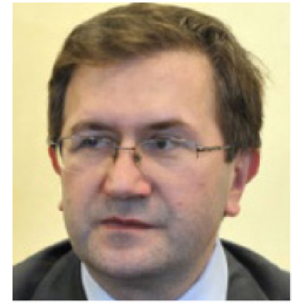
# From the Editor



At the end of last year, the President of the country and the Government presented an investment plan called "Leap into the Future - Serbia 2027," worth 17.8 billion euros. Although the investment plan was associated with EXPO 2027 by the authorities, the content of the announced investments is much broader and includes the construction of roads, railways, energy facilities, stadiums, research and innovation centres, healthcare institutions, etc. Based on the statements of government representatives, it can be concluded that the plan covers most of the public investments planned for the next four years. The plan encompasses the most important infrastructure projects that are currently being implemented, as well as projects that are yet to be launched. According to the government's estimate, investments for EXPO amount to about 2.5 billion euros, which is 14% of the investment plan. Starting from government projections on GDP movement and inflation in the coming period, assuming a fixed exchange rate of the dinar to the euro, investments within the plan would amount to about 5.4% of GDP annually. It is estimated that total public investments, including projects that are not part of the "Leap into the Future - Serbia 2027" plan, will amount to about 7% of GDP, which is similar to the share of public investments in GDP over the previous few years. Given the amount of planned investments, it is certain that they will affect economic activity, employment, the standard of living of citizens, and the sustainability of Serbia's public finances in the coming years.

The short-term impact of public investments on the movement of Serbia's GDP in the coming years will be positive, but the magnitude of this impact will depend on the degree of engagement of domestic resources in its implementation. To the extent that domestic workers, equipment, and raw materials are more engaged in project execution, the short-term positive impact will be greater. The magnitude of the short-term impact will be greater if projects are implemented within the planned deadlines and wastage of resources through corrupt activities is low.

Economic growth depends on total investments (public, private, and foreign) which, relative to GDP in the period 2024-27, will likely be similar to what they have been in previous years. The reason for this is that public investments will be at a similar or slightly higher level, while foreign direct investments and domestic private investments will remain at the current level or decrease. A stagnation or decline in foreign direct investments is expected due to the rising costs of doing business in Serbia, primarily due to wage increases and energy prices, as well as due to the slow recovery of economies from which the majority of foreign investments in Serbia come. The introduction of a minimum effective tax rate for companies generating revenues above 750 million euros annually, which have their headquarters in the EU from the beginning of this year, may reduce the effectiveness of tax incentives Serbia grants for large investments, affecting the decrease in foreign investments. Domestic private investments have been at a very low level for a longer period, therefore they have the potential for growth. Due to the absence of institutional changes that would improve conditions for domestic investors, significant growth is not expected in the coming years. If conditions for the domestic economy were improved by eliminating administrative barriers, more efficient protection of contracts and property rights, and equal treatment of all businesses, it would represent an impulse that could lead to further acceleration of Serbia's economic growth. In the next year or two, interest rates in Serbia and on the global market will continue to remain high despite the expected gradual decrease, which will negatively affect domestic and foreign private investments.

The impact of other factors on Serbia's economic growth over the next four years is very uncertain. It is expected that the recovery of European economies will be slow, which will negatively affect not only direct investments but also the growth of exports from Serbia. For now, it is uncertain when and how the wars in Ukraine and the Middle East will end, how geopolitical conflicts will be resolved, whether the fragmentation of the world economy will continue or whether there will be a return to globalization. In the case of Serbia, it is uncertain whether the deterioration in the functioning of institutions will continue or whether there will be an improvement. It is also uncertain how Serbia and Europe will solve the problems with the shortage of labour, and how much impulse to growth will come from technical progress in the fields of information technology, bioengineering, etc? Given these uncertainties, it is estimated that Serbia could achieve a cumulative GDP growth between 15% and 20% in the period 2024-2027. The real GDP growth over the next four years would be about 4% annually, which is at the level of growth in the period 2001-2012 (4%), but significantly above the average growth in the period 2012-23 (2.6%).

GDP growth in euros in the period 2024-2027, assuming a fixed exchange rate of the dinar, could amount to over 30%, but this figure does not represent an indicator of the real progress of Serbia's economy, as prices in euros in Serbia will also increase by at least 15% during the same period. A faster growth in GDP in euros would imply that inflation is higher than the current official projections, with the exchange rate of the dinar remaining fixed. The consequence of such deve-

lopments would be an additional increase in prices in euros, as well as a decrease in the competitiveness of Serbia's economy, thereby undermining the chances for long-term economic growth.

