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THE REPUBLIC OF SERBIA IN THE REGION: ANALYSIS OF SOCIO-ECONOMIC PERFORMANCES

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Abstract: *Serbia wants to be the part of the European Community. To do that, it must fulfill certain conditions- not just formal, like the adoption of acquis communautaire, but also the essential– like the convergence of economic performances to be able to compete with more developed countries on the single European market. The paper shows that this task was major challenge even for economically more successful countries in the region.*

After short introduction, the second part of the paper summarizes similarities in the development model in former "Eastern Block"countries until 1990s', differences in the privatization model and development model in new millennium. The third part analysis key economic performances of selected countries in order to point out the position of Serbia among neighboring countries and at EU level. Since the workforce is an important production and economic development factor, the fourth part of the paper analyses the demographic structure and its dynamics.

Keywords*: transition, development model, economic convergence, demographic changes*

1. Introduction

Strategic goal of Serbia is EU (EMU) membership. To achieve this, it must complete the process of essential reforms that will ensure sustainable macroeconomic stability. Serbia, like other countries of Central and Eastern Europe had serious problems with large macroeconomic imbalances, such as high and variable inflation, unemployment, unstable exchange rate, low rate of economic growth. Serbia is still among the countries that have the most macro-economic problems in the region.

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European Union countries are main trade partner of Serbia (62.2% of total trade-Privredna komora Srbije 2013), so the increase in economic cooperation with these countries will stimulate economic development and growth in Serbia. Accession process itself involves previous macroeconomic stabilization, structural changes and liberalization of economic flows. The stability of macroeconomic and the business environment and greater development opportunities should contribute to increase of the economic performances, unemployment reduction and higher living standards.

For the country to meet all the requirements for EMU membership, it is necessary to have strong discipline in monetary and fiscal policy, but also on the market. The choice of an adequate strategy of monetary and exchange rate policy is critical for the achievement of price stability and creation of business environment that would enable real convergence. The paper will analyze some key socio-economic performances of Serbia and some countries from Central and Eastern Europe that had similar development models until 1990s, but had more success during the transition period and now are EU members: Slovenia and Slovakia (EMU members since 2007 and 2009 respectively), Check Republic, Poland, Hungary (EU members since 2004), Bulgaria and Romania (EU members since 2007) and Croatia (EU member since 2013). Analyzing the experience of those countries, that had similar economic structure, could help drawing paths of economic reforms that are needed in Serbia. The goal of the paper is to provide the outlook of the Serbian economic situation, which still deals with transition, economic crisis and process of European integration, and to compare it with more successful countries in the region.

2. Historical aspect of the economic growth

The different paths of economic growth in European countries after II world war were analysed in literature through general framework consisting of western and eastern countries. The countries analysed in this paper belong to the second group. This group noted three clearly differentiated periods: 1) period until the beginning of 1970s (the communist “Silver Age” growth period); 2) the period of slowdown finished by collapse at the end of the 1980s, and 3) the transition period to a market economy. (Crafts 2005)

During the period 1950-1973, growth rates in Central and Eastern European countries were only a little below those in Western Europe. For example, the growth rate of 3.4% per year for this period in USSR compares quite unfavourably with the achievements of countries like Italy or Spain who started out with similarly low income levels. A similar evidence emerges if we analyse Czechoslovakia that performed almost 2 percentage points per year lower GDP growth than Austria in this period.

After the beginning of the 1970s, the Eastern and Central European countries had the levels of real GDP per capita well below those in Western Europe countries and over time the gap has widened, especially after 1973. This was partly the consequence of the collapse in output at the end of the communist period and the delay before economic growth started to recover in the transition economies.

Table 1. Real GDP per capita growth 1820-1992 (%)

	1820-1870	1870-1913	1913-1950	1950-1973	1973-1992	1973-2005
Czechoslovakia	0.6	1.4	1.4	3.1	-0.1	1.32
Hungary	n.a.	1.2	0.5	3.6	0.0	1.45
Poland	n.a.	n.a.	n.a.	3.4	-0.6	1.46
Bulgaria	n.a.	n.a.	0.3	5.2	-1.4	0.96
Romania	n.a.	n.a.	n.a.	4.8	-1.6	0.44
USSR	0.6	0.9	1.8	3.4	-0.4	n.a.
Yugoslavia	n.a.	n.a.	1.0	4.4	-0.5	0.79
Albania	n.a.	1.4	0.6	3.6	n.a.	1.34

Source: Maddison, A. (1996) Macroeconomic Accounts for European Countries. in van Ark B. and Crafts N. (eds.), *Quantitative Aspects of Post-War European Economic Growth*, Cambridge: Cambridge University Press, pp. 27-83.

