

Serbia at a crossroads

Building a new vision for Serbia's economic future

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❖ Where will growth come from in Serbia?

- i. Is the **structure of the real economy** competitive and business friendly with no obvious disequilibria? (bureaucratic restrictions, competitiveness, current account, unemployment, labor laws, etc.)
- ii. Are the **nominal magnitudes** in equilibrium? (Inflation, Monetary policy, Public Debt dynamics, Pension system)
- iii. Is there a **consensus** among the population of what is required to be done when it comes to economic policy?
- iv. Does the country have specific **comparative advantages** it can exploit and is it following an aggressive strategy in that direction?

❖ The **conference**, from its title, **focuses on item (iv)**

❖ **IFIs** tend to **focus on items (i) and (ii)**

❖ **Reality dictates** that we should concentrate on (iv) while fixing (i) & (ii), and persuading the population on their necessity. i.e. item (iii)

The target is convergence to the living standards of Western Europe

- ✓ Significant convergence in Serbia over the last 12 years
- ✓ Yet, lower convergence than neighboring countries
- ✓ Of course, research shows that the lower the initial income level, the easier it is to grow and converge

Serbia Relative Living Standards EU-15=100 in PPS

2001	23.7
2005	28.1
2009	32.4
2012	31.7
2013	32.5
2014	32.9

Bulgaria Relative Living Standards EU-15=100 in PPS

2001	25.9
2005	32.5
2009	39.8
2012	43.0
2013	44.1
2014	44.8

Romania Relative Living Standards EU-15=100 in PPS

2001	24.2
2005	31.0
2009	42.8
2012	43.6
2013	44.7
2014	45.3

❖ Characteristics of the economy that raise questions:

- 1) **Can the economy become more competitive with higher investment?**
 - Is bureaucratic red tape being reduced? Does the State sector become more efficient?
 - How come infrastructure is not improving as fast as it should to exploit Serbia's geopolitical position in the region?
- 2) **Why is population declining and why is the unemployment rate so high for so long?**
 - Are there structural features in the labor market that can be cured?
- 3) **Why is the Debt –to-GDP ratio rising so fast over the last five years?**
 - Are policy makers complacent thinking the market will finance the borrowing requirement forever?

	<u>Serbia</u>	<u>Bulgaria</u>	<u>Romania</u>	<u>EA-15</u>
1. <u>Investment</u> (% GDP)				
2001-2010	18.4	24.3	24.6	19.7
2013	17.7	21.8	27.0	17.5

- ✓ Investment share is low for a developing country, as high as in EA-15. Serbia needs to improve its physical capital
- ✓ Population growth represents a major constraint for future growth, although the level of education is a comparative advantage

	<u>Serbia</u>	<u>Bulgaria</u>	<u>Romania</u>	<u>EA-15</u>
2. <u>Human Capital</u> (Population Cumulat. Δ%, from - to)				
2000 – 2010	-3.0%	-4.3%	-4.5%	+5.5%
2010-2013	-1.2%	-4.0%	-0.6%	+1.1%

Sources of Growth: Factor productivity

Substantial room to improve the business environment

<i>Score (0-100)</i>	<i>2008</i>	<i>2012</i>	<i>Change</i>
<u>Ease of Doing Business</u>	48	49	+1
Starting a Business	41	51	+10
Dealing with licences	6	4	-2
Registering Property	46	78	+32
Protecting Investors	61	57	-4
Paying Taxes	30	22	-8
Trading Across Borders	66	50	-16
Enforcing Contracts	47	45	-2
Closing a business	45	35	-10

- For comparability, all indices normalized so that they range from 0 (lowest) to 100 (best)
- Source: World Bank-Doing Business 2008-2012 rankings, IMF Country report No 13/206

Ease of Doing Business : Two opposite examples

- ✓ Improvement in starting a business
- ✓ Deterioration in construction permits

Year of Report	Starting a Business					Dealing with Construction Permits			
	Rank	Procedures (number)	Time (days)	Cost (% of income per capita)	Paid-in Min. Capital (% of income per capita)	Rank	Procedures (number)	Time (days)	Cost (% of income per capita)
2004	..	12	56	15.9	113.4
2005	..	12	56	15	101.6
2006	..	11	23	12	7.6	..	19	205	3,896.00
2007	..	11	23	10.2	7.6	..	18	204	3,055.30
2008	..	11	23	8.9	8	..	18	204	2,513.60
2009	..	11	23	7.6	6.9	..	18	279	2,017.50
2010	..	7	13	7.1	6.1	..	18	279	1,767.20
2011	..	7	13	7.9	6	..	18	279	1,690.00
2012	91	7	13	7.8	6	178	18	279	1,603.80
2013	42	6	12	7.7	0	179	18	269	1,427.20

In cross-country comparisons, a smaller government is positively correlated with growth

- ✓ Improvement in the size of government
- ✓ Yet, size of government remains higher than the relative size of neighboring countries

Government consumption

(% of GDP)

