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THE EVALUATION OF INDUSTRIAL POLICY OF SERBIA

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INTRODUCTION

Developing countries are faced both with challenges and opportunities that are a consequence of the rapid flow of knowledge, large capital movements, rules and disciplines foreseen by bilateral and regional trade agreements. While some developing countries are more able to catch up with the developed world, others have not been as successful (ul Hauque, 2007). However, there is no single perfect model that can be applicable to all countries, and therefore, each country needs to find the best policy to achieve sustainable growth and catch up with developed world.

Throughout the history of economic thought, the role of the government in an economy has been observed in different ways. On one hand, the conservatives believed that the government's role should be limited, while liberals pointed out the limitations of the market system by emphasizing that governments can do a great deal to overcome these limitations. Various authors defined term industrial policy differently, depending on which side they belonged (Tanzi, 1997).

In European context, Republic of Serbia (hereinafter: Serbia) may be classified as mediumsized country in terms of area and population. Serbia is a developing, upper-middle income state, located in the central part of the Balkan Peninsula in Central South-Eastern Europe, with 4,821 Euros (hereinafter: EUR) of gross domestic product (hereinafter: GDP) per capita in 2016. After the dissolution of Yugoslavia, Serbia's economy was influenced by civil wars and political unrests which resulted in isolation from the rest of the world. The transition process began in 2000s led by Serbian Prime Minister Zoran Đinđić, with the main goal to catch up with the developed world and become the member of the European Union (hereinafter: EU) member. So far, the development of industrial policy was generated from economic policy and driven by directives of European Commission. Serbia's growth model was driven by strong inflow of foreign direct investments (hereinafter: FDI), consumption based domestic demand and borrowings.

The basic industrial policy measure in Serbia in the last decade was state aid. According to the most recent available data, the amount of state aid in the EU in the last decade was 0.6% of GDP in average, while it amounted to 2–3% of GDP. From 2000, Serbia allocated the highest amount of state aid to development of small and medium sized enterprises (hereinafter: SME), restructuring and in transportation sector (railway). The share of horizontal state aid had increased from 5.9% in 2013 to 35% in 2015. On the other side, the share of regional state aid had decreased from 40% to 29.9% in the same period (Republic of Serbia Commission for state aid control, 2015). In addition to the poor economic situation, another huge problem is the process of de-industrialization. Additionally, the value of industrial production in the period from 1990-2016 fell by more than 60% (Milivojević, 2015). During the observed period, the role of state in economy was important in terms of constructing and implementing the industrial strategy in a way to create conditions for sustainable growth and prosperity. In

the last two decades Serbia has taken steps to establish a market economy and macroeconomic stability. However, the World Economic Forum (2016) ranked Serbia on 94th place, as the least competitive country in the region in 2016.

The purpose of the thesis is to analyse the past industrial policy in Serbia in view of its economic development and the theoretical approaches to industrial policy. The past measures will be analysed according to the Stiglitz and Greenwald (2014) model and then evaluated. The goal is to prepare suggestions that could help the policy-makers identify the most suitable industrial policy measures, based on the evaluation of the past and theoretical guidelines.

The work will be guided by the following main research questions:

- 1. What are the main approaches to industrial policy in theory; what are the main measures they propose; how the suggested approaches differ and how do they differ in consideration to the suggestions made for different levels of economic development?
- 2. What were the main characteristics of economic development in Serbia after the dissolution of Yugoslavia? How was the first stage of transition done; what were the main factors of growth before the crisis and what happened during the crisis?
- 3. How strong was the role of the state during this development process, how well was the development process guided by the state and what were the main goals and measures of IP in different development plans?
- 4. Given the answers to (2) and (3), what was done well and what not?
- 5. What are the future development challenges of Serbia? How can the state contribute to accelerating it via IP?

The methodology of the paper is based on the description and analysis of relevant data. In the first part, information and facts about different approaches of industrial policy is obtained from relevant books and papers, such as Aghion and Cohen 2011 book "Rethinking industrial policy", Spector, Chapsal and Eymard 2009 "Competition Policy, industrial policy and national champions" and Stiglitz and Greenwald 2014 book "Creating learning society". Further on, the macroeconomic situation in the observed period is described with the help of working papers of the World Bank, European Commission, International Monetary Fund (hereinafter: IMF) and other relevant institutions. To summarize, the main methodological approaches are: description, analysis and synthesis. Data presented in paper is related to industrial policy and the measures that were used in the past were gathered from relevant institutions, such as National Bank of Serbia, Republic of Serbia Commission for state aid control, Ministry of finance, Statistical Office of the Republic of Serbia as well as Doing business, Eurostat, European Bank for Reconstruction and Development. In addition, data are analysed and presented by using suitable statistical tools. Analysis in this part is also based on relevant jurisprudence, case law and legal sources. Future challenges are drawn from the predictable path that the government will proceed presenting, most likely effects and actions for the future.

Purpose of the thesis is 1) to analyse economic development in Serbia 2) to describe the different industrial measures that was used in Serbia and 3) to identify main advantages of industrial policy of Serbia that was implemented. Goal of the thesis is to evaluate Serbia's industrial policy and based on that to sumaize and develop recommendations for Serbian govenment for further development of the country.