During the transition period the catching-up process (between Western Balkan countries and EU countries) was very slow due to different reasons. Western Balkan countries suffered from "over-industrialization" and underdeveloped service sector during the communist era. Also, the essential market institutions were missing (the protection of property rights and support to the innovation and entrepreneurship). The main influence on the further catching-up process during the transition period had the method of privatization. But, there are also other reasons for slow economic growth – the inadequate institutions for intensive growth (growth through innovation), rent-seeking, corruption.

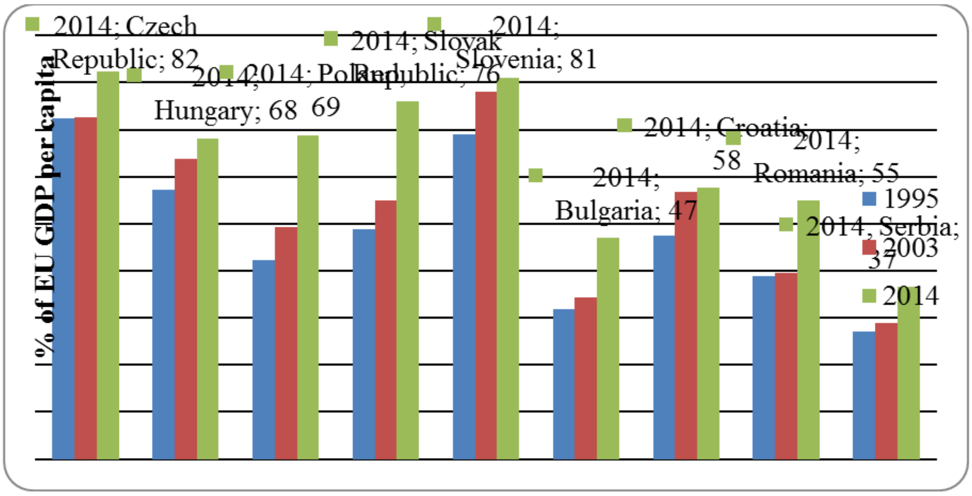
These countries also have poorly developed infrastructure to serve information technology. In that case, most countries can find themselves in the "technology trap". Specifically, in such countries, yields on information technology and its associated infrastructure are very small, and they need investments in basic infrastructure. Some forms of "traditional poverty" (lack of basic infrastructure, drinking water and wastewater treatment, good health and education services) are still greatly expressed.

3. Economic performances of Serbia in relation to the countries of the region

Observed countries managed, in the period of 20 years, to improve their real performances compared to the EU average. Almost all of them started the decade of 1990s with quite low level of GDP per capita in comparison to EU level- Graph 1. Transition brought further decrease of indicator, but till the end of 1990s and during 2000s the situation improved. Graph 1. shows the level of GDP per capita based on purchasing power parity, in constant 2011 international dollar.

The Czech Republic, Slovenia and Slovakia achieved the best results and have the highest level of living standard in the observed group of countries. Still, their GDP level per capita is lower than EU average- around 80%, which means they didn't reach the full convergence of real performances with EU countries. Hungary and especially Poland, 2004 newcomers, improved significantly their living standards. Bulgaria and Romania still have very poor performances, their GDP per capita is just around a half of EU average. There was no catching up process in this group of countries. They have significant problems with their development model and the transition process is not finished. Croatia, that is EU member since 2013, made small progress in catching up with more developed EU countries, in previous 10 years. Its GDP per capita reached 58% of EU level of indicator. Serbia is in the worst position, it has only a third of EU GDP per capita level.

