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MOKRA GORA SCHOOL OF MANAGEMENT



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GOVERNMENT: FRAMEWORK FOR NECESSARY AND UNAVOIDABLE REFORMS

Serbia's Economy: Overcoming Challenges to Sustainable Growth

Bogdan Lissovolik, IMF Resident Representative in Serbia

VIVALDI FORUMS

SUMMER VIVALDI FORUM - FORECASTING 2012
Mokra Gora, June 23-25, 2011



Outline



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- The global crisis shock looks to have been a long time ago, but few in Serbia see “light at the end of the tunnel...”
- Two key questions:
 - What is the reason for Serbia’s problems?
 - What to do (for the Serbian government)?
 - *Answer: re-orient the public sector to unleash private sector supply-side response... with challenges on two fronts:*
 - *fiscal responsibility*
 - *investment climate*

Easier said than done, but let’s see “what it takes....” in the Serbian context



Global context



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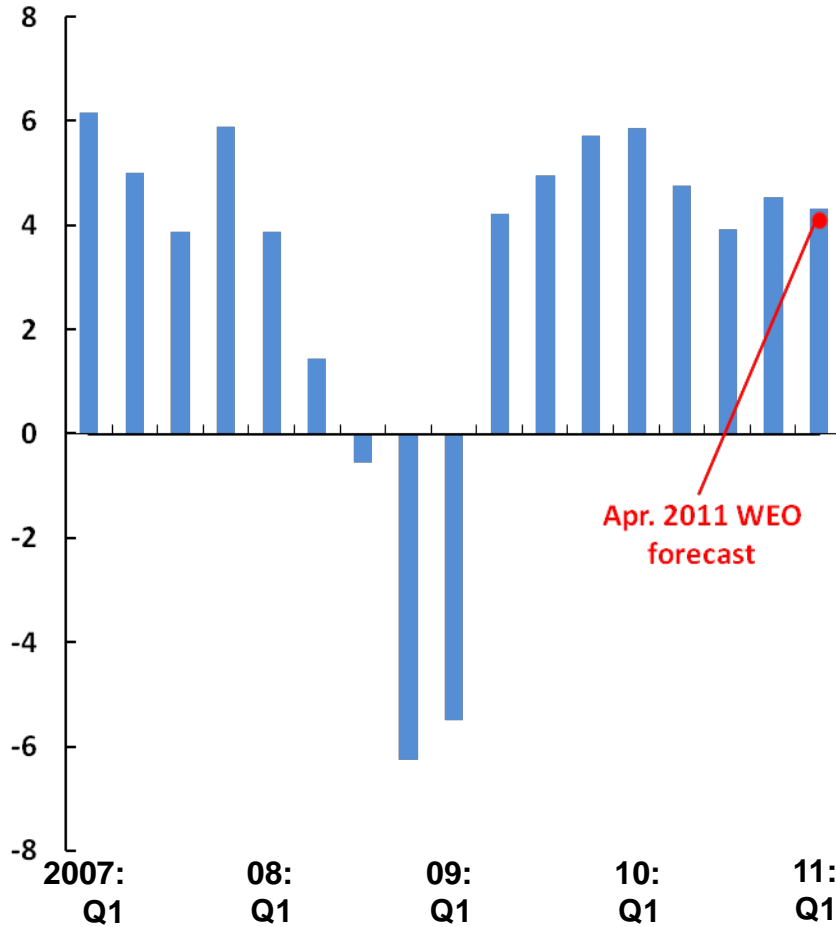
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- “Macro-prudential” failures and the savings glut masked competitiveness problems in a number of key countries;
- Now a “multi-speed,” bumpy recovery;
- The process is turbulent across countries and issues, with volatility in (i) capital flows; (ii) commodity prices; (iii) risk appetite, with pockets of vulnerabilities in financial institutions and with sovereign crises
- Fiscal /monetary relaxations unprecedented – buy time to recover and for prudential tools to catch up (but things get complicated, including due to politics)
- We are in uncharted territory: recent examples of policy stand-offs and uncertainties are sobering...

