativized by two factors. *First*, a part of the deficit decrease at the beginning of the year came from temporary factors (sale of 4G frequencies) and inefficient implementation of the planned policies (lower severance payments due to downsizing delays). Without these, the fiscal deficit in 2016 would amount to 3 - 3.5% of GDP, which is the real measure of the 2016 deficit going into 2017. We reiterate that this is still a relatively good fiscal result, being that the budget had planned for a significantly larger deficit of 4% of GDP. *Second*, for several years in a row, there have been large unplanned expenditures arising at the very end of the year, drastically deteriorating the fiscal results compared to expectations projected during the year. Two years ago it was the guaranteed debts of state-owned enterprises, commercial debts of JAT and expenditures for the rescue of state banks; last year, it was the takeover of Srbijagas's debt to NIS, claims from military pensioners and arrears in the payment of agricultural subsidies. It cannot be excluded that the 2016 budget will end up taking over some unplanned expenditures at the end of the year as well, increasing the deficit. Such obligations would be: individual debts of socially-owned enterprises (Petrohemija's debt to NIS, guaranteed debt of RTB Bor etc.), expenditures arising from the decisions of the International Court in Strasbourg (claims of workers of former socialy-owned enterprises for unpaid salaries and contributions, claims from citizens of Bosnia and Herzegovina for old foreign currency savings) etc.

The fiscal deficit decrease in 2016 compared to the plan is the result of a strong public revenue performance. The most significant and best fiscal trend in the first five months of 2016 is the strong and widely spread public revenue increase (see chapter "Public Revenue in 2016"). The Fiscal Council finds the increase of tax revenues particularly interesting, as we believe this could be sustainable throughout the year. The reason why tax revenues in 2016 exceeded the plan lies in the visibly better macroeconomic flows than the ones projected in the development of the budget. This pertains primarily to the trends in average salaries and the number of employees, which allowed for increased collection of contributions and income tax. On the other hand, increased collection of VAT and oil derivatives excise cannot be fully explained by changes in macroeconomic circumstances, so it is likely that there has been a certain decrease in grey economy. Increase of non-tax revenue, compared to the plan, primarily stems from one-time payments for licences for use of mobile network 4G frequencies in January, in the amount of almost 13 bn dinars. This increase in non-tax revenues will have an effect on the slightly smaller fiscal deficit in 2016, but does not represent a permanent improvement of the fiscal flows.

Overall public expenditure will most likely conform to the amount in the budget, but with a significantly different structure compared to the one planned. Implementation of public expenditures so far indicates an increased spending on public investment, procurement of goods and services and other current expenditures, so these items could collectively exceed the budgeted amount by about 20-25 bn dinars. However, savings in the similar amount will be made from the planned expenditures for severance payments, pensions and unemployment benefits. Hence, the overall public expenditure in 2016 will be at a level similar to the one planned in the budget, but with a significantly different structure. The evaluation of these trends by individual public expenditures, however, is not uniform. Even though, generally speaking, exceeding expenditures is undesirable and savings are desirable, increase of certain expenditures is now justified, while some of the savings made are not so good. For instance, a good part of expenditures exceeding the budget come from increased public investments (about 10 bn dinars), which is an economically favourable trend, even though it increases the deficit. On the other hand, some of the savings made are unfavourable, as they reflect an inefficient downsizing of the general government, delays in restructuring of public enterprises and postponement of a permanent resolution of the fates of enterprises undergoing privatization. These are the main reasons why severance payments have come below the budgeted amount, and partly the reasons behind smaller expenditures for pensions and unemployment benefits compared to plan (the plan called for a certain increase in expenditures for pensions and unemployment benefits as a consequence of structural reforms during 2016).

