






Weekly Briefing

**Serbia Economy briefing:
Economy Development in Serbia
IIPE**

China-CEE Institute

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The beginning of the year brings a new budget, announcements, promises, and forecasts. Usually, none is fully realized as expected. There have been four events of importance for Serbia in the last forty days. First, on February 22, 2018 the three-year fiscal consolidation program through the Precautionary Agreement with the IMF had successfully completed. Second, the Board of Directors adopted EBRD Serbia Country Strategy 2018–2023 on February, 27 2018. The third is a Kopaonik Business Forum in early March. Fourth, elections for the Assembly and Belgrade Mayor.

IMF, World Bank, EBRD, and the European Commission largely respect the results achieved by Serbia in their documents. Successful cooperation with international organizations, the European Union and great powers is of great importance for Serbia and its future development. Their recommendations for the future are a list of activities that the government has not yet accomplished to a sufficient extent (most often: reforms, rule of law, anti-corruption, administrative barriers, etc.). EBRD set three strategic priorities in Serbia in next five years: Foster competitiveness and governance; enhance integration; and support green economy. The convincing victory of the ruling party in the local elections in Belgrade will strengthen the political stability of the government.

Serbia entered this year with the achieved fiscal consolidation and surplus in the budget of 1.2% GDP (the first time after 2005). It can be expected that the net FDI inflow will be close to previous years. According to the latest projections, inflation will remain within the targeted range $3.0 \pm 1.5\%$. The outcome of foreign trade will largely depend on external demand (mostly in the Eurozone) and energy prices. The Fiscal Council has made many detailed and precise comments on the Fiscal Strategy and the 2018 Budget. These remarks are already well known in the circles of economists, and some are repeated year after year. These days, a number of speakers at the Kopaonik Business Forum reiterated the main problems of the Serbian economy. Although a number of government representatives also took part in this summit, it can be assumed that

previous experiences will be repeated: the government will not take the experts' opinion into consideration or will do so to a small extent.

It should take into account the warning given by prof. Dejan Šoškić (daily news "Danas", March 6, 2018) that fiscal consolidation is not completed despite obvious results. "Long-term fiscal consolidation is inseparable from economic growth, and economic growth depends primarily on investments. They, however, require developed institutions, i.e. depend on the rule of law, the level of corruption, the development of infrastructure, quality education, scientific research potential, etc."

The growth rate of Serbia's GDP in 2017 was 1.8%, while over 4.5% was in the CEE countries. Also, the cumulative growth of GDP 2010–2017 in CEE countries was 22%, and in Serbia in the same period 6.5%. For comparison, total investment in Serbia amounted to 18% of GDP, and in CEE countries 22% of GDP in the last five years. The official projected GDP growth rate in 2018 is 3.5%, and has an estimate that it could reach 4%. There is no doubt that the government would like a higher growth rate than the projected one, which certainly can not generate accelerated growth, but it is also certain that higher and more desirable growth rates do not have their basis in the growth of total investment.

The insufficient level of total investment activity is recognized as the main reason for the low GDP growth rate. Inward FDI in the past years has made a significant contribution to the growth of total economic activity in the country, export growth and GDP (net FDI inflow was 6,6% of GDP). Numerous economists point out that one of the main structural problems is the low technological level of the production sector. That is why subsidies that the government selflessly gives to foreign investors for job creation have no full effects, ie. do not generate growth. Also, several studies point out that FDI have no positive impact or very low on GDP growth. It is possible that such conclusions are correct if we take into account that most of FDI is placed in the activities of low technologies and employs the least paid labor (investors from

labor-abundant countries such as Turkey and Korea place capital in the unskilled labor-intensive sectors). Reducing the unemployment rate (of low-skilled workers) is incomparably less important than the total amount of stimulus (monetary and non-monetary) donated to foreign investors. The mere fact that some investors enjoy incentives and others do not point to an inequitable market position. This is one of the reasons why large domestic investors prefer investing capital abroad than in Serbia.

There is noticeable emigration of labor from all countries of the region mainly to the developed countries of the European Union. This led to the shortage of skilled labor in a number of economic sectors. Serbia has followed such a trend of neighboring countries. Currently, there are not enough available qualified workers in certain professions such as IT engineers, computer programmers, truck and bus drivers, medical personnel and doctors, more profiles in the construction industry, clothing industry, etc. According to estimates from the carrier associations, some 5,000 truck and bus drivers have left Serbia for work in the countries of Western Europe in recent years. It can be expected that this trend will continue. In addition, a certain number of unskilled and skilled workers will be hired in Croatia and Slovenia during the summer tourist season.

It can be said that the government is putting a lot of effort to overcoming these problems, especially lately. Activities are directed towards the legislation, education sector, increased number of specializations for young doctors, announced possible establishment of a computing faculty in Belgrade. Realizing these goals takes time. Recently, several legal solutions have been announced aimed at facilitating business and reducing procedural and administrative restrictions.

ICT exports (mostly software) amounted about €900 million in 2017, showing stable year-on-year growth (growth rate of 21.5% compared to 2016). It is estimated that it could reach a value of €2 billion over the next three years. The export of ICT services thus exceeded the export of traditional goods such as

grain, fruits, vegetables, etc. It should be noted that development and export of ICT belongs to private small and medium-sized companies that are domestically or jointly owned. Most owners and employees are educated at state universities in Serbia. With the exception of this fact, the state's contribution to the development of ICT in Serbia is negligible. The government recognized the development potential of ICT sector and increased quotas at faculties with ICT departments and programs in order to support its future development. Also, the introduction of new computing programs in elementary education is envisaged. The government has recently announced a strong and stable support for the ICT sector, the establishment of scientific parks, and so on.

The opening of sales facilities chain of the German company Lidl, which is expected soon, will certainly lead to the strengthening of competition in the market and jeopardize the oligopolistic position of several large retail chains. The future Ikea retail park of a 30,000 square meter, with investment of €50 million, will have similar effects.

Amazing good news has emerged these days: Aero East Europe (AEE) from Jagodina exported 2 small aircraft to the United States and plans to export another 50 in the next few years. It is encouraging that the company has managed to meet very strict standards in the European Union and the USA.

Some things are difficult to predict because they have character of Act of God. This is the case with the current situation with large and small rivers like all over Europe. If large floods occur, this would significantly reduce agricultural yields this year.

As before, so in the future, the main problems of the Serbian state and economy are systemic in nature. That's why they can not be solved quickly. The great impact of politics on all aspects of economic activity is not always an incentive effect. Therefore some necessary solutions are very late. According to Fiscal Council: "A major problem of the Serbian public sector lies in the - predominantly loss-making state-owned enterprises undergoing privatisation, which still employ about 50,000 people." The projected GDP growth will be

achieved, but this is not enough for the accelerated growth that Serbia needs. It can be said that many key reform processes take place slowly, which retroces the dynamics of economic activity.

Although forecasts often remain in the sphere of speculation, it would be realistic to expect that positive trends in economic activity continue this year. If the promises of the government and adopted legislation were applied in practice, this would lead to faster implementation of the necessary reforms. Also, there are many encouraging examples which prove that significant results can be achieved in the world market, without state aid and in a poor business environment such as ICT services, gaming, organic food production, smal aircraft production.