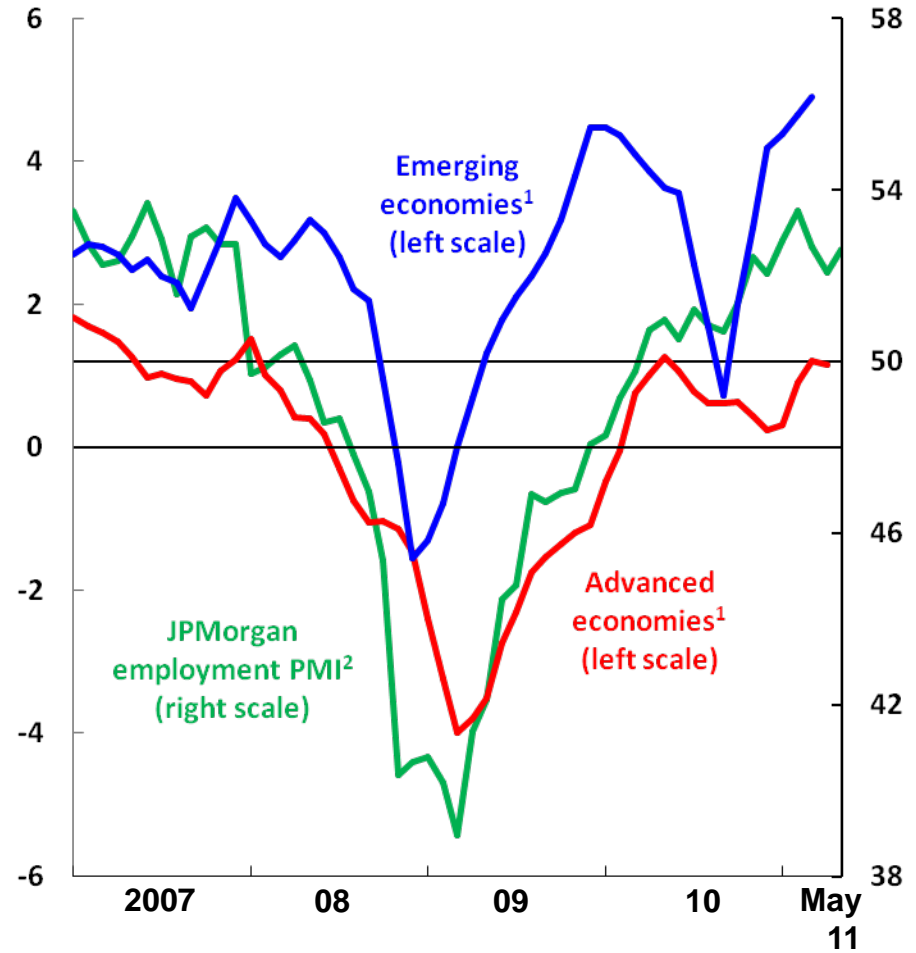
The global economy has continued to expand despite some negative surprises: many emerging markets are taking advantage *but Serbia has yet to catch up by reaching high GDP and (any significant) employment growth*

Quarterly World Growth

(percent; quarter over quarter, annualized)