Graph 1: GDP per capita as % of EU level, ppp, in constant 2011 international dollar



*Data are in constant 2011 US dollars – to eliminate the impact of inflation on the growth of nominal GDP

Source: The World Bank Databank- World Development Indicators, http://databank.worldbank.org/data/home.aspx

During last 15-20 years formal Eastern Europe countries went through a radical transformation- in terms of economic development, regional cooperation and integration into global economic and financial markets. While in Central European countries opening boundaries for foreign capital was used to facilitate serious restructuring of economy and reorganization of companies, in Serbia and other Western Balkan countries the growth was not driven by productive investments. Beside, here the transition process was much more turbulent than in Central Europe, in the case of ex-Yugoslavia followed by the disintegration of the country and the war. In Serbia, Bulgaria and Romania, transition recession had as a consequence significant loss of GDP. In Yugoslavia, the interruption of economic cooperation, loss of markets and production cooperants in other republics (now independent states), loss of markets in the countries of Eastern Europe that have entered the process of transition, war and United Nation sanctions have led to a drastic fall of GDP. Yugoslav economy started to decline even in early 1980s, when large part of the world was in the recession. GDP per capita fell for 5,3% till the end of the decade. General instability in the region, together with high political and military instability and broken regional tradiing links made the region unattractive to FDI, that would rise the production and export capacities, unlike the Central European transition economies.

The growth of GDP in Serbia started only in 2000s and it was interrupted in 2009 due to severe financial and economic crisis in Europe. That growth, unfortunately, was based on the demand increase, financed with foreign loans, privatization revenues and remittances, which is not sustainable in the long run. Mass privatization of financial sector, and especially banks, enabled huge capital inflows and led to high and growing current account deficits until the crisis emerged, in 2007 and 2008. The worst situation was in Bulgaria, Serbia and Romania. Slovenia, Hungary and later Bulgaria managed to improve current account situation after 2010. Last two years situation has improved in Croatia and Czech Republic. Serbia, Romania and Poland still have very high deficits.

The countries of Central and Eastern Europe in the past decade have made significant progress in disinflation. Some of them began decade of 2000s with a two-digit inflation rate, and previous decade even with three-digit rate of inflation. The disinflation is the result of sound macroeconomic policies, especially monetary policy focused on price stabilization. However, in addition to achieving low inflation, it is important to maintain price stability in the long run and reduce the variability of inflation. Volatile inflation rate brings macroeconomic instability and uncertainty, that destimulates investments in production capacities and in financial sector. Table 1 shows results achieved in disinflation policies.

Table 1. Descriptive statistics of inflation- π (measured by average consumer prices), 1990-2015, in %

	1990-2015				2004-2015				2015
	Average	Max	Min	CV	Average	Max	Min	CV	π
Czech Republic	3,3	10,7	0,1	90,1	2,2	6,3	0,3	74,2	0,3
Hungary	11,5	34,2	-0,2	86,0	4,0	7,9	-0,2	63,0	-0,1
Poland	34,4	585,8	-0,9	330,7	2,3	4,3	-0,9	74,7	-0,9
Slovak Republic	5,2	13,5	-0,3	75,8	2,6	7,5	-0,3	87,7	-0,3
Slovenia	6,8	31,9	-0,5	108,5	2,2	5,7	-0,5	74,9	-0,5
Bulgaria	75,0	1061,2	-1,6	283,9	4,0	12,0	-1,6	98,8	-1,1
Croatia	7,2	97,5	-0,5	282,8	2,3	6,1	-0,5	74,1	-0,5
Romania	54,1	256,1	-0,6	134,1	5,5	11,9	-0,6	61,5	-0,6
Serbia	18,5	80,7	1,4	123,8	8,3	16,3	1,4	50,8	1,4