A deficit decrease to 0.5% of GDP by 2019 requires savings in the amount of 3.5-4% of GDP. A detailed analysis of public expenditures and revenue in 2016 indicates that the permanent fiscal deficit going into 2017 amounts to 3-3.5% of GDP (although the achieved deficit will perhaps diverge from this figure). Therefore, in order for the deficit to reach the targeted 0.5% of GDP by 2019, it needs to be permanently decreased by 2.5-3% of GDP in the upcoming three years. However, it should be noted that the share of public investment in GDP needs to be increased by about 1% of GDP at the same time, as the current spending on this item cannot provide an infrastructure of sufficient quality. Hence, the target for fiscal consolidation in the upcoming three years should be 3.5 - 4% of GDP in savings, decreasing the general government deficit to 0.5% of GDP and freeing up fiscal space to increase public investments by 1% of GDP.

The prerequirement for public finances recovery is the resolution of issues of public and state-owned enterprises - without it, all other measures are in vein. Fiscal Council's analyses indicate that the greatest risk to public finances, as well as the country's macroeconomic stability, stems from the three public enterprises with greatest fiscal significance (EPS, Srbijagas and Železnice) and large enterprises undergoing privatisation (RTB Bor, Resavica, petrochemical complex etc.) We thus believe that, at this time, a decisive resolution of the problems/fates of these enterprises in the following six months to a year is the most important, highest priority task for the new Government, as this could cause the public finances to cave in, undoing all the good results of fiscal consolidation in the previous year and a half. Successful resolution of the issues of public enterprises and completion of the privatisation process would not only steer Serbia into "calmer waters", but would also have a positive effect on economic activity. In the end, fiscal savings that would be achieved by 2019 by resolving the issues of the public and state-owned enterprises are quite extensive (we estimate them to be about 0.8% of GDP). They would come from two sources. *First,* through a direct decrease in state subsidies (for Resavica and possibly for Železnice as well); and *second,* by 2019, the state would no longer be paying for the majority of their guaranteed loans.

Structural reforms in Železnice are somewhat delayed, but are being implemented, while slightly better results of EPS's and Srbijagas's operation in 2015 cannot be a substitute for their restructuring, which has practically not even begun. The largest issues of public enterprises had been identified a long time ago (see the Fiscal Council's Study from 2014: "Analysis of State-Owned Enterprises: the Fiscal Aspect") and pertain to: superfluous employees, low revenue collection for services rendered, non-economic prices, non-rational units within the system, technical losses, organisational discrepancy from EU rules and environmental standards, increasing debt, insufficient investments etc. A cause for concern, however, is that the majority of identified problems are not yet being tackled with sufficient efficiency, even though they have been known for years.

- Železnice Srbije is practically the only one among the three most important public enterprises that has started serious restructuring. They are divided into four separate companies (for passenger transport, freight, infrastructure management and holding company), the subsidizing method has been modified to stimulate enterprise efficiency and a professional reform plan has been developed for the upcoming four years. However, there are issues with the implementation of certain measures. The planned downsizing has not started yet and there are indications of certain issues with the division of the enterprise.

- EPS has enjoyed a bit more success in 2015 and has turned a profit, but has not come far in overcoming its greatest structural issues. In 2015, EPS corrected the electricity tariff (receiving 4.5% of the increase in the price of electricity for households, in the total amount of 12%), decreased the number of non-performing claims and modified the organisational structure towards greater centralization. However, these improvements are only the tip of the iceberg among the operational issues EPS suffers from. For a long time, the company has failed to invest sufficiently (the investments are significantly lower than depreciation), and its debt has increased from less than 600 m Euros in 2009 to over 1.1 bn Euros at the end of 2015. Expenditures for employees, which had already been too high, increased additionally at the end of 2015 by about 8.5% (about 5 bn dinars). Even though adoption of a Collective agreement, which would allow for downsizing, had been planned to take place by the end of 2015, this has still not occurred.
- In 2015, Srbijagas increased its claim collection; this was supported by an extremely low gas price. However, even with this collection improvement, the company is still not operating with success. The profit made by Srbijagas in 2015 is not the result of improving business results alone, but also the collection of old claims. Had it not been for the old debts being repaid, Srbijagas would have finished 2015 with losses as well. In addition, the division of the enterprise, in line with the requirements of European Energy Community, has not yet been operationally implemented, even though this should have been done a long time ago. Srbijagas still owns a large number of loss-making companies, whose uncollected debt had been transformed into ownership stake. To make matters worse, the problem can even be exacerbated further, as the pre-packed plans for companies undergoing privatization call for Petrohemija's 20 bn dinar debt, as well as the somewhat smaller debts of Kablovi and Ikarbus, to be converted to Srbijagas's ownership stake.