Employment Growth and Employment PMI



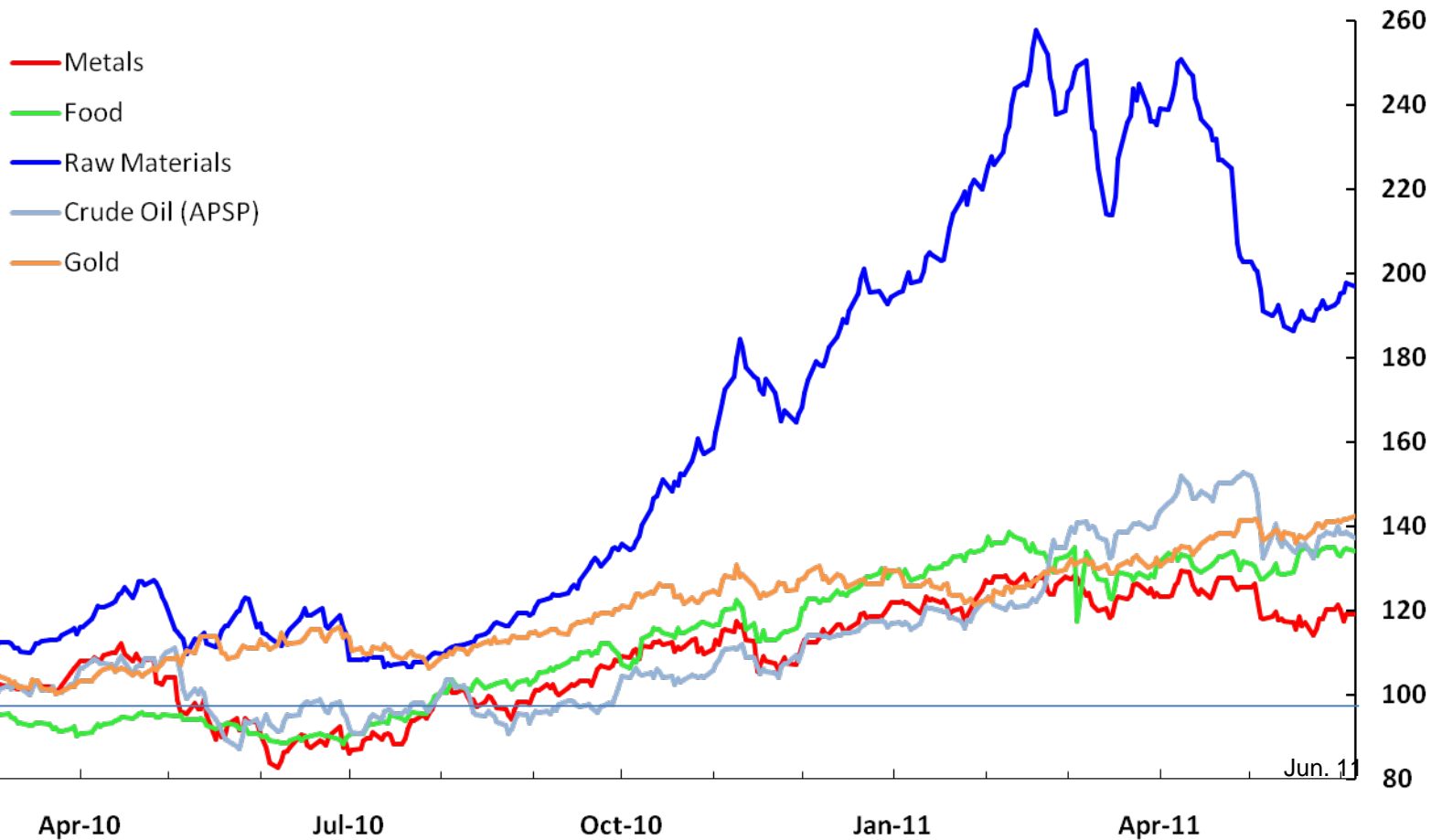
¹Percent; three-month moving average (3mma) over previous 3mma, annualized.

²Index; JPMorgan global composite (manufacturing and services) employment PMI.

Commodity prices high, but have recently receded somewhat: *this should help inflation, including in Serbia*