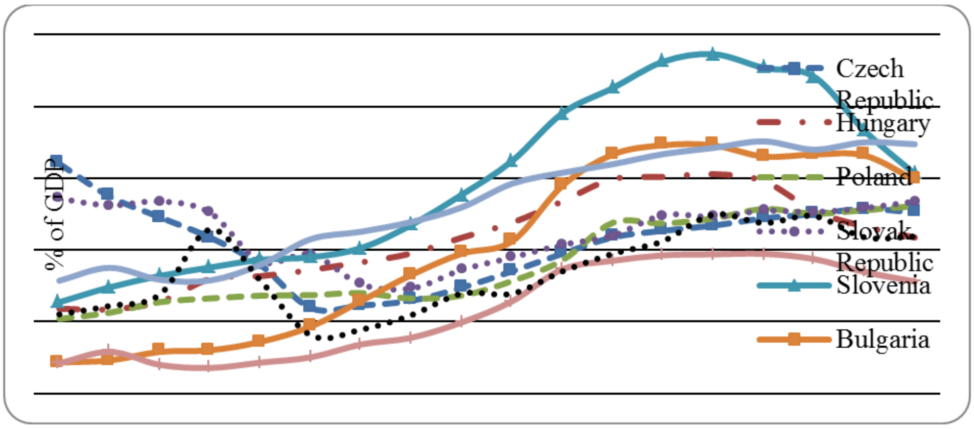
Source: World Economic Outlook, International Monetary Fund

https://www.imf.org/external/pubs/ft/weo/2015/02/weodata/index.aspx

None of these countries has reached the level of inflation as in the EMU. Lower average level of inflation rate, in the last 10 years, had Czech Republic, Slovenia, Poland and Croatia, but with significant variations. Beside, since the crisis emerged, the inflation rates have been very low in the whole Europe, in some years even negative and that reduced average rate. In the group of EU member states, the most problems with inflation in ten years period had Romania, inflation was on average 5,5%. Hungary and Bulgaria also had high average inflation. Croatia achieved significantly better performances with price stability, but with higher variability of inflation. The most problems with inflation throughout the observed group of countries has Serbia, which in 2000 had a three-digit inflation- 113,3%. The inflation rate during this decade significantly decreased, however, it was still often in the double digits level. At the moment, inflation rate in Serbia is very low, as the result of weak domestic demand, low inflation and demand in EU, low oil and primary agricultural products prices.

Different indicators could be used to analyze the level of financial markets development. Authors used domestic credit to private sector granted by banks, since European financial sectors are largely bank-centric. Banks finance around 75% of euro zone economy (Geeroms, Karbownik 2014, 5), and in less developed countries that percentage is even higher. During 1990s banking sector in ex Yugoslav republics and the other observed Balkan countries went through serious crisis. Banks were illiquid, insolvent and unprofitable. During 2000s there were bank sector reforms, banks were restructured and privatized. The majority of banking sectors in region is now owned by large, mostly European banks.

Graph 2: Domestic credit to private sector by banks, as % of GDP



Source: World Development Indicators, The World Bank Databank, http://databank.worldbank.org/data/home.aspx

The level of financial intermediation was quite modest during 1990s, but started to grow significantly after 2000. The exceptions are Czech Republic and Slovakia, which had the level of domestic credit to private sector by banks around 60% of GDP in 1993. After that the indicator had a sharp drop until 2002, and still hasn't recovered, reaching in 2014 the level of around 50% of GDP. The highest level of financial intermediation was in Slovenia, almost 95% in 2010. Sizable growth of bank credit activity started after accession to EU. Unfortunately, that growth was debt fuelled. Slovenia witnessed economic boom, with the GDP growth rate reaching almost 7% in 2007. Especially the investments in the construction sector rose due to an unprecedented growth of credit. In this period Slovenia entered the same "trap" as Greece. After EU and ERM II entrance and later on to the Euro zone, interest rates converged towards the level that prevailed in the Euro zone. This enabled the Slovenian banks the access to cheap credit from abroad, and caused the shift in bank financing from deposits to foreign capital markets. This shift made the Slovenian economy much more dependent on foreign capital. Beside, ERM II membership prevented the central bank of Slovenia to depreciate tolar, and thus facilitate the export. The export sector started to lag behind in terms of competitiveness, and the current account deficit started to rise. Crisis brought huge fall in economic growth, and the inflow of cheap credit from abroad stopped, causing the bubbles in the construction and real estate sector to burst. Banks accumulated high levels of non performing loans. Sovereign debt crisis followed due to the fall in tax revenues and rise in welfare spending, but also due to government interventions in the banking sector.

Although almost all observed countries had sound public finances before the crisis- the level of general government gross debt was below Maastricht criteria, crisis worsened the situation. Still, in Slovakia, Poland, Czech Republic, Romania and Bulgaria the level of indicator is still significant below Mastrichts' 60% and has a downward trend.

