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Country Economic Memorandum (CEM) Serbia's New Growth Agenda

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Country Economic Memorandum (CEM)

Serbia's New Growth Agenda

- ➡ Serbia is not growing as fast as it could.
- ➡ Investment and productivity are low and slow-growing; and the continuing large role of the state in the economy makes it difficult for the private sector to accelerate economic growth.
- ➡ Serbia is well-positioned to turn itself into a fast-growing, sophisticated modern economy, driven by its private sector.
- ➡ To succeed, Serbia needs a new strategy - a New Growth Agenda (NGA) to speed up growth, enable catch-up with its peers in Central and Eastern Europe and hasten convergence with the EU.

Serbia is not growing as fast as it could.

Since the start of transition, Serbia has progressed on the path of economic reforms, experienced a period of solid economic growth, and has begun the process for accession to the European Union. But after the global financial crisis of the late 2000s, its annual growth averaged a mere 0.8 percent, only half of what was achieved in transition economies of Central and Eastern Europe (CEE) during the same time. As a result, the Serbian economy is still smaller than in 1990. At the same time, CEE economies are now 75 percent larger than in 1990 and Baltic economies are 42 percent larger.

Stagnating growth since the global financial crisis

(GDP index, 1990=100)

Source: CEM, based on Eurostat

Chronically low investment, low exports, and a fall in consumption

(contributions to GDP growth, percentage points)

Source: CEM, based on data from the Serbia Statistics Office

Investment is low.

As liquidity was withdrawn from the global economy after the global financial crisis, Serbia's investment dropped and consumption decreased. At the same time, already low investment also contracted while the economy was not competitive enough for exports to become a major driver of growth. In Serbia, annual investments average about 20 percent of GDP, while at least 25 percent of GDP is necessary for stable economic growth.

Recent strong employment growth will level out soon.

Unemployment was reduced to 13.2 percent in 2018, among the lowest in the region, with over 60 percent of the working age population employed in 2018. Since 2011, about 80 percent of the net increase in employment has been due to jobs created in the services sector. But this trend is likely to level out: services are already employing a higher share of population than in peer countries.

Employment growth is driven by services in recent years...

(contributions to employment growth, pp)

Source: CEM, based on data from the Serbia Statistics Office

...But employment in services is already larger than in other countries, limiting future growth (2017)

Source: CEM, based on data from the Serbia Statistics Office

Productivity is low and slow-growing.

Large sectors (such as transportation, services, food industry) remain relatively less productive. Productivity has been low and slow-growing, with substantial barriers to efficient allocation of the factors of production to the most productive firms—at the cost of an estimated 85 percent in potential output. In product markets, state involvement has induced 65 percent of the distortions. In particular, not only is the state role and support to the economy large, subsidizing SOEs and other firms by about 3 percent of GDP yearly, it is often inefficient and ineffective and generally crowds out private sector efforts that could be more innovative and value creating; it has also previously pushed up debt to the point that fiscal consolidation became necessary.

Firm-level productivity is low and slow-growing

Real value added per worker is low in the largest sectors

Firms are not growing fast enough.

Low productivity is part of the competitiveness problem for Serbia. Firm-level productivity is low, slow growing, and there are not enough high-growth firms (gazelles). Although there has been much progress, there is still high unexploited potential to increase growth through exports diversification and expansion: exports are below 50 percent of GDP, while they are over 80 percent in other small transition economies of Europe. While the taxation system has been effective in collecting revenue, it discourages the growth of private firms.

Room to grow exports.

Substantial recent export growth has not been effective enough in making exports more sophisticated: except for Fiat production, the exports basket has not changed much since the early 2000s.

Share of high-growth firms in total

(High-growth firms and gazelles, turnover-based, % of firms with 10+ workers)

Source: CEM, based on data provided by the Business Registers Agency (BRA)

Financing for growth needs to become more strategic.

Both to enable more diverse private sources and to rationalize public support. Direct support to firms has not been as effective as it could be, yet it takes up significant fiscal space. On the private sector side, small firms face triple the financing barriers as large firms. Yet, those able to access credit are more productive than others. The financial sector remains shallow and undiversified.

Lending to private enterprises is constrained

(Euro million)

Source: CEM, based on data provided by Serbia's National Statistics Office, 2013.

Small firms face greater constraints in accessing financing

(percent of firms facing constraints)

Although private firms and exporters are increasingly driving growth in a broad range of sectors, **the incomplete transition to a market economy is making it difficult for the private sector to accelerate economic growth.**

How Can Serbia Re-Ignite Its Growth?

Serbia is well-positioned to turn itself into a fast-growing, sophisticated modern economy, driven by its private sector. Just as the Zastava factory: Although destroyed during the war, it has since been transformed into one of the most modern factories in the world turning out 100,000 modern cars a year and exporting to the European Union and United States. To grow at 5-6 percent a year, thus doubling income per capita in 15 years, a clear, bold and evidence-driven strategy is required.

The World Bank new Country Economic Memorandum (CEM) will analyze Serbia's growth model and provide evidence at macro, sectoral, and micro-levels that Serbia can use to underpin a new growth model. The CEM is titled: The New Growth Agenda (NGA).

Reforms under the New Growth Agenda (NGA) could speed up growth, enable catch up with its peers in Central and Eastern Europe and hasten convergence with the EU

At present the New Growth Agenda guideposts are:

- Maintain hard-won macro stability
- Reform and rationalize the substantial state support to growth
- Develop a front of regulatory reforms, especially in product and service market competition areas
- Enhance growth and productivity of firms, through leveling the playing field, improving access to finance, and removing constraints to labor mobility
- Encourage the shift to the “new economy” through education and skills reform, actions to promote technology diffusion, and eliminating any behind-the-border constraints to importing and exporting
- In line with EU accession reforms, bring lagging sectors to the forefront of growth (e.g., agriculture)

In support of the NGA, the CEM will produce analysis and policy papers on the following topics:

- Speeding Up Growth
- Serbia's growth challenges and the NGA
- Financing Growth
- The financial sector as enabler of small-firm growth
- Fiscal policy for growth
- Human Capital for Growth
- The labor market
- Skills and education system
- Raising Productivity and Exports
- Firm-level productivity diagnostic
- Facilitation of business and investment and internationalization of firms
- Product market regulation
- Agriculture and food processing as drivers of growth

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