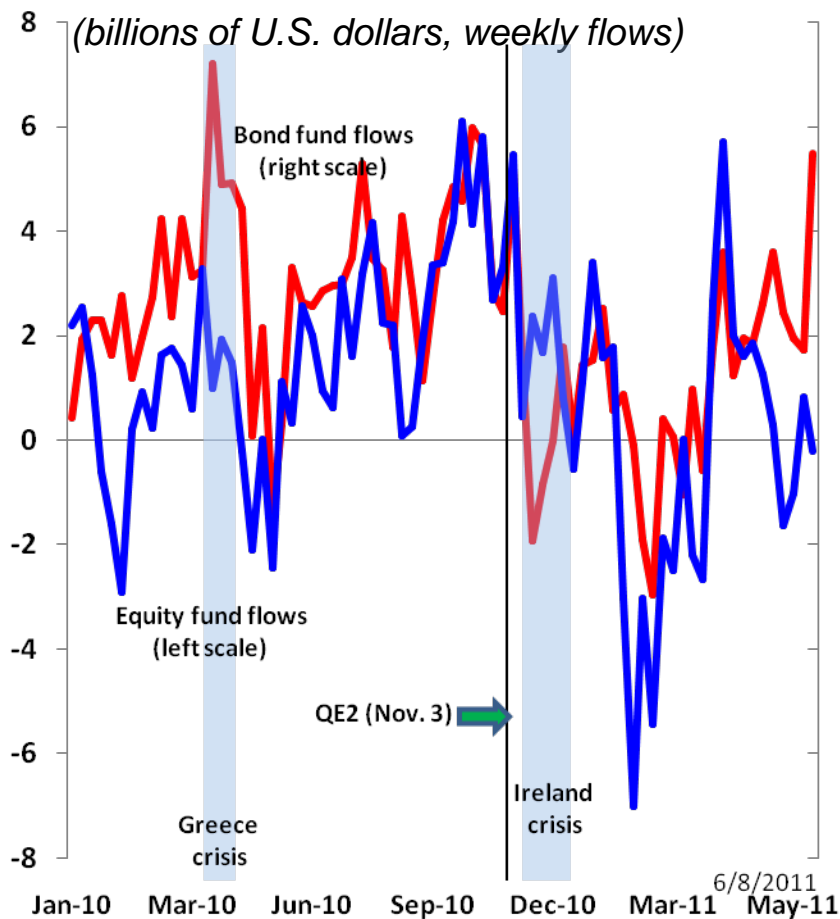
Commodity Price Indices

(Jan. 1, 2010 = 100)



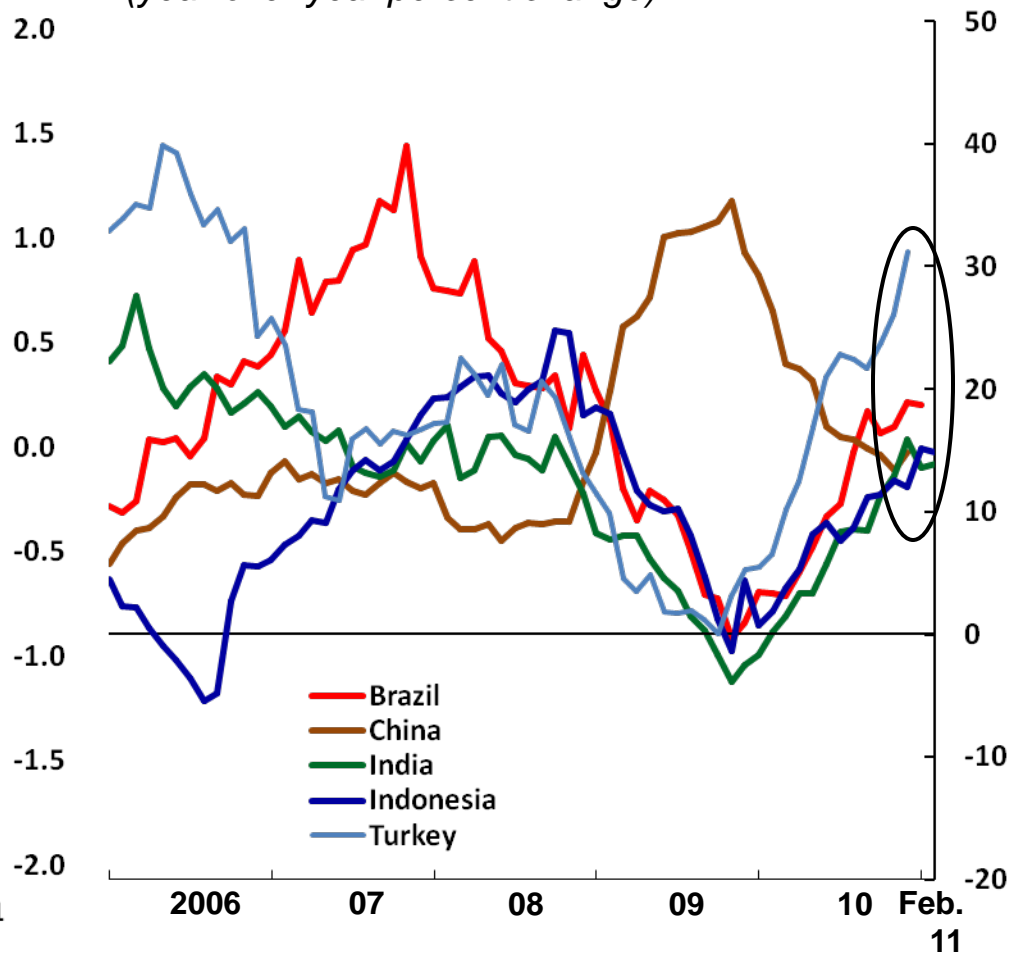
Emerging economies are on a roller coaster, and currently on the upswing: *large inflows also help Serbia finance its remaining current account deficit but real credit is weak*