The thesis is divided into four larger chapters. The first part deals with the theoretical aspects of industrial policy. In this part three main approaches are described, with the focus on main concepts and importance of industrial policy in overall development of countries. The second, which is divided into three parts, describes both the economic situation and role of government in Serbia after the dissolution of Yugoslavia. Further on, the focus is on the measures of industrial policy that Serbia was employing in the past. In the last, forth part, questions related to obstacles and reasons for unsuccessful implementation are analysed. Suggestions about what the government should do, what are the future challenges and path to continue on in achieving social welfare and growth are described in the last part of the thesis.

1 THEORETICAL CONCEPTS OF INDUSTRIAL POLICY

The global financial crisis had wiped away the economic and social progress in many EU countries that were achieved in the last decades pointing out many structural weaknesses in their economies. The dramatic fall in growth rate and manufacturing activities during and after the crisis necessitate a rethinking of economic (and industrial) policy and development strategies for EU countries. Also, the question about what should be the role of state in creating that environment has arisen. There are many empirical studies about the role of state in creating countries' environment, whose size and importance has been changing through the history. In the 20th century the role of the state was dominant, which was evident due to large growth of public spending as a share of GDP in most countries. Over time, the role of state had been changed and shifted from supporting the market to one that replaces it. Many countries, where the role of state was extensive, recorded macroeconomic imbalances, while the countries with the limited role of state had performed much better. Subsequently, the opening up the economies and trade liberalization were seen as engines of economic development.

Countries shifted to the market emphasizing the role of the state in improving market operating. As Tabellini (2005) suggests, the role of the government for the most developing countries should be in creating a legal and institutional framework, as well as compounding economic policies, in order to achieve stable macroeconomic environment. In addition, examples of Scandinavian countries where the role of the government has always been significant pointed to an increase in innovation and productivity growth over the past two decades (Aghion & Cage, 2012).

In addition to different understandings of necessity of the role of state, there are also many different understandings and views on industrial policy among policy-makers and economists.

Three approaches that are described in the first part of thesis focus on different assumptions and give different understandings of importance of industrial policy and role of the government in creating sustainable environment. Stiglitz and Greenwald (2014) advocate that the government and appropriately defined and implemented industrial policy is precondition for achieving sustainable economic growth. They pointed out that markets are inefficient, thus the government actions are necessary in creating an environment. A totally opposite view is supported by those, who claim that a competitive policy leads to the competition as the main growth accelerator while government interventions may harm growth. The intermediate approach suggested by Aghion, Boulanger and Cohen (2011) indicate the importance of switching towards high tech sectors with the help of both, the government.

1.1 Stiglitz and Greenwald approach to industrial policy

Global financial crisis highlighted the importance of the government's role in the certain economy, since it had been shown that market mechanisms alone are not efficient. Regarding this, development of the most EU economies had proven to be unsustainable since growth was mainly backed by service sector and FDI that was allocated into tradable sectors. Further on, Pianta and Cirillo (2014) emphasize that global crisis in 2007 was a consequence of inadequate development model, low skilled workers in manufacturing sector, low investments in ICT, renewable energy and innovation.

The first, the Stiglitz and Greenwald (2014) approach, highlights the importance of industrial policy and interventions of government in correcting market failures. Gaps in resources are not the only thing that separates developing countries from developed ones, but rather the gap between "best practices" and "average practices" (gap in knowledge). Moving the production possibilities curve towards frontier is expected to close this gap and contribute to the increase in the standard of living. Closing the gap is possible only if a certain economy invests in learning and knowledge, because knowledge is determinant of economic growth. Regarding this, the developed countries should ensure that all companies learn quickly in order to improve productivity and narrow the gap between the best and the average practices, while developing countries have to focus on coming closer to advanced economies by learning from them.

The question is: how could the government help in creating a learning society? Stiglitz and Greenwald (2014) claim that there is no one model that is applicable to all countries and that every government has to create and implement its own strategy of industrial policy. Additionally, the most appropriate policy mix depends on country's competitive advantage and history. Government through industrial policy has to focus on sectoral allocation, predominately on those which generate more spillovers to the entire economy. Therefore, the government targets favourable sectors (such as manufacturing), where benefits of learning can increase social welfare and create a learning society. Industry is recognized as an important source of growth, in both developing and developed countries (Naudé & Szirmai, 2012).

Precondition for creating a learning society is macroeconomic stability of the country. Macroeconomic stability is necessary since in the instable environment companies are focused on survival, not on improvements and investments in knowledge. Also, the analysis conducted by Masino (2012) indicates the negative impact of macroeconomic instability on the share of R&D financed by the business sector.

Bearing in mind that learning is a result of R&D, Stiglitz and Greenwald (2014) claim that monopoly is not necessarily bad for the economy, since large companies have more capital to invest in R&D. Competition policy creates small companies, which invest smaller amounts of capital in R&D. Regarding this, low R&D can cause the hazard of free riding in case that spillovers occur. The government's support of "national champions" is justified on the premise that the private sector alone cannot foster development of new sectors, while provisional aid from the government is desirable in order to speed up the economy. In addition to the fact that larger companies are able to bear and assess risk better, they are also important since they can increase the overall skills of work force or generate complementary activities. Learning spillovers are greater in some industries (such as manufacturing) and they are localized since the transfer of knowledge in similar industries is much easier. In that sense, the role of the government is to recognize those industries and help this process of learning transfer through efficient bureaucracy and to motivate learning through both monetary and non-monetary rewards.