Serbia

Bulgaria

Romania

EA-15

2001

21.0%

18.8%

16.2%

20.0%

2001-2010

20.4%

17.9%

16.9%

21.1%

2012

20.2%

15.5%

15.7%

22.0%

2013

19.3%

16.0%

15.5%

22.1%

- ✓ Not only politicians, but economists as well, who do extensive research, insist on the need for Quality Institutions
- ✓ Corruption indices are not good
- ✓ Rule of Law and Government effectiveness below median

Quality of institutions	Serbia	Bulgaria	Romania	EA-15
1. <u>Corruption Perceptions Index</u> 2012 (0-100)	39	41	44	67.1
2. <u>Rule of Law</u> 2012 (score -2,5 to 2,5)	-0.39	-0.12	0.02	1.32
3. <u>Government Effectiveness</u> 2012 (score -2,5 to 2,5)	-0.11	0.14	-0.31	1.31

Source: Transparency International, World Bank

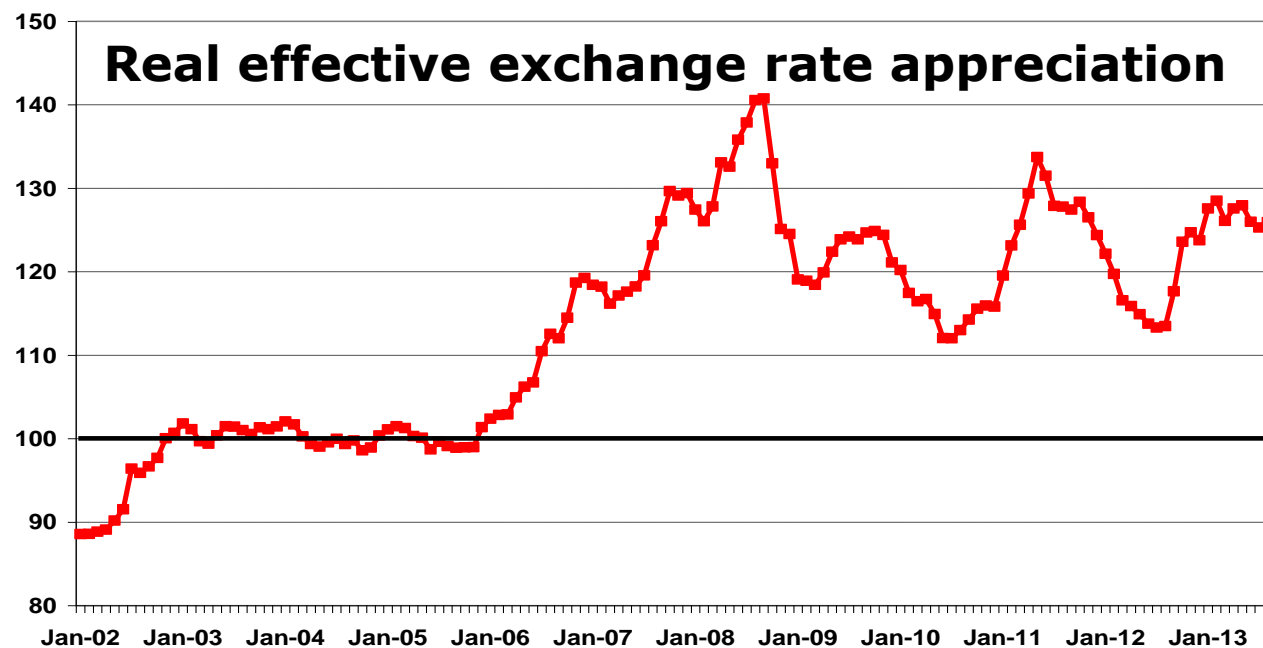
In cross-country comparisons, low inflation and competitiveness matter for growth

- ✓ Inflation improvement
- ✓ Yet, competitiveness has deteriorated since 2006

Inflation

(Average %)

	<u>Serbia</u>	<u>Bulgaria</u>	<u>Romania</u>	<u>EA-15</u>
2003-2007	11.6	5.9	9.5	2.2
2008-2012	9.0	4.6	5.7	2.1
2013	8.5	1.4	4.5	1.6



