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Current situation in Serbia very similar to the one in the other countries of the Western Balkans (WB) as well:

I. Substantial increase of none-tradables fueled by salary increase, credit boom, foreign borrowing and FDIs resulted in substantial GDP growth in the region of WB that cannot be continued in the future. In the upcoming (next) stage of transition growth should depend more on the export and local investment demand instead of consumption lead demand!

In Serbia, like in many other countries in the region, during the first 8 years of the transition process consumption demand increased substantially (data as of the end of 2008):

1. Average salaries increased from EUR 89 to EUR 400 per month,
2. Loans to private individuals from EUR 11 reach almost EUR 600 per citizen,
3. Privatization revenues equaled EUR 12bn
4. Legal entities accumulated fresh private capital of EUR 13bn (from EUR 2.5bn reached almost EUR 16bn)
5. Donations, remittances, etc

The result of all of this substantial increase of the consumption demand, in addition to achieving an average GDP increase in average of 5.5% per year (more than halve driven by none-tradables i.e. financial services, telecommunication, transportation, real estate) contributed to a substantial increase of current account deficit: from -2,5% of GDP in 2001 (EUR 318mn ,lowest ever) to -17,2% of GDP in 2008 (equals to EUR 5,790mn).

In the case of Serbia, consumption demand cannot be kept at the previous level simply by the state substantially increasing its borrowing, as it is happening in several developed countries! The agreement with IMF requires from Serbia not only to freeze its pensions and wages but also to reduce their proportion from 13% to 10% of GDP and from 10% to 8% of GDP respectively by 2015. The key question today is: How will our countries grow if salaries / pensions are frozen, loan portfolios of local banks and cross border loans are flat, privatization revenues modest and legal entities are paying off their foreign debt instead of increasing it?

The only one way out for the region is an export-driven growth, but for that one it needs: a) competitive labor force, b) good infrastructure, c) stable political and macroeconomic environment, d) strong strategic partners ...

II. The recent crisis not only uncovered the inefficient state but also brought the structural reforms to almost a complete standstill. Moreover, in some cases subsidizing became popular again but this time under a different name as they are

called “fiscal stimulus”. In addition, public debt is increasing only for the sake of pure consumption.

That we have built up a “premature welfare state” (Janos Kornai), taking into consideration how much we are spending of the GDP for certain social functions (e.g. pension in Serbia some 13% and wages 10% of GDP), is now more evident than ever. Long overdue reform of the educational and health care system, public and local enterprises politicians would like to postpone using the crises as a major excuse. The current status quo is not maintainable on a long run: while budgetary revenues are falling social spending is even increasing, public debt is accelerating at a pace not seen before. In the case of Serbia, public debt increased by some 7% within the first 9 months of this year (from 26 to 33% of GDP). What is even worse, in order to meet the social spending requirements, the amount of capital expenditures from the budget decreased substantially (reduction to only 0.53% of GDP in 2009 compared to around 2.8% of GDP in 2007).

If economy does not rebound relatively fast, countries of the Western Balkans could face substantial social challenges! Compared to the EU members (Hungary, Latvia, Romania, Poland) that substantial EU, IMF and WB funding, our region can count only with IMF while other support is very modest (e.g. Serbia will get only EUR 100mn in 2009 and even that as a conversion of already pledged IPA funds, while in 2010 EUR 200mn of macro financial support).

Although financial support from the IFIs is very useful for the financial firefighting, countries need more, name adjustment for which policy advice is crucial.

What needs to be done?

III. EU should assume a leading role conditioning financial support to the countries of the western Balkans based on economic reforms (carrot and stick approach) as except Bosnia, Romania and Serbia other countries do not have a program with the IMF.

Albania, Macedonia, Montenegro and Croatia used the international financial markets to raise substantial amount of money paying partly even up to 10% p.a.! EU should condition the financial and economic support of WB countries to carry out necessary economic reforms. In the case that the EU has no adequate resources to carry out such program, they should ask support from the IMF even outside an IMF program. This way EU will not only try to make sure that economically strong and financially stable countries will enter the EU tomorrow but also that efforts are well coordinated with the other IFIs.

IV. We need to move on, from the “firefighting” to structural adjustment – tough road ahead.

Policies of the EU cannot be simply copied in the region of Western Balkans as the pre-crisis times will not be back in the near future. Therefore, we must revisit every single category of social policy related expenditures in the budget. “To do more with less”, meaning with less social spending to achieve a better and fairer distribution especially in the crisis times, should be crucial in the times ahead of us. If that adjustment does not take place urgently within 3 to 5 years public debt could be increased substantially and servicing foreign debt could become a major budgetary item again. Without a clear road map to the implementation of the Euro this could not be financially sustainable. The region cannot improve substantially its competitiveness without these long overdue structural changes. .

V. The region needs a “big brother” and I wish that Germany will assume the role it had already had in Central European countries

But compared to the Central European countries that are already EU members, it is going to be much harder to convince Europe that Serbia, Albania, Macedonia etc. should also one day join the EU. In addition, economic interest is also substantially less present while the EU is much more prone to depending before expanding further. It is also hardly conceivable, that the region, taking into consideration still present political problems, can speak with one voice in order to make the case of faster integration.

Except if the new minister of foreign affairs, just like his party predecessor Mr. Genscher, does not take up the region! He could even earn some street names in the western Balkans!

Role of the banks

The crisis did prove that banks in the region, owned by strategic partners from the EU, do deserve the confidence of the local population, supervisory agencies and governments. Problems that took place in the banking sector were only due to the locally owned banks with shareholders who understood bank ownership as license to print money! In addition to that, IFIs, surprisingly, also proved in practice that in challenging times they not only provide the necessary support but coordinate efficiently their activities as well.

The “Vienna initiative” organized by the EBRD and IMF did show tangible benefits to all participants including the stress test!

As far as the future of the banking sector in the region is concerned it will be determined mainly by the following issues:

1. Growth model: Domestic demand or more export driven growth model - to which extent will adjustment take place in fiscal or monetary policy ?
2. International capital market conditions: Will money be available at the price and in the amount as previously?
3. Conditions in the country of the banks’ headquarters: Will the origin of the bank be an asset or a liability?
4. Speed of adjustment: How fast will particular bank adjust to a new reality?