Stiglitz and Greenwald (2014) advocate that the knowledge and positive spillover effect can flow freely. On the other side, trade policy encourages the industrial sector to maximize social welfare. They highlight that barriers should exist, but on level that will not obstruct the economy. Additionally, barriers that are too high, create protectionism of domestic companies, which could have a negative effect in terms of efficiency and productivity of the whole economy. For countries with limited access to finance, FDI has played important role in funding and have to be directed in tradable sectors (one that are likely to have large spillovers). It has also empirically proved that technology spillovers from foreign to local companies in emerging economies through FDI influences the host economy significantly. As Sönmez & Pamukçu (2013) claim through the creation of a favourable business environment, the government can attract the inflow of foreign capital in the country. On the other side, the government should be careful since the surge of FDIs can influence domestic currency and lead to appreciation, which ultimately deteriorates competitiveness of export.

Stiglitz and Greenwald (2014) claim that industrial policy is necessary and point out that many advanced economies have been using this tool during their development. Every action that the government undertakes impacts the future, and therefore can be considered as a kind of an industrial policy. Regarding this, the governments shape certain economies through instruments, so-called broadband measures, such as exchange rate, tariff system, FDI, exports. The first precondition for an effective industrial policy is macroeconomic stability and favourable instructional framework. This is why developing countries (including Serbia) often face multiple challenges when designing and implementing their industrial policies. In less

developed countries, agriculture sector is predominant, so the government should foster industrial sectors (electronics, pharmaceuticals or biotechnology). Also, government should support new types of activities, such as design, R&D, added value services and fostering specialization, which will ultimately foster innovation and productivity (Primi, 2013).

1.2 Spector, Chapsal and Eymard approach to industrial policy

The supporters of neoclassical economic theory, contrary to the first approach, claim that only markets can effectively allocate resources. The government (state) has limited and irrelevant information, and therefore is not qualified to decide which industrial sector or companies should be supported. Finally, the problem of asymmetric information leads to adverse selection and moral hazard. There is also a problem of corruption in the decision-making process at all levels of the government and making economically irrational decisions. Furthermore, the effectiveness of industrial policy is limited by the issue of rent seeking (Putna, 2012).

Spector et al. (2009) claims that the market mechanisms will create conditions for the sustainable growth in a certain country. Therefore, the competition policy is the best engine of growth. It is the rivalry between companies that shall create environment where efficient companies will stay on the market. The reason behind is that high-cost companies cannot compete against more efficient companies, which simultaneously leads to rationalization.

The main disagreement between those who support industrial policy on one side and the others, who support competition policy, is the issue of national champions. Spector et al. (2009) claims that politicized governments allocate huge amounts of funds towards national champions (and incumbents), which is more likely to obstruct growth, both in developed and developing countries. That is why government should rather support idea of reallocation resources between different firms, predominately to new entrants. Two or more merged companies and the creation of national champions often reduces competition and creates conditions where one company has sole power on the market. Therefore, the idea of making national champions in order to realize economic of scale and getting benefits from various synergies is rather unsuccessful, since only in a sufficiently competitive market companies strive to become more efficient.

Spector et al. (2009) claim that industrial policy should be focused on the development of small and innovative companies. Additionally, sustainable growth is a process of creative destruction in which small companies are the main growth accelerator. It has always been questioned, whether benefits of creative destruction are applicable both in developed and developing countries. On one side, economic development of developing countries in the first phase would require national champions, while creative destruction should be achieved in later stages.

New industrial policy must promote that competition and a cooperative climate between the government and companies is necessary. Contrary to Stiglitz and Greenwald (2014), Spector et al. (2009) claims that there are no substantial knowledge spillovers. He suggests that spillovers are less present in case when large companies settle in a region, indicating more important role of small companies. That is why he claims that horizontal measures are the most effective in creating conditions for innovation. Furthermore, by targeting cartels and entry-deterring strategies, competition policy contributes to increase in productivity and efficiency (Prašnikar, 2014).

1.3 Aghion, Boulanger and Cohen approach to industrial policy

The intermediate study by Aghion, Boulanger and Cohen (2011) highlights that the industrial policy has always been connected with picking winners and distorting competition. However, in the wake of events connected with the financial crisis, as well as the climate change issue, pointed out the importance of industrial policy and the government. First, climate change and global warming impose the need for the development of alternative and clean technologies in order to prevent droughts, deforestations and other negative externalities. Many countries are aware of this issue, and without governments' interventions global warming would intensify in the future. Secondly, the recent financial crisis has opened up a question of regulation and the recall of the need of the state to regulate markets. Further on, non-tradable sectors had been widely expanded, which did not contribute to sustainable growth. Finally, Chinese economic growth and sustained rapid industrialization, that accelerated the productivity growth and social development, was based on industrial policy. Research conducted by Dic and Mei (2014) pointed out that the State had played a significant positive role in Chinese economic transformation and thereby growth in productivity and employment. Chinese government's actions were focused on two channels: creation of an appropriate environment and industrialization through direct intervention.