Resolving the fate of the remaining state-owned enterprises has slowed down, while no credible, lasting solutions are in sight for the most problematic among them. At the beginning of 2015, about 80,000 people were employed in enterprises destined for privatisation. The privatisation should have been completed by the end of last year, but, following a relatively intense wave of sale and bankruptcy of enterprises at the beginning of 2015, the process slowed down. We estimate that the enterprises in privatisation currently employ just shy of 50,000 employees, i.e. more than half of the total from the beginning of 2015 (see Chapter "Assessment of Privatization of State-Owned Enterprises"). What is new is that since June, eight strategic companies (with a total of 10,000 employees) have been operating under a pre-pack reorganisation plan (PRP) and, for four additional enterprises, protection from creditors has been revoked (about 9,000 employees). In some cases, PRPs make sense - if the enterprise has an economically viable business model, but is burdened with prior debt. However, in certain cases, it seems that the PRP is there only to postpone the inevitable insolvency. The majority of the remaining employees is employed in just ten of the largest non-privatized enterprises, which simultaneously represent the highest fiscal risk. The brunt of Government efforts should, therefore, be aimed at resolving their status.

- PRP for Bor rests on a very thin margin of profitability - wherein small deviations from the projected values could create loss. Critical assumptions of the PRP are that copper prices shall rise by about 2% annually (using World Bank prognoses) and that the copper content in wet ore shall increase from 0.3 to 0.33%. If any of these assumptions fails, the enterprise would have a negative cash flow and would fail to meet its obligations as they accrue. Another possible PRP weakness is that it calls for lower investments into reinforcing existing and opening new tailings ponds than expected. The examples of environmental disasters stemming from tailings ponds issues are not rare (Romania, Brazil), additionally emphasizing just how important these investments are. In case of RTB Bor, we believe that the competent professional bodies are keeping environmental risks under check, but there are concerns that a possible shortage of funds could jeopardize the enterprise's operations. In the end, we believe that the downsizing plan should be more ambitious. It would be better to fire the majority of superfluous employees in the early stages of reorganisation, instead of the current gradual rationalisation plan over a five-year period. With fewer labour costs, RTB Bor would be prepared to face the market conditions, which could prove less favourable than projected.

- Resavica's problems are getting more complex and no clear solutions for these problems are emerging. By its status, Resavica is a public enterprise and as such cannot enter into a PRP. Resavica's operations are completely dependent on budget subsidies, as the enterprise's revenues cannot even cover the expenditures for employees. In addition, there have been statements coming from the line ministry that four mines have run out of ore and should be closed. Since the current situation is unsustainable, we expect the Government to come up with a plan as soon as possible and to commence restructuring Resavica (downsizing, closing down mines with no perspective for profitable operation etc).
- Enterprises that, in our analysis, have the highest chances of survival without financial support, given adequate solutions, are: PKB, Galenika and Petrohemija. These enterprises have a market for their products. PKB and Galenika could potentially, with certain organisational changes, be attractive to investors. Petrohemija is in a specific position. On one hand, not many investors would be interested in privatization. On the other hand, Petrohemija is currently operating with success, as the current input (gas) to final product price ratio is extremely favourable. Favourable market conditions could last for several years and this period could be used to resolve the fate of this enterprise.
- Industrija Kablova Jagodina and Jumko could have a future, but only with significant downsizing. Industrija Kablova Jagodina places its products on the Russian market and it is possible that, with serious rationalisation, it could continue to operate without state support. However, the number and structure of employees are extremely unfavourable: there are 800 non-production workers to 400 production workers. Jumko, on the other hand, has not submitted a PRP and is now operating only thanks to state support (its main clients are the army and communal services). For both enterprises, sustainable operation is only possible if the number of employees is decreased to 200-300.
- FAP, Ikarbus and Trajal have the poorest outlook, as neither of these enterprises has a sustainable business model. Although all three enterprises have submitted their PRPs, it is unlikely that they will manage to fulfil the plan. The only plan that could conceivably work is division of these enterprises that would perhaps allow some of the separated units to survive.