The long-term impact of public investments on economic growth will depend on the business results achieved using the built infrastructure: highways, railways, oil pipelines, gas pipelines, expo venues, stadiums, research and development centres, etc. Profitable operations would imply a direct positive impact on economic growth, while in the case of loss-making operations, the long-term impact would be negative. Loss-making operations would likely also have negative fiscal implications, as maintaining these facilities would require state subsidies. The implementation of projects such as the construction of highways and railways can generate significant indirect effects on economic growth through the reduction of transportation costs. Similarly, there is a possibility that exhibition spaces built for the Expo could attract a certain number of tourists. Positive indirect effects can to some extent compensate for direct losses, but it is unlikely to be the case if the losses are large. Therefore, a positive long-term impact on economic growth will only exist if the majority of the facilities built as part of the investment plan operate profitably.

The impact of public investments on employment will be mildly positive due to increased investments in high-rise construction, which is labour-intensive, and it is possible that the total volume of public investments will also increase. To the extent that foreign labour is employed, the positive short-term impact of investments on the economy will be reduced, as foreign workers will send a significant portion of their earned income to their home country.

The expected growth in real wages from 2023 to 2027 will be similar to GDP growth, meaning it will amount to 15-20%. In some years, real wages grow faster, in others slower than GDP, but over a longer period, they have a similar growth rate as GDP. For example, in the period 2012-2023, real wages increased by 31.5%, while the real GDP growth was 32.8%. The rise in living standards will be similar to the growth in real wages, as they constitute about 50% of household disposable income, and the movement of other incomes (pensions, etc.) is linked to wage trends. The growth in wages in euros, in the case of continuing the fixed exchange rate policy, will be higher, but it is irrelevant from the standpoint of living standards because it shows how much people can buy in euros, not how much they can buy in goods and services. Movements in wages in euros are not relevant to the standard of living if the movement of the dinar exchange rate significantly differs from the movement of inflation.

The planned public investments will mostly be financed through state borrowing, so a significant increase in Serbia's public debt is expected over the next four years. For now, it is not possible to give a more precise estimate of the increase in public debt, as it depends not only on public investments but also on the movement of current public spending (salaries, pensions, interest expenses, subsidies, etc.), as well as on tax policy. Interest expenses have already seen a significant increase last year (see the section on fiscal policy), and it is certain that their real growth, as well as growth relative to GDP, will continue this year and in the coming years. Subsidies for agriculture were permanently increased last year, meaning they will affect the increase in state expenditures in the coming years. The movement of salaries and pensions is defined by fiscal rules, but there is uncertainty regarding adherence to these rules. With a fairly high possibility of deviation, it is estimated that public debt could increase by about 15 billion euros by the end of 2027, exceeding 50 billion euros. If inflation and real GDP move according to official projections, and the exchange rate of the dinar remains fixed, the share of public debt in GDP by the end of 2027 would be about 55% of GDP. However, the fixed exchange rate policy under conditions of inflation would result in further weakening of the price competitiveness of Serbia's economy and maintaining high external deficits. Such a policy is sustainable as long as there is a strong inflow of foreign capital in the form of foreign investments, but precisely the strengthening of the dinar leads to an increase in wages and other prices in euros, making Serbia less attractive to some foreign investors. In conditions of high wages and prices in euros, Serbia would be interesting for companies operating in highly productive activities, which are typically capital-intensive and whose products are mainly intended for foreign markets. Such investors are very desirable because their operations allow for the payment of high wages, but there have been few such investors in Serbia in recent years. A possible significant weakening of the dinar would increase the share of public debt in GDP, as well as interest expenses, worsening Serbia's fiscal position. The fixed exchange rate policy is consistent with international competitiveness and rapid economic growth only if the difference between inflation in Serbia and the eurozone is approximately equal to the difference in productivity movement in Serbia and the eurozone.

In case salaries, pensions, subsidies, and other current expenses grow faster than GDP, this could further increase state borrowing, thereby increasing the costs associated with servicing public debt. A possible decrease in the inflow of foreign investments, which maintains the exchange rate but also creates export that is competitive even with a strong dinar, would create pressure on the foreign exchange market, which, if prolonged, would lead the state to choose between defending the exchange rate and economic growth, with either choice negatively affecting fiscal sustainability. Generally, it can be assessed that there is a risk of worsening Serbia's fiscal position, but there is a possibility to avoid it. The government can postpone some investments or abandon them, slow the growth of salaries, pensions, subsidies, and thus reduce the fiscal deficit and state borrowing. Also, it is likely that planned investments will not be realized within the planned timeframe, as has been the case with almost all major infrastructure projects in previous years, which would result in investment expenses over the next four years being lower than the planned 17.8 billion euros, and thus borrowing would be less.