Net Fund Flows to Emerging Markets



Real Credit Growth in Selected EMs

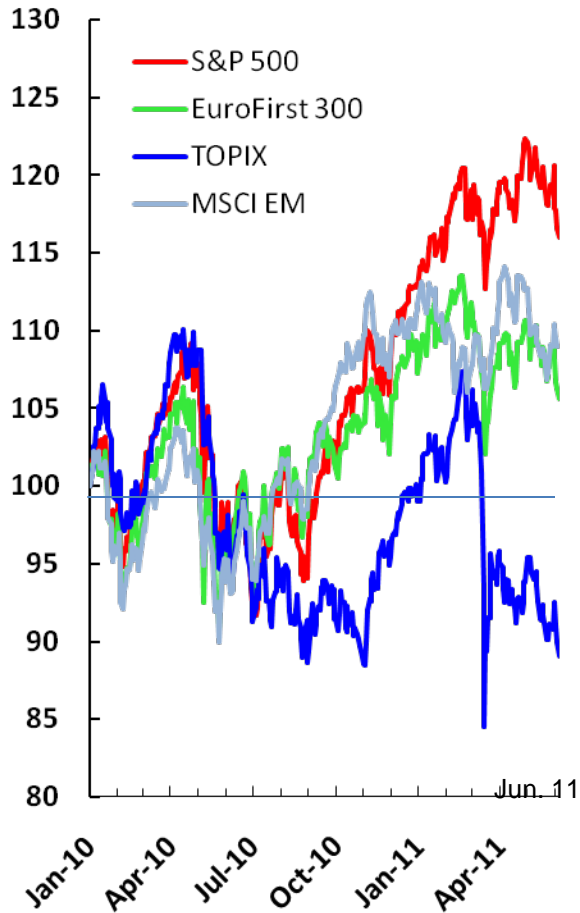
(year-over-year percent change)



Financial stress has recently risen, with concerns over sovereign risks in the euro area, but also over U.S. recovery: Serbia's risk premium also on the rise in recent weeks

Equity Indices

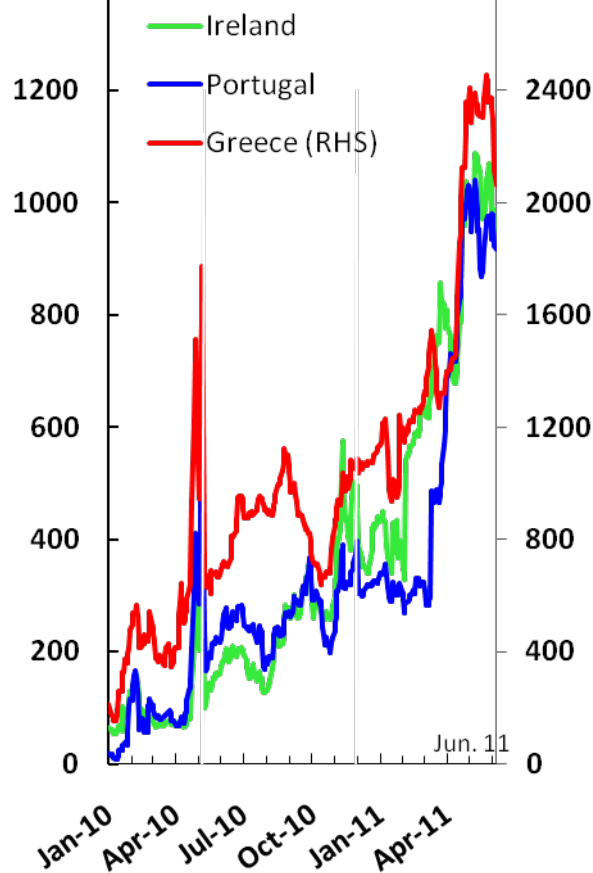
(Jan. 1, 2010 = 100)