Hungary, since 2002 had continuously growth in government debt that reached maximum in 2011, after that it started to fall. Situation with public finances in Croatia, Slovenia and Serbia is constantly worsening after 2008. In Croatia, general government debt-to-GDP ratio rose due to increased state budget deficits (consequence of revenue shortfalls and expenditure pressures) and costs related to the materialisation of contingent risks in state–owned enterprises (mostly debt taken by the state based on guarantees granted to public corporations) (European Commission 2016, 14). Serbia has weak fiscal performances, since 2009. Until 2014. general government debt doubled, due to additional liabilities transferred to the government's balance sheet from state–owned enterprises. In 2014. the increase in public debt to GDP was very high, mostly due to a strong growth of the U.S. dollar against the euro and the Serbian dinar. Strong increase of debt-to GDP ratio is also caused by higher fiscal deficit (Narodna banka Srbije 2016, 2).

4. Demographic aspect of economic development

The population size and its demographic structure could give one country strategic advantage over another, or it could become a very serious burden. It depends on demographic processes but indirectly it depends on the economic development level, too. One can say that demographic structure and dynamics on one side, and economic development on the other, stands in certain causal link.

Among these nine countries, Poland stands alone by its population size (almost 40 million people). However, if we study another demographic characteristics, Poland has positive trends in natural increase, but has strong emigration process and negative population growth. This characteristics is common for countries of less economic size (Romania, Bulgaria, Serbia). It is evident that negative population growth is the consequence of negative trends in natural increase rate (with an exception of Poland), but also is pushed forward with very intensive emigration process (net migration rate is negative for Poland, Bulgaria, Romania, Croatia and Serbia). If we compare it with some economic development indicators of these countries, we could conclude that there is positive correlation between economic development of the country and the negative migration processes.

Such population trends produced certain demographic structures and economic processes that resulted in serious social and economic disparities among all countries and among differentiated groups of countries (Manić, Popović and Molnar 2012). One of the most important of these consequence is demographic aging. Demographic aging is well underway in many European countries. The proportion of the population aged 65 and over, grows every year in most countries with serious consequences on the future of the European labor force. This is very sensitive question especially for the countries which is trying to catch the EU-development countries "train".

Table 2. Demographic indicators of EU-28 and EU- accession countries

	Population, 2015	Population density (inh./km^2), 2014	Crude rate of population change (per 1.000 inh.)*, 2014	Crude rate of natural change (per 1.000 inh.), 2014	Net migration rate (per 1.000 inh.)**, 2010-2015
Czech Republic	10.538.275	136,3	2,5	0,4	0,6
Hungary	9.855.571	106,1	-2,2	-3,3	0,6
Poland	38.005.614	124,1	-0,3	0,4	-0,4
Slovakia	5.421.349	110,5	1	0,7	0,1
Slovenia	2.062.874	102,4	0,9	1,1	0,4
Bulgaria	7.202.198	66,3	-6	-5,7	-1,4
Croatia	4.225.316	74,9	-5,1	-2,7	-0,9
Romania	19.870.647	86,5	-3,9	-3,1	-4,4
Serbia	7.114.393[1]		-4,5[1]	-4,5[1]	-2,2[2]

[1]without province Kosovo and Metohia which is under United Nations Security Council Resolution 1244/99

[2]with estimated data for Kosovo and Metohia

*The crude rate of population change is the ratio of the population change during the year to the average population in that year. The value is expressed per 1 000 persons. Population change is the difference between the population sizes on 1 January of two consecutive years.

