
From the Editor



In the fourth quarter of 2014 and the beginning of 2015, negative trends in economy were halted, with some improvement in certain segments. However, there is still not enough basis to interpret this improvement as the beginning of a sustainable economic growth. Growth of economic activity was for the most part the result of renewed production in sectors that were particularly affected by the May floods, while exports and investments, the main drivers of growth, are still stagnating. Unemployment stagnated in the last quarter, while wages declined in real terms, primarily due to decrease of wages in the public sector. Year-on-year inflation reached a historic minimum, and as of mid last year, most of the months had a deflation. After a moderate depreciation at the end of last and beginning of this year, the dinar exchange rate has mostly been stable since the beginning of February.

After four consecutive quarters with declining economic activity, the last quarter of last year saw an increase in the seasonally adjusted GDP. Seasonally adjusted GDP in the last quarter was higher by 0.4% than in the previous one, and the main drivers of growth were industrial production and construction. Analysis by sectors indicates that the biggest growth was realised in activities that were most affected by floods, such as energy, but also that production is growing in certain activities that were not affected by floods, such as food industry. The growth of industrial production continued in January as well, with recovery spreading to a larger number of activities within the processing industry. Considering that the growth of economic activity was not generated by the growth of investments and exports, which represent the only sustainable drivers of growth in conditions of fiscal consolidation (government spending will drop this year and the following two-three years, and private spending will decrease at least this year), but rather by the growth of supplies/reserves, realised results for now cannot be interpreted as the beginning of a long-term sustainable recovery.

Signs of economic recovery are still quite weak, so it is necessary for the Government in cooperation with NBS to apply anti-recession measures, together with fiscal consolidation and reforms. Stronger growth of public investments would have the most direct and powerful

impact on economic activity, which is why public investments have to increase this year by at least 1 percentage point of GDP (around 300 million euros) compared to the previous year. Increase of public investments would be realised through accelerated implementation of contracted infrastructure projects, but also through reactivation of investments in municipal infrastructure, which has been on a low level in the last two years. Reduction of restrictiveness of monetary policy, through reduction of reference rate and the rate of mandatory reserves, would indirectly affect the growth of credit activity. NBS should cooperate with commercial banks in Serbia and examine the possibility of using a share of increased liquidity in the eurozone to credit companies in Serbia.

At the end of February, a three-year agreement between Serbia and IMF came into effect, which has three key components: fiscal consolidation, restructuring of public and privatisation of former socially owned enterprises, and improvement in the stability of the financial sector. Signing of the agreement increased the chances of realising ambitious Government plans for economic policy and reforms, while macroeconomic risks, such as public debt crisis and balance of payments crisis, were considerably reduced. We expect financial markets to have a positive reaction to the signing of the agreement and that borrowing conditions for the state and companies in Serbia at the international financial market will improve. Consistent implementation of the agreement would have a positive impact on business conditions and growth perspective, as well as gradual increase of foreign direct investments in Serbia.

During the fourth quarter, a large number of measures of fiscal consolidation has been implemented, such as the reduction of wages in the public sector and pensions, while at the beginning of 2015, subsidies for most of the state companies were abolished. Fiscal deficit since the beginning of 2015 declined considerably, as a result of fiscal consolidation measures, combating grey economy, but also some one-time factors. After excluding the effects of one-time factors, reduction of fiscal deficit is approximately going according to plan, which means that no spectacular results were achieved that would enable abandoning planned savings in the future.

However, even if fiscal consolidation results would be somewhat more favourable than planned, they should be used for the growth of public investments, instead of giving up on savings from government current spending.

According to the Prime Minister's statements, Serbia's budget during the first two months, realised a surplus of 2 billion dinars, while in the first quarter, a deficit of around 30 billion dinars is expected, which is significantly less than the maximum deficit of 55 billion dinars that was arranged with IMF. Considerably lower deficit in the first quarter will be mostly realised through one-time factors, such as payment of dividends from public enterprises, but also through a very low level of public investments. If the value of payments from public enterprises would be equally divided by months, fiscal deficit in the first quarter would be around 40 billion dinars. If the public investments had been on a "normal" level, the deficit would have been higher by a few more billion dinars. In addition, it is quite obvious that the planned deficit for the first quarter was set a bit higher than expected, so that the Government could successfully pass the first IMF review. Therefore, even if the results are slightly better than planned, the difference is not as big as is sometimes presented to the public.

A competent, dedicated and uncorrupted administration is a key condition for implementing the planned reforms in Serbia. Administration has an important role in creating policies and a key role in implementing them. This poses a question as to what extent the Serbian administration is capable of implementing numerous announced reforms. Based on past experience, it is estimated that the administration is an impediment to the implementation of reforms. According to the functioning of state institutions, Serbia is ranked extremely low on international competitiveness and business conditions lists.

Building of a strong administration requires time that by far exceeds the duration of an election cycle. That is why the main condition for improving the work of state administration is for elected officials to give precedence to long-term and general interests rather than short-term and partial interests. Even though building good administration is a long-term process, certain improvements are possible in a relatively short period. In

addition to fiscal consolidation, which reduces the state spending, it is necessary to also implement measures for advancing the operations of the administration. One of the first measures that could be implemented is tightening the hiring criteria in the public sector. This includes consistent applying of existing regulations, as well as their improvement, with the aim of hiring the most capable and the most qualified candidates, instead of, up till now, dominant hiring through partisan, family or other irregular channels. The second important step is to introduce clear criteria for certifying degrees, in order to put a stop to mass employment of people with dubious degrees of very low quality. Good administration means making the key criteria for advancement capability, expertise, not being corrupted, and being dedicated to the job, instead of party affiliation and other irregular criteria. Domination of irregular criteria over the past few decades has resulted in a strong negative selection in the public sector – key positions are not held by the best candidates. Naturally, efficient public sector requires a responsible rewarding policy, as it is highly unlikely that low wages for some of the most complex jobs in the society, which are being performed in the public sector, will attract and retain good staff. In that sense, our estimate is that the planned reduction of the number of employees and real wages in the public sector in the next three years is not only difficult to achieve, but will also present an aggravating factor in the advancement of its operations.

This issue of the Quarterly Monitor, beside the regular analyses, includes three Highlights and one Spotlight On. Highlight 1 (Arsić) analyses the scope and limitations of the IMF arrangement, while Highlight 2 (Ranđelović) assesses the effects of measures of combating grey economy and recommends additional measures. In Highlight 3 (Stamenković) we continue a series of articles dedicate to the analysis of the education system in Serbia and possible measures for its advancement. Focus of Highlight 3 is the analysis of the effects of economic and social factors on the PISA test results of our students. Spotlight On (Tanasković, Jandrić) analyses the determinants of bad loans, gives an overview of international experiences and analyses the implemented and planned measures of solving this issue in Serbia.