Aghion et al. (2011) have found that there is a U-shaped relationship between innovation and competition. On one hand, in a highly competitive market an innovator cannot take advantage of its innovation due to reduction of post-innovation rents, while on the other hand a monopolist will not invest in different (competitors') products, but rather replace its old product with new one. In their paper, Aghion et al. (2012) argue that the question should not be whether certain country needs an industrial policy, but rather on how such policy should be designed. So, this approach could be understood as intermediate, somewhere between the two above described, Stiglitz and Greenwald (2014) and Spector et al. (2009) with the main point being that for the sake of the future the competition and industrial policy should go hand in hand. In other words, sectoral policy should be focused on a few companies (rather than aiming at a single company), which will then contribute to the fostering of innovation and growth. When more companies are involved in competition in the same sector, they tend to escape competition and innovate "vertically" rather than differentiate "horizontally".

Aghion et al. (2011) suggest a few channels of sectoral interventions. With the increasing concern over climate change, the question of what policies could be used to reduce the use of dirty technologies in the future and prevent further environmental pollution arises. However, as Acemoglu et al. (2012) emphasize, companies that tend to allocate resources in dirty technologies will find it more profitable to continue to innovate in dirty technologies. In the absence of the government intervention, the *laissez-faire* policies lead to environmental disasters. Therefore, the government intervention (through carbon taxes and clean R&D subsidies) could "redirect" the technical change towards clean innovation. The economic costs of redirection towards clean technology can be reduced by using combination of two instruments: clean innovation subsidies and carbon tax.

Aghion et al. (2011) suggest sectoral policy as tool for overcoming credit constraints and limit capital inflows, in particular in economies where bank credit is the primary channel of the company's financing. In less developed countries state aid is more positively correlated to promote export. Governments' interventions may be driven by political rather than economic needs in turn of affecting the creation of national champions. However, more decentralized state aid (regional and sectoral state aid rather than central) will create its own champion for each region or sector. In the last instance, there is a positive correlation between positive effect of state aid on a country's export and innovation performance. Furthermore, competition is not often interfered by the government intervention.

Aghion et al. (2011) emphasize that targeted subsidies in several companies within the competitive sector have positive impact on innovation. Consequently, by supporting a few companies in a competitive sector, the government will encourage those companies to innovate in order to "escape competition". The more competitive the sector where funds are allocated, the more positive effects will occur in terms of growth and product innovation. Additionally, sectors such as energy, biotech, information, communication technology and transportation should be supported by the government. Industrial policy should be focused on helping those sectors since they are more likely to create spillovers that will ultimately foster innovation and the entire economy.

Table 1 summarizes the main points of alternative industrial policy approaches (Prašnikar, 2014). Many successful examples based on those approaches have been copied and adapted, and many new individual models of industrial policy have been developed in different countries. However, it is important to emphasize that there is no one "right model" that should be followed by countries. Many factors (such as level of development, achieved level of macroeconomic stability, competitive advantages) determine the most suitable way to develop for certain country.

In light of better understanding the undertaken actions in the past and suggestions for the future in creating Serbia's environment, the second chapter of the paper briefly analyses and explains macroeconomic developments and the role of Serbia's government in creating macroeconomic environment.

	Stiglitz and Greenwald, 2014	Spector, Chapsal and	Aghion, Boulanger and Cohen
		Eymard, 2009	approach, 2011
A need for industrial policy	Industrial policy is needed and the government actions are necessary in achieving learning economy. Although industrial policy is risky, it is even riskier not to have it at all. Most developed economies foster industry and use industrial policies during development	Industrial policy is not efficient because it creates national champions. Competition creates rivalry between companies which are considered the best engine of growth. Market mechanisms have to function without state's interventions, since the state does not have appropriate information and it is often corrupted	Intermediate approach, where need for industrial policy arises in wake of recent events, such as climate change, laissez-faire complacency of the government policy which resulted in financial crisis, expanding of non-tradable sectors and development of China. Industrial policy should be properly designed and work hand in hand with competition policy. The focus is on avoiding first order mistakes rather than on issue of industrial policy
Segments of economy	Creating learning society is conditioned by investments in R&D and higher education. Knowledge is in the heart of the theory and only when knowledge is involved, market and the government are complementary	Efficient policy should be oriented towards the development of new activities. Development of cartels and entry-deterring strategies are conditions for productive efficiency	The more competitive sector, the more positive effects of targeting. This approach emphasizes that competition policy should be oriented towards a few companies within the sector (not only one), which will enable them to innovate vertically. The government should support energy, biotech, information and communication technology
Methods of the industrial policy	The government uses broadband measures to create stable macroeconomic environment and learning society	The government role is seen as insufficient (by picking winners) and only horizontal measures could foster competition	Horizontal measures in both competition and innovation friendly environment
Characteristics of methods of the industrial policy	 1) low exchange rate to make domestic companies more competitive 2) tariffs and 3) subsidies for promoting learning and manufacturing sector 4) fostering export in sectors that promote learning 5) FDI in sectors that promote growth by generating and capturing learning spillovers 6) various support systems to enhance growth of SME sector 	Competition policy create conditions for overcoming industrial policy concerns	1) green technologies and innovation in skill-intensive industries 2) sectoral policy is more successful in competitive environment and 3) if it is decentralized 4) subsidies that create access to credit for companies in chosen sectors 5) investments towards down the stage research not only upstream research

Table 1. Matrix comparison of alternative industrial policy approaches

Source: J. Prašnikar, Industrial policy in retrospective, 2014, p. 15.