It is necessary to continue the salary freeze in 2017 and the pension freeze in 2017 and 2018. Stabilization of public finances shall crucially depend on the control of growth of pensions and salaries in the public sector, as these expenditures remain too high for the country's economy (see Chapter "Control of Pensions and Salaries in the Public Sector"). In addition, the planned savings from general government downsizing have not been achieved and rationalisation cannot be a substitute for salary and pension control in the upcoming years either. Salary freeze in 2017 will lower the expenditures for (gross-1) salaries to an economically viable level of 8% of GDP in 2018. Expenditures for public sector salaries in the amount of 8% of GDP are comparable to other Central and Eastern European countries and we deem them suitable for Serbia. When it comes to pensions, they are somewhat farther from their economically sustainable level, compared to salaries. The Law on the Budget System prescribes that pensions shall not be increased until their share in the GDP is decreased to the sustainable level of 11% of GDP. Taking into consideration that they are currently exceeding 12% of GDP, the Law on Budget System would imply a pension freeze in 2017 and 2018, which the Fiscal Council sees as economically justified. Salary freeze in 2017 and pension freeze in 2017 and 2018 would bring about fiscal savings in the amount of approximately 2% of GDP.

Public investments increase to at least 4% of GDP could compensate for short-term negative effects of savings on growth and allow for economic development in medium and long term. Public investments are public expenditures of the highest quality as they have a significant positive effect on economic growth (see Chapter "Public Investments Increase"). In the short term, public investments directly contribute to civil engineering industry and engagement of local operational work force, while in the long term, improved infrastructure indirectly contributes to better regional connections and more pronounced economic growth. A relatively poor state of infrastructure in the country emphasizes the necessity of increasing public investments (which has also been concluded in international research). In addition, a comparative review shows that Serbia spends far less on public investments than other comparable countries of Central and Eastern Europe. Finally, it is also very important that there are funds already secured with institutional creditors for major infrastructural investments, meaning more favourable financing conditions (low interest rates, longer grace period). Still, increase of public investment should not be unconditional. There is no shortage of international examples in which certain capital expenditures, implemented without proper analysis of cost-effectiveness and contrary to economic priorities had negative effects on economy. Hence, prior to plunging into major public infrastructural projects, appropriate (and publicly available) cost-benefit analyses are needed. The effects of investments implemented by foreign contractors (engaging their own work force and materials) need to be carefully considered, as in such a case, the fiscal multiplier is significantly lower.

Tax Administration reform is key to grey economy suppression. International experience and examples from domestic practice clearly show that development of a high quality Tax Administration is key for grey economy suppression and improvement of business climate (see Chapter "Tax Administration Reform"). However, Serbia has the fewest tax officers per capita of all the countries in the region, their salaries are not competitive when compared to the private sector (especially for experienced tax officers) and Serbian Tax Administration bears the additional burden of a large number of non-tax competencies (baby VAT refunds, software legality, valuation of real estate etc). The situation is particularly alarming in the segment of tax inspectors, of which there are only 500, even though international experience calls for at least 1000 (qualified) inspectors for a country such as Serbia. Expert assessments suggest that development of a suitable Tax Administration could secure an additional 1% of GDP in tax revenue in the upcoming years. This, however, will take some serious efforts invested into building a modern, successful Tax Administration, which will take several years as there are no quick and easy solutions. It is good that such a plan has already been made for medium-term Tax Administration reform, but its full implementation has been postponed for years.