Government Bond Spreads

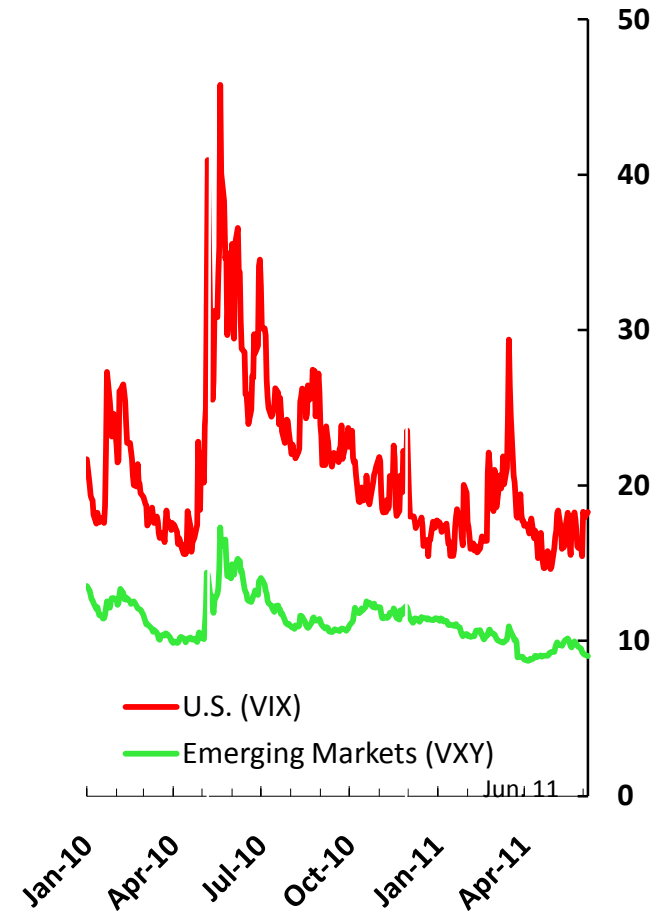
(two-year yield spreads over

German bunds; basis points)



Implied Volatility

(percent)





Lessons from sovereign crises



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- Sovereign crises unmasked competitiveness weaknesses: euro-area “periphery” a case in point – complicated by fixed exchange rates and low (political) capacity for “internal devaluation.”
- Main domestic causes of recent problems in euro-area countries
 - Fiscal irresponsibility (poster child: Greece)
 - Chronic slow growth (poster child: Portugal)
 - Financial sector excesses (poster child: Ireland)