2 MACROECONOMIC DEVELOPMENTS IN SERBIA

After the dissolution of the Socialist Federal Republic of Yugoslavia (hereinafter: SFRJ) in the early 1990s, social, political and economic conflicts erupted in that region. On 27th April 1992, Serbia and Montenegro formed the Federal Republic of Yugoslavia (hereinafter: FRY) and Slobodan Milošević came to power. In the next ten years Serbia experienced civil wars, sanctions, isolation and expansion of shadow economy which resulted in socioeconomic and political deterioration of the country. In such economic, social and political circumstances, the role of the government in employing industrial policy was minor, almost invisible. On the contrary, the main purpose of the state was to stabilize the economy. Opening up of the Serbia's economy started in 2000. In the first decade of 2000s, the main drivers of the economic growth were FDI inflows, privatization revenues and domestic consumption. The transition growth model (2000-2010) ultimately led to high external and internal imbalances and expansion of non-tradable sectors (which contributed to around 80% of growth in this period). In 2011 Serbian government compounded the Strategy and Policy of the Industrial Development of the Republic of Serbia for the period 2011-2020 (hereinafter: Strategy 2011-2020). This document is the first document that defines in a consistent and compressive manner the basis of the development priorities of the industry and the manner for their realization in the next decade. The new model of industrial growth was export oriented and was focused on the increase in investments and the export of goods, as well as the increase in industrial employment.

In the context of the economic situation and the role of the government in Serbia the observed period in the paper could be divided into three parts:

- Milošević era (1992-2000),
- The transition process in Serbia (2001-2008),
- Serbia after the World financial crisis (2009-2016).

2.1 Milosević era (1992-2000)

During the Milošević era (1992-2000) Serbia was characterized by civil wars, economic and political isolation, hyperinflation and general pauperization. Furthermore, European and United Nations (hereinafter: UN) sanctions after civil wars in the region further tightened the strings in the country, which created an altogether highly unstable environment. During this period, FRY experienced a large decline in GDP (Table 2). In 1991, GDP amounted to - 11.6%, which after introduction of UN sanctions in 1992 further worsened to -27.9%. Additionally, hyperinflation contributed to GDP deterioration at 30.8% in 1993. FRY experienced moderate economic recovery in the period from 1994 to 1999, but conflict over Kosovo had further contributed to decline of output. Serbian economy (without Kosovo) registered a negative average annual growth rate of 7.5% in the period from 1991-1999. Effects of the North Atlantic Treaty Organization (hereinafter: NATO) bombing were

dramatic: in 1999 the real GDP declined by 25%, the poverty rate was above 20% of the population, unemployment rate was over 30% (Đerđ, 2003). Since this period was characterized by shadow economy, there were several hundred thousand people, who in that way contributed to the formation of the GDP. According to data from Table 2, the real unemployment rate was growing during the entire period (from 19.7% in 1990 to 26.5% in 2000).

Indicator	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Annual GDP growth (in %)	-7.9	-11.6	-27.9	-30.8	2.5	6.1	7.8	10.1	1.9	-15.7	5
GDP per capita (in US dollars)	81	526	904	2,755	3,525	4,610	6,592	7,386	7,502	8,250	9,008
Unemployment rate (in %)	19.7	21.4	22.8	23.1	23.1	24.6	25.7	24.5	25.1	26.1	26.5
Inflation, consumer prices (annual average)	1,285	551.6	115.0	207.3	32.9	21.0	13.5	9.9	8.4	8.0	6.2
Total debt (in millions USD)	17,792	16,472	16,483	12,709	13,035	13,839	14,619	15,091	13,742	12,949	11,407
Trade balance (% of GDP)	46.8	39.8	34.2	45.2	23.6	27.5	37.2	41.3	42.3	46.2	67.10
Export (% of GDP)	20.5	18.3	13.6	22.2	10.4	10.0	12.2	14.8	15.7	14.4	21.3
Import (% of GDP)	26.3	21.5	20.6	23.0	13.2	17.5	25.0	26.5	26.6	31.8	45.8
Foreign direct investments (inflow in mill USD)	-	-	126	10	63	45	102	740	113	124	29

Table 2. Main macroeconomic indicators in FR Yugoslavia in the period 1990-2000

Source: S. Đerđ, Ekonomske reforme u Jugoslaviji – jedno viđenje spolja, 2003, p. 107.