Local governments are facing major problems in their finances - poor expenditure structure and a budgeting process that leads to arrears and pressures on the national

budget. Although local governments are currently not in deficit overall, their public finances are far from ordered and are getting worse, while in some local governments they are slipping towards unsustainability (see Chapter "Local Government Public Finances Reform"). One of the major structural issues of local government' finances is the lack of investments. As a consequence, in many communities citizens have no access to drinking water of adequate quality, while some segments of communal infrastructure (such as sewers network, flood defence system, wastewater treatment, waste treatment etc) are still in the early stages of development. On the other hand, we estimate the local expenditures for salaries and subsidies to be exaggerated. Growth of salaries at local government level in the previous years was not completely in line with the legislative indexing, which allowed them to increase faster than salaries at the national level. It is also noticeable that salary expenditures can differ significantly between different local governments, even between structurally similar cities and municipalities, which is an additional argument supporting the view that there are irrational expenditures for these purposes in certain local governments. As for the budgeting process, many local governments are artificially inflating their revenue projections, so as to formally adopt a balanced budget. The revenue during the year then, expectedly, fails to meet the prescribed target, which creates pressures on the national budget to approve additional funds (budget reserve, earmarked transfers) to the local governments, otherwise, defaults accumulate. Finally, a part of the local government public finances reform is the complete eradication of vertical imbalance between national and local revenues, which was created when detrimental amendments to the Law on Local Government Financing were adopted in 2011. The existing draft for new amendments of this Law, proposed by the Ministry of Finance, is good and the Fiscal Council supports its prompt adoption.

Economic recovery is accelerating in a healthy and sustainable manner - GDP growth in 2016 could amount to 2.5%, perhaps even a little higher. The trends of the deseasonalized GDP, as well as analysis of the individual GDP components (private and public expenditure, investments, net export) indicate that the growth of economic activity in 2016 could amount to about 2.5% and it would not be surprising to see it slightly exceed this figure either. Agricultural recovery after the drought of 2015 also has an effect on GDP growth, which is not a sustainable trend. Hence, the true trend of economic recovery, without the one-off factors, falls somewhat under 2.5% at about 1.5-2%. Still, the assessment of GDP trends for 2016 is very favourable. Economic recovery is gradually and steadily accelerating over a wide front, lead by the growth of investments and net exports. Recovery acceleration is one of the important factors that had contributed to better fiscal results in 2016, through an increase in public revenue.

Investments are the GDP component that is key to the establishment of a high and sustainable growth exceeding 4% in medium term. By its low level of overall investments (from private and public sector), amounting to about 18% of GDP in 2015, Serbia was one of the negative record holders among the countries of Central and Eastern Europe. To allow for high and sustainable economic growth, investments need to be increased to 20-25% of GDP; fiscal policy can contribute in a major way, both directly and indirectly. Direct effects of fiscal policy on investment growth would be reflected in the increase of public investments, which should be increased to at least 4% of GDP; through the reform of public enterprises leading to their higher investments; as well as through possible privatization of some of the remaining state-owned enterprises and launching of new investment cycles within them (as is now expected for Železara Smederevo). Fiscal policy also has a strong indirect effect on investments and economic growth. Majority of investments pertain to the private sector, and improvement of the business climate is the key for a lasting private investments increase. Several fiscal consolidation measures can significantly contribute to the improvement of investment climate. This pertains primarily to ensuring macroeconomic stability through a strong fiscal deficit decrease to 0.5% of GDP by 2019. Of the remaining fiscal measures/reforms, a reform of the education and healthcare would have a strong positive effect on economic growth, as would the improvement of infrastructure quality as a consequence of increased public investments. Finally, it should be pointed out that fiscal reforms and macroeconomic stability are a necessary, but not sufficient condition for the increase in investments and economic growth. Investment climate improvement will also depend on other measures and reforms the new Government undertakes: improvement of judicial efficiency; accelerating permitting procedures and removing other administrative barriers to investments; improved competition protection; decrease in corruption; and others.