Source: NBS, Eurobank Research

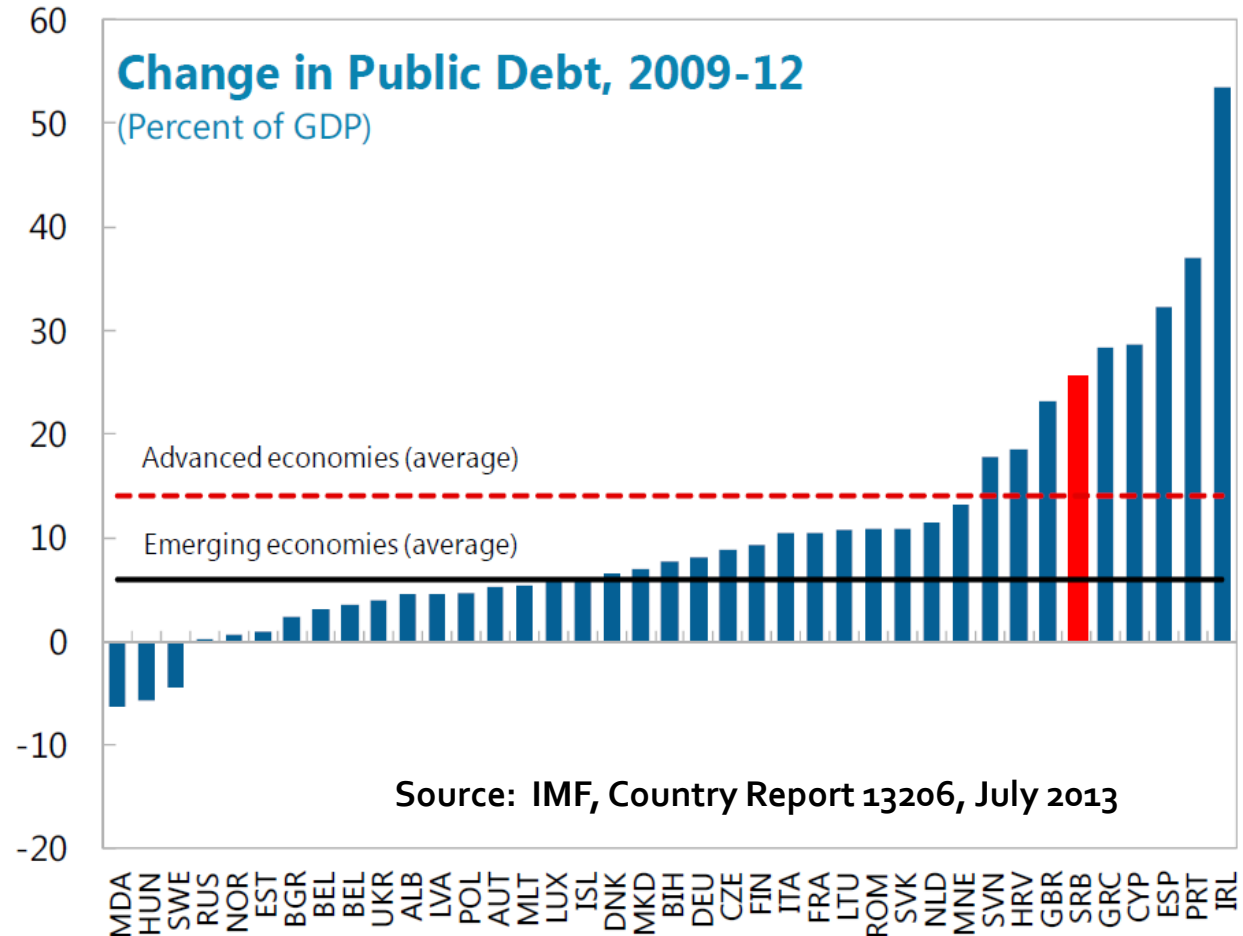
- ✓ **Education and technological readiness carry good rankings**
- ✓ **Macro-environment, business sophistication, goods market efficiency, institutions, labor market efficiency, financial market development carry low rankings**
- ✓ **Overall rank slightly worsened during the last two years**

Serbia

	Rank (out of 148)	Score (1–7)
GCI 2013–2014	101	3.8
GCI 2012–2013 (out of 144).....	95.....	3.9
GCI 2011–2012 (out of 142).....	95.....	3.9
Basic requirements (40.0%)	106	4.0
Institutions	126.....	3.2
Infrastructure	90.....	3.5
Macroeconomic environment	136.....	3.4
Health and primary education.....	69.....	5.7
Efficiency enhancers (50.0%)	92	3.8
Higher education and training.....	83.....	4.0
Goods market efficiency	132.....	3.6
Labor market efficiency	119.....	3.9
Financial market development	115.....	3.5
Technological readiness.....	60.....	3.9
Market size.....	69.....	3.7
Innovation and sophistication factors (10.0%)	125	3.0
Business sophistication	137.....	3.2
Innovation.....	112.....	2.9

Is Serbia next in line to be shut out of international bond markets?

- ✓ Most countries with a higher deterioration in the Debt/GDP ratio than Serbia - and more developed - are already shut out of markets
- ✓ Serbia needs to provide a strong signal of fiscal austerity and no complacency
- ✓ Markets close very suddenly
- ✓ Short-term solutions of specific loans from specific countries are not substitutes for a long-term solution



- ✓ Economy converged to EA-15 over the last 12 years but at a slow pace
- ✓ Serbia has comparative advantages
 - in education, in technological readiness, in agribusiness
 - In its geostrategic position, as it can become a transportation hub
 - Via a Free Trade Agreement with Russia
- ✓ Yet, it needs to
 - Fix its public finances or it may be shut out of international markets
 - Attract more FDI and improve the share of private investment
 - Institute a wide range of reforms in product and labor markets, in its pension system, and simplify bureaucracy
 - Push the privatization agenda

THANK YOU
FOR YOUR ATTENTION !

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I wish to thank my colleagues at Eurobank for their comments