In the period of 1992-1994 Yugoslavia experienced hyperinflation as a consequence of the loss of monetary and fiscal control, wars in the region and currency depreciation. At its peak in January, the monthly inflation rate reached 313 million %, which classified Yugoslav hyperinflation as a second highest recorded in monetary history, after Hungarian hyperinflation in 1945-1946. Yugoslav hyperinflation lasted for 24 months, from February 1992 to January 1994 thus becoming the second longest, after Russian hyperinflation in 1920s, which lasted 26 months. Bearing in mind the high degree of correlation between trends in exchange rates and prices, National Bank of Serbia started using the exchange rate as a nominal anchor to contain inflation pressure. With introduced stabilization programme on 24th January 1994 by Dragoslav Avramović, the rate of inflation was reduced. However, the effects of the program were short-lived, because there were no political interests in carrying out reforms (Bogetić & Urošević, 1999). During the entire period, the economy suffered from fiscal and external imbalances. In the period from 1990 to 2000, the external debt of Yugoslavia decreased from 17,793 billion of United States Dollar (hereinafter: USD) to

11,573 billion USD, but it was still huge (140% of GDP in 2000). Furthermore, Yugoslav economy was characterized by non-transparent information, especially in public finance, where more than half of the government expenditures went through non-budgetary funds. The burden of the Yugoslav conflict, as well as the Kosovo crisis, together with financing various paramilitary organizations and meetings, contributed to increase the government expenditures and consequently the budget deficit increased from 2.2% of GDP in 1994 to 8.3% of GDP in 1999 (European Bank for Reconstruction and Development, 2002).

In 1992-2000 period, Serbia experienced large decline in export as a consequence of UN and EU sanctions and bad economic policy. Export decreased sharply in the period of 1990-1995 and plummeted faster than any other variable (it amounted to 2 billion USD or 12.2% of GDP in 1996). During the Milošević era imports were almost twice as large and amounted to 3.7 billion USD (or 25% of GDP) in 1996. During the whole period, export declined by 9.7% on average annually, while import declined by 3.9%. Consequently, in the same period the trade balance decreased on average by 6%. In the period between the lifting of UN sanctions and the outbreak of the Kosovo crisis (November 1995 - March 1998) external restrictions were gradually removed, however, Kosovo crisis led to new sanctions. Simultaneously with the decline in export during the entire period, its structure had radically changed: exports of machines and spare parts for automobiles fell from more than 15% to less than 5%, while the share of agricultural products increased from 4.8% to more than 20% (Derđ, 2003).





Source: S. Đerđ, Ekonomske reforme u Jugoslaviji – jedno viđenje spolja, 2003, p. 111.

As Figure 1 shows, the structure of GDP in Yugoslavia had slightly changed in the period from1990-2000. The share of industry in GDP creation decreased from 35.4% to 31.3%, while the percentage of people employed in this sector decreased from 30.5% to 23.7%. The share of services in GDP basically did not change, while number of employees increased by 1.1 times in the same period. Between 1990 and 2000 the share of the agricultural sector to gross domestic product decreased for 1.2 p.p. and number of employees by 1.1 times (Đerđ, 2003).

In the period of 1990-2000, FDI inflow was rather poor and amounted to 14 USD per capita in 2000. The largest foreign capital inflow was in 1997 (740 million USD) when Telekom Serbia was sold to Telecom Italia (29% of share), Greece Telecommunication Organization (20%) while government had 51% of share in ownership. In the period of 1995-2000 FDI were mainly directed towards trade (33.6%), transport (30.7%), food industry (26.6%) and machinery production (36.3%) (United Nations conference on trade and development, 2001).

The situation in the banking sector was extremely poor, as a consequence of the war destruction and sanctions, which negatively affected confidence in this sector. In 1997, the banking sector in Serbia consisted of 106 banks, of which 80% were state owned. In addition, the lack of financial investment negatively influenced the quality of the loan portfolio, which consisted of about 50% of non-performing loans. Confidence in the banking sector was low and during the 1990s the banking sector was characterized by high degrees of illiquidity and insolvency of the largest banks, poor asset quality and low profitability (Dobromirov & Knežević, 2016, p. 460).

As the country underwent a complete economic and social collapse during the 1990, the European Bank for Reconstruction and Development (2007) named this period as "the lost decade" in the Serbia. In this period, the government had only minor role in using industrial policy measures to create a more stable macroeconomic environment.

Industrial production recorded a sharp decline (Figure 2). The process of de-industrialization contributed to the decrease of domestic production competitiveness on the world market, which further worsened the situation in the economy. After sharp decline in 1993, industrial production barely recovered in 1998.

In terms of economic policies, the government introduced some measures in order to achieve macroeconomic stability of the country. In 1991, Serbia's government adopted Privatization Law. By the end of 1994, about 60% of Serbian companies were privatized. Serbia adopted a new Privatization Law in 1997 in order to attract foreign investors and speed up process of privatization (European Bank for Reconstruction and Development, 1998).



Figure 2. Industrial production and GDP in Serbia in the period 1990-2000, index 1990=100

Source: S. Milivojević, Reindustijalizacija Srbije u cilju jačanja srpske privrede, 2015, p. 555.

According to the Report from the Direction for the Assessment of Capital, out of 428 enterprises that started the privatization process in 1997 only 18 of them were privatized by the end of 2001 (Pavlović, 2003). In the following years the pace of privatization has slowed down due to problematic enterprises that remained in state ownership and financial crisis that occurred. Unorganized and incomplete privatization directly affects production loses, bankruptcy and liquidation for a great number of public enterprises. In 1997 Serbia adopted the Anti-Monopoly Law in order to regulate free market competition, however, this Law was not implemented. The government spending on health care decreased dramatically from 200 USD per capita in 1990 to 30 USD in 2001. In the same year, and for the first time, all regular welfare benefits were paid. The government allocated only 4.6% of GDP on health care, while it allocated 14.5% of GDP for social protection and pensions. The government allocated only 2.7% of GDP for education in 2001 (European Commission, 2003). Yugoslav economy was relatively protected due to complicated system of tariffs on import, wide-spread price controls, restrictions on trade and access to foreign exchange. During the observed period, limited progress had been achieved in economic liberalization (European Bank for Reconstruction and Development, 2002).