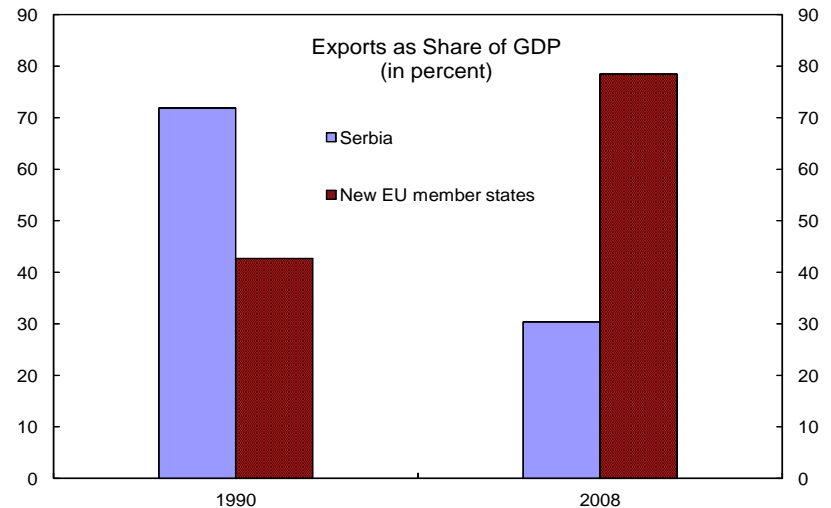
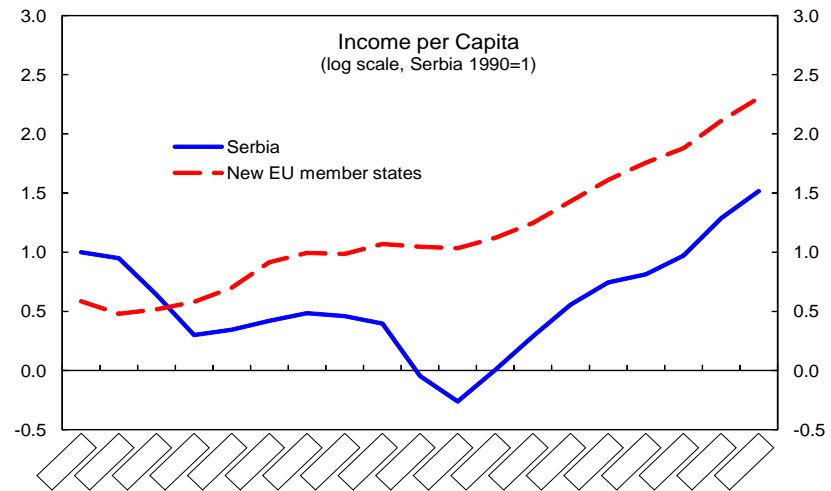
But it’s a combination of the 3 problems that makes a crisis...

Positive examples: **Germany: did things largely “by the book”** and is one of the more dynamic economies in Europe (ditto for parts of Latin America and Asia)

Lesson for Serbia: avoid problems through pre-emptive reforms...

Serbia: Historical “Baggage”

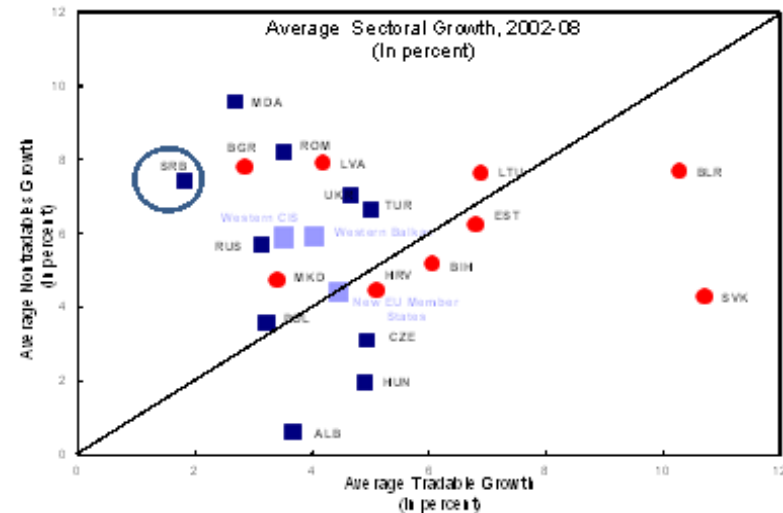
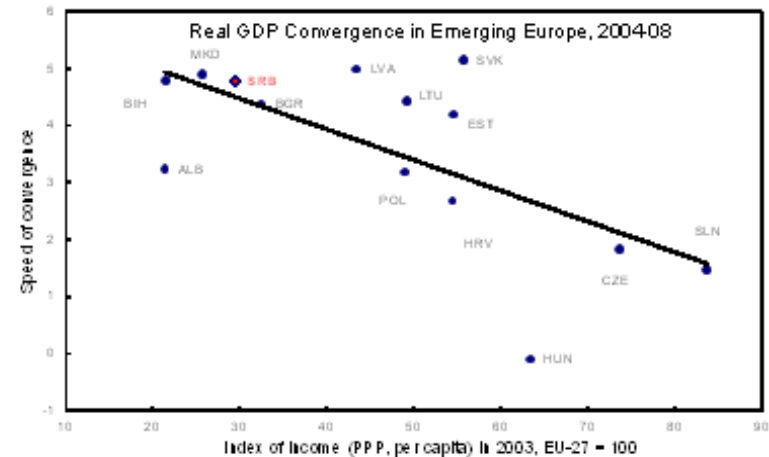
- In 1990 relatively rich and “export oriented”
- Economy derailed by 1990s traumas (hyperinflation, trade sanctions, wars)
- Re-emerged as a relatively poor and closed economy
- Social/political consequences
 - Unhappy population
 - Fragmented politics
 - Distributional issues dominate the debate
 - But majority in favor of EU accession



