



CEVES Newsletter - September '05 Issue 1

A monthly electronic bulletin on current developments and research at the Center for Advanced Economic Studies in Belgrade, and a brief on the Serbian Economy.

The Center for Advanced Economic Studies' (CEVES) mission is to develop current economic thinking founded on world-class standards in research and education in order to enhance decision-making in South East Europe (SEE) and contribute to a better understanding of modern economies by its public. CEVES is working to build institutional capacity, particularly through improved data and analytical skills, but also to build knowledge. It aims to identify, analyze, and interpret Serbian economic issues both for local policy-makers and for the mainstream economics research community. It also endeavors to awaken concerted capacity raising efforts by the international economic research community for SEE as a region, similar to those that have laid the foundations for the world-class economic research centers in Central and East Europe.

Contact:

CEVES

Lazarevacka 1

Belgrade 11040

Serbia & Montenegro

Tel.: 011/3021-069

Tel./Fax: 011/3021-101

E-mail:

ceves@ceves.org.yu

Web site:

www.ceves.org.yu

CEVES got started this spring...

upon the approval of USAID project support in April. Together with earlier grants from the Belgrade Office of the Fund for an Open Society and the Royal Netherlands Embassy in Belgrade, it has been possible to engage five permanent employees, including Kori Udovicki, President; Tatjana Bajovic, Business Manager (currently on a maternity leave); Jelena Zdrale and Goran Radosavljevic, Researchers; Bosiljka Zubic-Ilic (replacing Tatjana); and Olivera Andjelkovic, Office Assistant. Additionally, there are about thirty local economists and five foreign nationals involved in CEVES ongoing projects on a part-time basis.

...and is now setting up, jointly with the Faculty of Economics of the Belgrade University (EF), the Foundation for the Advancement of Economics (FREN).

In CEVES efforts to raise the analysis level of the Serbian economics, EF will share an oversight of the research and education activities directly related to it, and CEVES and EF will donate to FREN the research projects and administration (CEVES) and the administrative support and premises (EF). FREN professional autonomy and high standards will be ensured by a Program Board made up of economists of prominent international standing. FREN will have the task to seek regional partners in order to create a research network for the South-East Europe (SEE). CEVES will continue to secure projects to be implemented by both FREN and CEVES and remain more oriented towards the education of the public and the circulation of research results as well as towards the focused policy promotion.

We have our hands full (and some!)...

while USAID generous project support ends in December 2005. We now have two USAID supported projects completed. Five are in course

and one more will be undertaken before the end of the year. In June a preliminary assessment was completed of Serbia's economic reform progress. Based on the available official data, it was not meant for the publication but rather as a guidance for our future work. We financed four courses taught by the professors affiliated with foreign institutions within the International Masters, in the Quantitative Finance Program (IMQF) in our ongoing cooperation with the South European Center for Contemporary Finance, a NGO committed to the development of cutting-edge finance and economics programs in SEE region [www.seccf.org].

...but expects to complete the first Quarterly Monitor (QM) by FREN at end-September and a comprehensive assessment of Serbia's macroeconomic characteristics and adjustment over the past five years by mid-fall.

We had to establish the informational, analytic and organizational infrastructure needed to monitor macroeconomic developments and policy regularly. FREN will analyze the problems such as: what is Serbia's growth and inflation performance and what exogenous factors and policies are driving it? A particular challenge at this stage is the validation of the available data. We already know we will have some interesting findings regarding the data that will change the professional perspective on the important macroeconomic issues.

Two or three research grants will be given on a competitive basis

for the research projects showing a potential for international publication. FREN will handle the application and selection processes and offer advisory support to those applying. A special course will be taught in October on how to draft a good research project proposal. While preference will be

given to proposals in the area of applied economics, notably those relevant to economic policy, the primary criterion will be the sophistication and contribution potentials of the proposed project. Applications and information may be obtained by writing to fren@one.ekof.bg.ac.yu. **Another two large projects are beginning to be off the ground: Mapping Serbia's Labor Market and Private Sector Development Facts: A Survey.** The former will establish the facts necessary to improve the effectiveness of the employment promotion programs at the local government level. The latter will establish the facts necessary to tune fine the transition of Serbia's corporate sector to a sustainable private economy.

As far as the Serbian economy is concerned, it is doing well, but there are risks. Our reform paper study suggests that Serbia's solid growth performance since the democratic changes at the start of the millennium may not be sustainable. The oversized public sector, the public expenditures heavily oriented towards consumption and insufficient progress towards the financial discipline in the private economy, are fueling domestic demand, undermining competitiveness, and leaving little room for investment and exports. Yet these need to increase for the sustained sizeable growth rates over the medium-term and for living standards to return to the levels engrained in the memory of the population. This can only be achieved by exacting and painful reforms, foremost to restructure and downsize the public sector and raise its efficiency.

Our ongoing validation of Serbia's economic data indicates this dire conclusion may need to be qualified... The reform progress study was based on the current official data just like the conventional wisdom is, and we see serious problems with it. We suspect our analysis will probably alleviate the urgency of the concerns the official data raise.

...but there is little doubt that the macro-economic environment has not stabilized. Year-on-year inflation stubbornly stood at 17% in August for the seventh month in a row, although the cash fiscal balance is going into surplus. Official figures point to high GDP growth in the second quarter of 2005, following a hiccup in the aftermath of the introduction of the VAT tax in the first quarter of the year. However, GDP ebull-

ience does not seem to be strong enough to justify the inflation record.

IMF is rightfully concerned that, after four years of reform, the restructuring of the public sector is not effectively under way yet. A government delegation has just returned from Washington ironing out rather strained relationship with IMF and announcing a visit from IMF mission on October 5. The stakes are high and the government will have a hard time showing that the public sector reforms are being undertaken in earnest. Yet an additional 15% write-off, under the Paris Club debt reduction deal negotiated in 2002, hinges on the outcome of the current program review. The key sticking points are two commitments that the Government seems to have hastily adopted during the review by IMF mission last May: to amend the Pension Law in order to reduce the government outlays for the mandatory pension scheme, and get the privatization of NIS - the large oil and gas utility underway in an effective way. In August the government reluctantly began this process adopting the legislation to unbundle NIS, but it seems to be shying away from taking the steps to privatize a majority stake.

However, business seems to be going strong and the business environment is improving. Serbia has received the top mark for its progress in this year's World Bank Cost of Doing Business Study.

FDI is growing at a record rate. According to BoP statistics, the total value of FDI in the first half of the year was EUR 600 million. This can be largely attributed to the acquisitions by several foreign banks as well as by Coca Cola. In addition, the investment by companies privatized in 2003 continues strong (e.g. US Steel and Philip Morris).

The foreign interest in the Serbian banks continues unabated even though there are already 17 foreign-owned banks operating on the Serbian market, controlling 60% of the banking sector assets, and the competitive pressure is growing. The spreads decline as the lending rates decline, despite several costly monetary tightening measures by the National Bank. ERSTE Bank has shown interest in the acquisition of Niska Banka and EFG Eurobank has applied to purchase a controlling stake in Nacionalna Stedionica.