Table 3 shows the main events during the so-called Milošević era. The role of the government in this decade was to establish peace, stop wars and contribute to social, political and economic balance in the region. The downfall of Milošević raised hopes for the future, however, Serbia lagged behind most Balkan countries.

Year	Event
1991	Dissolution of SFRY
1992	Serbia and Montenegro formed the Federal Republic of Yugoslavia
	Economic sanctions introduced by UN
1993	SFRY experienced the second largest hyperinflation in monetary history
1994	Widespread price controls
	Stabilization program introduced
1997	Privatization Law (first law on privatization was adopted in 1991 with amendments to the
	law in 1994 and 1995) Anti-monopoly Law
	Economic sanctions were tightened
1999	Economic sanctions and NATO war
	Poverty rate above 20% of population
2000	End of Milošević era
	Price controls relaxed

Table 3. Federal Republic of Yugoslavia in the retrospective for the period 1991-2000

2.2 Serbia at the beginning of transition process (2001-2008)

The process of transition, reforms and opening of economy toward global market started in 2000 and had been mandated under the leadership by Prime Minister Zoran Đinđić. During the first three years of transition, great improvements in the macroeconomic environment, international relations and reforms in many segments of society had been achieved. However, after the assassination of Zoran Đinđić in 2003, who was driving force of the transition and modernization, Serbia failed to achieve the previous rhythm and pace of reforms in the following years, as in the period 2001-2003 (European Bank for Reconstruction and Development, 2007).

In 2006, the government implemented national priorities in Serbian Sustainable Development Strategy for the period 2006-2012. This strategy was created in accordance with EU Sustainable Development Strategy, which was adopted in 2001 and revised in 2006 as the EU's Lisbon Strategy. It was also harmonized with all Serbia's sectorial strategies. The main objectives of National Strategy on Economic Development of the Republic of Serbia for period 2006-2012 were sustainable economic growth, economic and technological progress, sustainable social development and environmental protection. In this strategy, the government emphasized their main goals: creating higher quality of life for all citizens based on efficient market economy and increase in the competitiveness of the country (Nacionalna strategija privrednog razvoja Republike Srbije od 2006. do 2012. godine, Sl.g. RS, no. 71/2005).

Serbia's government listed five key national priorities in the Strategy:

- Development of competitive market economy and balanced economic growth,
- Investment in human resources and enhancement employment,
- EU membership,
- Development of infrastructure and balanced regional development,

- Promotion of the importance of environment and rational use of natural resources.

During the 2001-2008 period, GDP growth averaged 5% per year. Slowdown in 2003 could be connected with uncertainty, as a result of the assassination of Prime Minister in March the same year. The greatest growth was recorded in 2004 when GDP grew by 9% and in the following years economy recorded a GDP growth of around 5% (Table 4). However, this growth was backed by increase in consumption and FDI inflows. During the transition period, wages grew more than four times in real terms (from somewhat below 100 EUR in real terms in 2001 to around 400 EUR in real terms in 2008). As a consequence, domestic consumption increased and contributed to growth of economy. Therefore, increase in consumption was primary engine of growth in economy (European Bank for Reconstruction and Development, 2007).

Indicator	2001	2002	2003	2004	2005	2006	2007	2008
GDP annual growth (in %)	5.0	7.1	4.4	9.0	5.5	4.9	5.9	5.4
Inflation, consumer prices (annual % change)	95.0	19.5	9.9	11.0	16.1	11.7	6.4	12.4
Exchange rate (RSD/EUR), average	59.7	61.5	68.3	78.9	85.5	79	79.2	88.6
Unemployment rate, total (% of total labour force)	12.8	13.8	15.2	18.5	20.8	20.8	18.1	13.6
Unemployment, youth total (% of total labour force ages 15-24)	28.5	30.8	34	41.5	46.9	46.8	42.8	34.2

Table 4. Main macroeconomic indicators for Serbia in the period 2001-2008

Source: Ministry of finance Republic of Serbia, *Macroeconomic and fiscal data, December 21, 2016*, 2016, Table 1.

Another engine of growth was the inflow of FDIs. Cumulative foreign capital inflow in this period was 10.9 billion EUR, which according to the World Investment Report (2001) classified Serbia as forth in FDI inflow in the period form 2000-2008. The highest level of FDI inflow was in 2006 (Figure 3) at 3.3 billion EUR and was the consequence of the privatization of the mobile telecommunications operator 'Mobtel', purchased by Norwegian 'Telenor', followed by 'Philip Morris', a mobile operator 'Austria group' and others. In the period from 2001-2008 76.3% of all FDIs went to non-tradable sectors and was mainly directed towards financial sector, telecommunication and trade. The rest of FDIs (23.7%) were directed towards processing industries (20.1%), mining (3.1%) and agriculture (0.7%). In volatile macroeconomic environments, foreign investors tend to direct its capital to sectors which generate fast returns, and Serbia was no exception. By 2010 the service sector reached the largest inflow of FDIs (75%). In the analysed period, the highest inflow of FDI in Serbia comes from the EU member states, as well as from the USA and Russia (Milenković & Milenković, 2012).