Table: General review of medium-term objectives and measures proposed

Objective	Measures	Savings / deficit decrease	Timeline	Effect on GDP
Overall objective - fiscal deficit decrease to 0,5% of GDP	Continuation of fiscal consolidation and structural reforms	2.5-3% of GDP	2019	Neutral in the short-term (slightly negative due to a decrease in current expenditures, positive due to increase of capital expenditures), expressly positive in medium and long term
Tax Administration Reform	Increase of the number of employees (tax inspectors), with rejuvenation of the work force, decrease/cancellation of the existing non-tax competencies (baby VAT refund etc), improvement of information systems.	1 % of GDP	2016-2019	Positive, grey economy suppression
Decrease of subsidies and payments for guaranteed debts from the budget to 2.5% of GDP (from the present 3.5% of GDP)	1) Restructuring of public enterprises (EPS, Srbijagas, Železnice) 2) Restructuring, then privatisation of RTB Bor, restructuring/insolvency of Resavice, completion of privatisation of the remaining enterprises undergoing privatisation (petrochemical complex, Galenika, Simpo, PKB etc) 3) Reform of local public enterprises	1% of GDP	1) The first 6 months to a year are key to the resolution of the most important problems 2) Full savings by 2019 (payment of the majority of guaranteed debt will be complete, with no new debt to pay)	Positive/strongly positive Privatisation and successful restructuring of socially owned enterprises - instead of loss makers and insolvency, positive contribution to growth by turning to profit and investment. Bankruptcy frees up entrapped resources /eliminates debt, new losses and generation of insolvency
Decrease of the share of pensions in GDP to the highest sustainable level of 11%	Pension freeze in 2017 and 2018	1.3% of GDP	2016-2018	Mildly negative in the short term, neutral/positive in the medium and long term
Decrease of the share of salaries to the adequate level of 9.3% of GDP (8% of GDP according to the old methodology)	1) Salary freeze by the end of 2017 2) General government downsizing by an additional 10,000 - 15,000, of which 5,000-6,000 in local governments	0.8% of GDP	2016-2017, downsizing by 2019	Mildly negative in the short term, neutral/positive in the medium and long term
Increase of public investments to 4% of GDP	1) Acceleration in withdrawal on approved loans for key infrastructural works (corridors, Belgrade bypass...) 2) Increase of local investments (water supply network, sewers, riverbed regulation...)	(-1% of GDP)	By 2019	Strongly positive
Reform of local government financing	1) Adoption of the prepared amendments to the Law on Local Government Financing 2) Salary freeze, downsizing, decrease in subsidies (decrease in current expenditures by about 0.7% of GDP) 3) Increase of local investments by about 0.5% of GDP 4) Stimulation of improvement in local revenue collection (property tax)	Net 0.2% of GDP, with a contribution to the increase in public investments by 0.5% of GDP	1) By the end of 2016, adoption of the Law on Local Government Financing 2) By 2019, comprehensive reform with a change in expenditure structure	Positive
Reform of the social welfare system	Increase of scope to include previously uncovered socially vulnerable groups, better targeting of existing benefits	Neutral, or mild increase in costs of up to 0.2% of GDP	2016-2018	Neutral
Healthcare and education reform	Education - increase of involvement in pre-school education, modernisation of curricula for primary and secondary education, increase of relevance and openness of higher education etc. Healthcare - improvement of employment structure in healthcare, improvement of the legislative framework for centralized public procurement, regulation of the relationship between public and private healthcare etc.	Savings are not a priority; the priority is to increase the quality of services. Savings only if it transpires, during the reform, that there is irrational spending	2016-2020	Positive