The environment for “catch-up” growth is ever more competitive: Serbia’s effort should be yet better than its EU-8 peers in the 1990s...

Pre-Crisis Growth Decent but Unsustainable

- Starting from 2001 catch-up growth
- But three troubling symptoms:
 - (1) Wrong engine (non-tradables instead of tradables)
 - (2) Excessive financing by foreigners
 - Domestic savings close to nil
 - 2008 CAD 21 % of GDP
 - (3) Risky currency structure of debts
 - Domestic credit (80 % FX)
 - Cross-border credit (all FX)
 - Corporates largely unhedged



The first stab at “catch-up” growth over the last decade did not play well, because the supply of tradable goods was weak...



Short-term Response



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- The 2008 crisis unmasked Serbia's unsustainable growth model...
- The IMF Standby Arrangement of 2009-11 sought to contain the damage...
 - Helped prevent banking/currency collapse;
 - Protected somewhat the fiscal position (spending freezes);
 - Supported start of economic rebalancing, but only a start...

But a more fundamental overhaul of the economic system is needed for a truly successful catch-up growth, because the reforms have been insufficient – how so? – Look at decisions!



Selected Policy Failures



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- Examples of problems created and “swept under the rug” – “shooting the economy in the foot” (lack of defense):
 - 2008 increases in pensions and public wages
 - 2005 labor law reform that changed severance benefits
 - Periodic amnesties: social contributions;
 - Loopholes in pension disability and other social benefits;
 - Recent decentralization proposal (so far fiscally irresponsible)?
- Examples of reforms that were aborted (lack of offense):
 - Public enterprise dominance unaltered since early 2000s
 - Rationalizations in PA/health/education not started;
 - Competition policy weak for much of the decade;



Task I: Fiscal responsibility



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Two sides of the same coin:

1. **Play Defense:** Deficit rules control 2011 and 2012 (and outer) deficits – a major challenge given the elections; handle restitution carefully to honor the debt rule...
2. **Play Offense.** Improve government efficiency and effectiveness (i.e., how to do “more with less”)
 - ***These two challenges go hand in hand: with an inefficient government the deficit spins out of control; missing deficit targets is by itself a key signal that the government is ineffective;***



Priorities on Offense



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- In what areas to do “more with less”?:
 - Government wage bill (health, education, etc.)
 - Pensions
 - Enforcing fiscal rules (PFM)
 - Public debt management
 - Public investment
 - Tax and social contributions collection



Task II: Investment Climate



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– Play defense

- stop uncontrolled proliferation of central and local fees

– Play offense! (not as much to defend?)

- Reform/privatize public enterprises
 - State/local
 - Formerly socially-owned
- “Guillotine” project and further deregulation
- Remove obstacles for using construction land
- Labor market reform (labor law, collective bargaining)
- Product market reform (competition, level playing field)



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Thank you!

Hvala!

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