From the Editor

In the middle of the previous year, a four-year expansion of European economies ended, during which developed European countries achieved a cumulative growth of 9%, and Serbia 12%, while Central and Eastern European countries achieved a GDP growth of 16% in the same period. The second quarter of this year saw a slowdown in growth not only in developed European countries but also in Central and Eastern European countries. Therefore, it is again a dilemma whether European economies are just slowing down or facing a recession and economic downturn. Although it is not yet certain how economic activity will behave in European countries, for now it is more likely that there is a slowdown in the growth of European economies, which may be accompanied by a slight decline of economic activity in some of them in one or two quarters. Such a slowdown in developed European countries, after the World War II, occurs on average every 3-4 years and lasts for several quarters. Countries that experienced a decline in GDP in the second quarter, such as Germany, have low public debt and fiscal surplus, which gives them the opportunity to boost economic recovery by increasing government spending. For now, it is unlikely that European economies are facing a new deep recession like the one from 2008-2009. years. Deep recessions are less frequent after the World War II and are most often generated by major problems in financial markets such as stock market crashes, banking crisis, public debt crisis, large real estate price declines, enormous leap in prices of important commodities such as oil. Some economists see trade disputes between the world's largest economies (US, China EU) and Bregzit as a potential trigger for a new strong recession, while other indicate that there are price bubbles in the stock and real estate markets of large economies.

For Serbia it is relevant how the slowdown or recessions in the EU will affect its economy and what economic policy can do to minimize the negative effects. It is quite certain that the slowdown in European economies will have a negative impact on Serbia's economy, but the intensity of this negative impact will depend on the depth and duration of the crisis in the EU, which are both unknown for now. In the event that economic activity in the European economies decelerates, with a slight decline in one or two quarters, the effects on Serbia will be negative, but not very large. Of course, the effect will also depend on how fiscal and monetary policy in Serbia will respond to the slowdown in European economies. Adequate fiscal policy response would be to increase productive public expenditures, notably public investments, and to further reduce the fiscal burden on labor. Due to a possibility that is not overly probable, but not excluded, that European countries will face a stronger recession in the coming year, fiscal policy in Serbia needs to be designed to remain sustainable even in the case a stronger recession occurs. This primarily means that the planned fiscal deficit in the coming year should not exceed 1% of GDP.

The impact of public investments on the economy, in the period of their realization, is transmitted through demand and it depends crucially on the volume and efficiency of investments, as well as on the share of domestic companies and workers in their realization. Having in mind Serbia's modest capacity to manage public investments, but also its fiscal position, it is estimated that public investments of about 5% of GDP would be appropriate. Public investments are effectively realized if, for example, 100 million euros of expenditure on the basis of public investments leads to an increase in public capital by an identical amount, which means that there is no waste of resources in the form of inflated prices, bribery, poor quality of work, etc. Finally, the short-term effect of public investments on economy is larger if more domestic enterprises, domestic workers and other domestic resources are involved in their implementation. The long-term effects of public investments on the economy and society will depend on the realization of economically viable projects that generate income in the future, reduce private costs, have a positive impact on human health and environment, etc., or projects supporting the goals of narrower political and business groups will be implemented.

In mid-2019, the President of the Republic announced a highly ambitious five-year national investment plan (NIP) worth 10-12 billion euros. Based on the time of the announcement of the NIP and method of selecting the project, it is estimated that it will partly cover undeniably justified projects, but will also include projects whose implementation is not economically and socially justified, yet is consistent with the political interests of the ruling party and its close business circles. Regardless of the motivation, the implementation of the NIP will be stimulating for the economy, but the degree of this positive influence will depend on the ability and desire of the state to select socially justified projects, and then efficiently implement them, as well as the level of involvement of local businesses and local workers.

