From the Editor

Serbia's economy in 2016 achieved a solid growth of 2.8% of GDP, which is the average level of the countries of Central and Eastern Europe, but slightly lower than the growth of neighbouring countries. However, the level of development of Serbia amounts to only 36% of the EU average, while compared to the Central European countries, with which Serbia was at a similar level of development in 1989, it is now lagging behind by 45%. To make up for the historical gap behind European countries, Serbia should achieve average GDP growth of 4-5% per year in the coming decades. For such growth of the economy, one of the key conditions is for the investments to increase from the current level of 18-19% of GDP to around 25% of GDP. Another important requirement for long-term sustainable growth of the economy is to increase domestic savings, i.e. local funds to finance investments. Domestic (gross) savings consists of savings of the economy (the sum of depreciation and profit), personal savings (savings in banks, investments in other financial institutions and investments in property minus bank loans to citizens) and savings of the state (public investment minus fiscal deficit). Total savings, in addition to domestic savings, include foreign savings (foreign capital), which are used in the form of foreign direct investments, portfolio investments, loans and others to finance investments in the country.

Over the past few years, in the general public and occasionally between economists themselves there is a disagreement over the role savings should have in the economy and the society. In public debates, confusions occasionally occur because of different meanings of the term savings in everyday speech and in economic theory. One of striking examples of this confusion is the claim that the savings and economic growth are mutually exclusive, and that savings lead to slower economic growth or recession. Therefore, it is good to be reminded that in the economic theory savings are defined as a part of the production (GDP), which is in a certain period used (saved) for future production. In this regard, all savings lead to a reduction in current consumption of the citizens and the state, with the aim for the production, and thus consumption, in the future to maintain its current level or to be increased. If there are no savings in a society or if it they are low it leads to a reduction in production, and thus to reduction of the consumption of citizens and the state in the future. Serbia in the 90s is an example of such development, when mainly because of the sanctions the savings were very low, which resulted in disinvestment and reduction of the capital by 40-45%. The lack of savings and investments particularly affected the industry, activity in which there is a strong technical progress, and where without any new investments technology becomes obsolete very quickly.

Based on the experience of many countries, we can conclude that it is necessary to use about 15-17% of the value of production (GDP) every year to compensate for the depreciation of capital coming from its use or the passage of time, and to maintain the same level of production and consumption in the future. If a society wants to achieve growth of production and consumption in the future it is essential that savings are higher than that level. By analysing the data of a large number of countries over a long period of time, we come to the assessment that for a growth of production and consumption at a rate of 4-5% annually, for countries that are at the similar level of development as Serbia, it is necessary that savings are about 25% of GDP, in other words that about a quarter of final production is invested in future production. As a reminder, during the fifties and sixties, when Yugoslavia achieved high economic growth, savings and investments were over 30% of GDP.

Thus, even inefficient system as socialism can achieve high growth rates in certain stages of economic development if it has high savings and high investments. Even now, Asian countries that achieve high rates of economic growth have savings of more than 30 or 40% of GDP. By the amount of savings, China particular stands out with savings of nearly 50% of GDP, investing in future production not only in China but throughout the world. According to the World Bank data, total domestic savings in Serbia in 2015 amounted to 14% of GDP, and this was not enough even to finance the investments required to maintain production at a constant level. In the same yea,r the neighbouring countries, Bulgaria, Macedonia and Romania, which are at a similar level of development as Serbia, had average savings of 26% of GDP. Investments in that year in Serbia were somewhat higher and amounted to 18% of GDP, which is slightly higher than the level which is required to maintain the production at the same level. The differences between investments and domestic savings in the amount of 4% of GDP in 2015, Serbia financed by foreign capital or foreign savings, in the form of foreign direct investments, loans and others.