Source: Eurostat- Population (Demography, Migration and Projections), http://ec.europa.eu/eurostat/web/population-demography-migration-projections/population-data, **United Nations, Department of Economic and Social Affairs, Population Division (2015) World Population Prospects: The 2015 Revision - Special Aggregates, DVD Edition

The old-age dependency ratio represents the ratio between the number of persons aged 65 and over (economically inactive part of population) and the number of persons aged between 15 and 64. Countries with older population have a higher value of ratio. They are (and will be in the future) the origin of immigration flows from countries with a younger labor force (the lower values of the ratio). This is an important impact factor to the labor market of the country because it directly influences the contingent of labor force, but also the economy of the country (Mayerhofer 2014). Poland, Bulgaria, Romania, Serbia, and Croatia are the constant source of the new labor force. However, among them there is one big difference. Although having negative net migration rate, some countries like Poland can afford this circumstance. It has big "demographic reservoir" and positive trend of the population natural regeneration. Serbia on the other hand, beside having permanent problems with strong outflow of the young work force, in the long run will face serious problem of labor shortage. With such negative natural increase, Serbia will continuously lose its population. Similar case could be with Hungary, Bulgaria and Slovenia.

5. Conclusion

There are significant differences in achieved economic performances between the Central European and observed Balkan countries. The central European countries have gone through the transition relatively painless, with smaller and transient loss of GDP. Opening boundaries for foreign capital was successfully used to facilitate serious restructuring of economy and reorganization of companies. Although it was shown that EU membership is not a panacea, those countries have been more successful in implementing economic reforms, integrating into the world economy and attracting foreign investment. Still, catching-up process with more developed EU countries is not finished. Slovenia and Czech Republic achieved the best results in terms of per capita wealth, but the others still lag behind developed Europe countries.

Observed Balkan countries have performed quite badly. Higher growth rates until crisis were the result of larger capital inflows, that caused significant rise in consumption, but not productive investment. Now, they are facing the problems that were supposed to be resolved in previous decade. They are severely hit by the crisis, and still didn’t recover. Those economies are lagging behind in the process of integration into the larger European economy. Although Bulgaria, Romania and Croatia are now EU members, their economic performances are quite week, at the very bottom of EU, which means they are not well integrated. Serbia, Romania and Bulgaria are not on the path of sustainable development, their economies are not able to keep up the pressure from significantly more developed EU and world markets. Their short run economic prospects are quite weak and vulnerabilities of their economies even increased with the euro zone crisis. Those countries need new model of development based on reindustrialization.

Serbia has the worst economic position among analysed countries. In the implementation of structural reforms and the transition process, it significantly lags behind the countries in the region. GDP per capita is only one third of EU level, it has large trade, current account and budget deficits as the result of consumption that is significantly exceeding the GDP level. The growth model based on consumtion financed with debt has failed. Now it needs new growth model. It is necessary to remove a number of macroeconomic imbalances, to encourage the growth of production, especially for the export, improve the competitiveness of the economy and provide employment growth. Current Serbian strategy is based on attracting FDI, but it showed to be unefficient. It should focus more on domestic savings and investments, economic policies should be directed towards institutional and structural reforms which would improve the business and investment climate. Better economic cooperation with countries from the region can also help to encourage domestic and foreign investors to invest in production in the export oriented sectors of the economy. Beside, having in mind very bad demographic structure and its dynamics, special attention must be given to demographic issues so that they don’t became an obstacle to the economic development of the country.

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REPUBLIKA SRBIJA U REGIONU: ANALIZA SOCIO-EKONOMSKIH PERFORMANSI

Apstrakt: Srbija želi da bude deo Evropske zajednice. Da bi taj cilj postigla, mora da ispuni određene uslove i to ne samo formalne- kao što je usvajanje pravne tekovine Evropske unije, već i suštinske- kao što je konvergencija ekonomskih rezultata, kako bi bila u stanju da podnese konkurenciju ekonomski mnogo jačih zemalja na jedinstvenom tržištu. Ova rad pokazuje da je to bio veliki izazov i za ekonomski znatno uspešnije zemlje regiona.

Nakon kraćeg uvoda, drugi deo rada sumira sličnosti u modelu razvoja u državama bivšeg Istočno-Evropskog bloka zemalja do 1990-tih, razlike u modelima privatizacije i putanjama razvoja nakon 2000. Treći deo rada posmatra ključne ekonomske performanse izabranih zemalja kako bi ukazao na poziciju Srbije među njima, ali i u okruženju EU. S obzirom da je radna snaga važan faktor proizvodnje i ekonomskog razvoja, četvrti deo rada analizira demografsku strukturu i njenu dinamiku u datim zemljama.

Ključne reči: tranzicija, model razvoja, konvergencija ekonomskih performansi, demografske promene