Efficiency of public investments realization in Serbia in the previous period was rather low, which was manifested by exceeding the deadlines for completion of projects, high prices, and in some cases the quality of work was also low. Low efficiency of the realization of investments is a consequence of a generally low quality of governing which is manifested in this area through the realization of non-priority or even unnecessary projects, poor project documentation, absence or faking of competitive procedures in the selection of contractors and inadequate control in execution of works. The impact of low quality management of investment projects on the efficiency was mitigated in previous years by the fact that the total amount of public capital was low, so the impact of increased public capital on production was high - the marginal product of capital was high. With the increase in the amount of public capital, its impact on the growth of production gradually declines, so the efficiency of investments will also decline, unless the quality of public project management is improved. Another factor that could negatively affect efficiency in the realization of public investments in the future is an inadequate selection procedure for investment projects. This problem existed in the past also, but it was mainly manifested in the implementation of small and medium-sized projects, while the largest investment projects such as Corridor 10 and Corridor 11 were indisputable. However, after the implementation of projects that were planned for decades and whose feasibility was thoroughly verified, large investment projects are now being proposed hastily, without a detailed analysis of the economic and social justification of their implementation. It is inappropriate for a democratic society that the decision to build new highways, or choose the Belgrade metro route, or build a national stadium and several stadiums across Serbia is made in narrow political circles without expert and public debate. In the absence of public and expert discussions, the risk of realizing economically unjustified projects is greatly increased. Therefore, as a result of the expected decline in the quality of management of public investments, on the one hand, and an increase in the amount of public capital on the other, it can be reasonably expected that the efficiency of investments and thus their positive impact on economic growth will decline in the coming years.

In order for public investments to have a positive impact on GDP growth in the long run, it is necessary that their financing is economically viable, that is, that their realization does not increase public debt and its financing costs significantly. Although a high-value national investment plan has been announced, so far government officials have not presented a clear plan for its financing. The President of the Republic has repeatedly claimed that the state can borrow an additional 2 billion euros per year, as he expects that the GDP growth in the coming years will amount to 5% which is around 2 billion euros. Moreover, he wrongly concluded from this that if public debt and GDP grew by an identical amount their ratio would not change, which would only be true provided that public debt and GDP were equal. However, since public debt in Serbia is about 50% of GDP, adding an identical amount to a numerator and denominator will result in an increase in the share of public debt to GDP. Hypothetically, if public debt and GDP were to increase by 10 billion euros in the next five years, the ratio of public debt to GDP would increase from current 52% to over 60% of GDP. This increase in public debt would be moderate and sustainable provided that GDP increases by about 5% annually in the coming years, and current government expenditures, such as salaries and pensions, do not grow faster than GDP. However, GDP is now more likely to grow at a rate below 5% in the coming years, and it is also not certain whether public sector wages will follow GDP growth. Therefore, it is likely that financing a NIP of 10-12 billion euros over the next five years would result in a public debt to GDP ratio significantly exceeding 60%.

Apart from fiscal policy, another measure available to Serbia to mitigate the negative effects of the slowdown in European economies is the slight depreciation of the dinar. A dinar depreciation would be an adequate response to the diminishing demand for our products in Germany and other European countries. Depreciation would make Serbian products cheaper in the European market, while foreign products would become more expensive in the Serbian market, which would have a beneficial effect on GDP and employment trends of Serbia. Depreciation, with an adequate income policy and control of domestic demand, would help halt a further growth of Serbia's foreign trade deficit, which has been ongoing for three years now, and gradually reduce it. Economically unfounded real appreciation of the dinar by about 7% over the last three years is one of the key factors of deterioration in Serbia's foreign economic position. Reducing the foreign trade deficit is a preventive measure that would keep macroeconomic stability in Serbia from the deterioration in the case a stronger crisis occurs in Europe which would result in an automatic fall in tax revenues and increase of fiscal deficit in Serbia. During the major economic crisis, which began in 2008, the largest economic downturn was experienced by European countries which entered the crisis with a large current account deficit, such as the Baltic States and Greece, which also pursued a policy of a fixed exchange rate.