In open economies such as Serbian, it is possible in a period of time to finance investments and thus economic growth and consumer spending with foreign savings, borrowing of the country and companies from abroad and with foreign investments. Foreign savings, i.e. foreign capital, in some periods can be an important driver of economic growth, because it provides the missing funds to finance investments, but also the introduction of new technologies, access to new markets and others. However, borrowings must sooner or later be returned, while foreign investments, over time, lead to the withdrawal of foreign capital through dividends. Besides, foreign capital in the event of global or internal crisis often suddenly leaves the country, which further deepens the crisis. Of course, the above mentioned does not mean that it is justified to set the limit for foreign investments, because foreign capital will also in the future be necessary for growth of the Serbian economy, its technological advancement and more. However, for rapid and stable growth of the Serbian economy, it is necessary to increase domestic savings, with the current level of around 15% of GDP to around 25% of GDP. The above mentioned data for neighbouring countries show that it is possible, even at our level of development and standard of citizens, to save a quarter of GDP. The increase in domestic savings would allow most of the investments in Serbia to be financed from domestic sources, part of the investments would continue to be financed by the foreign capital, but also the companies from Serbia would invest part of domestic savings in other countries, primarily in the countries of the region. Balancing domestic savings and investments to around 25% of GDP is in line with the other important goal, which is to establish a balance in economic relations with the world.

Savings of citizens and the economy are several times higher than the state savings, but the state savings are significant for the economy and the society because it finances projects that are important, and in which the private sector would not invest at all or not sufficiently (infrastructure, education, health, cultural institutions, security sector, etc.). State savings in Serbia, which present the difference between public investments and fiscal deficit, in the last year, amounted to 2.1% of GDP as public investments were about 3.5% of GDP, while the fiscal deficit was 1.4% of GDP. Just two years earlier, in 2014, state savings have been deeply negative at -4.2% of GDP, as the fiscal deficit was bigger that much than public investments. Thus, the state has through fiscal consolidation over the last two years contributed to the increase in total savings in the country by as much as 6.3% of GDP, and this was done by reducing the fiscal deficit to 5.3% of GDP and increasing public investments to 1% of GDP. Therefore, fiscal consolidation contributed significantly to the increase in domestic savings, which means that fiscal consolidation also in this way has a positive effect on long-term growth of the economy. Of course, we need to take into account the other ways in which fiscal consolidation has a positive impact on private investments and economic growth, as eliminating the risk of the debt crisis and the consolidation of macroeconomic stability. Increased state savings over the past two years had relatively little impact on the increase of total investments, although they were also increased, but significantly increased the share of domestic resources in their financing thus reducing dependence on foreign capital and the probability of debt crises. The results achieved in the last two years also show how country in the future can have a positive impact on economic growth, and that is to further increase public investment and reduce the fiscal deficit.

An important question is how the increase in state savings affects private savings, i.e. savings of citizens and companies. The answer to this question depends on how the increase in state savings was generated, i.e. how was the fiscal deficit reduced, and what will happen with public investments. If the fiscal deficit was reduced by increasing tax rates then you will probably have a negative impact on private savings, because the higher taxes reduce the funds available for investments of the economy and citizens. However, if the reduction of the fiscal deficit was achieved through reduction of government spending, primarily current spending, then this will have a positive effect on private saving. From the standpoint of impact on private and the overall savings and investments, it is the best when the growth in government savings is realized by the reduction in the current consumption of the country and an increase in public investments, while keeping tax rates unchanged. Public investments, in particular those in infrastructure, reduce costs of the economy which has a positive effect on its profitability and thus on private savings. In the case of Serbia, increased government savings over the past two years have been achieved by reducing government spending by 2.9% of GDP and an increase in tax revenues by 2.4% of GDP, as well as an increase in public investments for 1% of GDP. From the standpoint of effect it has on private savings and the growth of the economy, structure of the fiscal consolidation in Serbia is worse than in other countries (Romania, Lithuania, Latvia, Estonia), which implemented about 70% of fiscal consolidation by decreasing expenditures. In the case of Serbia only 55% of fiscal consolidation was carried out by reducing expenditures, while the other part was achieved by increasing tax and non-tax revenues. It is therefore important to continue fiscal consolidation by reducing some current expenditures (subsidies, interest, etc.) and slower growth of other current expenditures then GDP growth (salaries and pensions), as well as a reduction of certain revenues that redirect funds intended for investments to current consumption, such as the case with dividends of public enterprises.

In this issue of QM, in addition to standard chapters analysing economic trends and economic policy, there is also a chapter Spotlight On by prof. Will Bartlett (LSE) and prof. Milica Uvalić (University of Perugia) which analyses higher education and the labour market in the countries of the Western Balkans.