High inflation in the period from 2001–2008 was the consequence of increase in domestic demand through monetary-credit expansion and the increase of public expenditures, the increase in the price of oil, raw materials, food, agricultural products, insufficient competition, monopoly and frequent elections – presidential, parliamentary and local (Bošnjak, 2009). Even though inflation rate dropped from 95% in 2001 to 12.4% in 2008, only in 2003 and 2007 the inflation rate was not represented by a two-digit number (Table 4).



Figure 3. FDI inflows in Serbia in the period 2001-2008, in millions of EUR

Source: National Bank of Serbia, Serbia's balance of payments, n.d.

Export was growing (from 22.4 % of GDP in 2001 to 29.1% of GDP in 2008) despite the strong real appreciation of currency, but it was still low compared to the region and EU countries. Import was also growing, from 37.7% of GDP in 2001 to 54.1% of GDP in 2008. Serbia mainly exported manufactured goods classified chiefly by material (33.7% of all export in 2004) and food (18.2% of all export in 2004). Until 2008, the share of manufactured goods classified chiefly by material (32.9% of all export), while machinery and transport equipment were second most exported with 17.3% of all goods. Serbia imported 18.1% of mineral fuels, lubricants and related products in 2008. EU remained the dominant trading partner (about 60% of trade), followed by former Yugoslav countries and its regional partners (CEFTA agreement), as well as Russia. Uneven distribution of FDI at all levels created regional disparities, which resulted that certain regions received more FDI (big cities and municipalities) and becoming more developed (Đerđ, 2003).

In the period from 2001-2008 Serbia's account deficit was high and pretty much equal, it amounted about 25% of GDP (Figure 4). However, in comparison to the region, only Albania and Montenegro had higher deficit in current accounts. Due to the introduction of VAT at the beginning of 2005, Serbia's current account deficit fell to 22.9% of GDP. Meanwhile, higher consumption and lack of export competitiveness raised the deficit up to 26.3% of GDP in 2008 (Boljanović, 2012).

Figure 4. Export, import and current account deficit in Serbia in the period 2001-2008, in % of GDP



Source: National Bank of Serbia, Serbia's balance of payments, n.d.

After 2005, the fiscal policy was expansionary, which increased expenditures and decreased revenues in the following period. Taxes on income and transfer of absolute rights were reduced and some products had a lower VAT rate. At the same time, public sector and pensions grew. As a result, the fiscal deficit grew from 0.5% of GDP in 2001 to 2.6% in 2008. In the years before the global economic crisis outbreak, public debt sharply declined, from 97.7% to GDP in 2001 to 28.3% of GDP in 2008. Overall external debt of the country measured as % of GDP decreased from 167.4% in 2001 to 64.5% in 2008 (European Bank for Reconstruction and Development, 2009).

The credit boom before crisis resulted in the boom in credit activity and inflow of FDI, which fuelled GDP growth of the country. However, despite the annual growth of 5%, the current model of growth proven to be unsustainable. External and internal imbalance, high inflation and unemployment rate had a negative impact on the overall macroeconomic environment in the country. Overall, recovery of the Serbian economy was slow and fragile (European Commission, 2010b).

The progress on privatization process was mixed and delayed. Between 2002 and 2007 a total of 1,737 firms were privatized for 1.88 billion EUR. However, the process of privatization remained incomplete and there were still a great number of the enterprises that were supposed to be privatized by the end of 2008. Additionally, privatization of Radio Television Bor, JAT Airways and JAT Tehnika was not successful. Incomplete and ineffective privatization led to

many obstacles, primarily in the labour market and competitiveness of the country with overall negative impact on public finances (Milenković & Milenković, 2012).

Serbia failed to improve the situation in the labour market. From 2001 until 2008, the total number of employees on average decreased by 0.6% annually (Table 4). Significant reduction in employment was in the manufacturing, construction trade, food service and the transport sector, while increasing trend was recorded in administrative, service and financial activities and education, as well as in scientific and technical activities, health and social care. Another huge problem for the economy was enormous high long-term unemployment rate (15-64) that was around 80% for the period from 2004-2008. Furthermore, as presented in Table 4, the youngest were most affected by unemployment, and youth unemployment rate had worsened from 28.5% in 2001 to 42.8% in 2009 (Statistical Office of the Republic of Serbia, 2011). Since the 1990s, Serbia has been experiencing a serious "brain drain" and according to Global Competitiveness Report (2010) Serbia ranked among the top four countries in this category.

In 2002, the Poverty Reduction Strategy Program was introduced and after discussion with the Boards of the IMF and World Bank it was finally adopted in 2004. In the period from 2002 – 2008 the poverty rate halved from 14.6% to 6.1% In the 2005 National Employment Strategy 2005–2010 was adopted in order to manage high rates of unemployment in the country. Human rights were gradually improved but are still at an unsatisfactory level in terms of minorities' rights, media, press and human rights organizations (Grečić & Pejin, 2012).

In comparison with the other Eastern and Central European countries, the privatization of the banking sector in Serbia started with a decade of delay – in 2000. With deep political and economic crises during 1990s, the position of banking sector in 2000 was weak. The Serbian banking sector faced huge debts to London and Paris clubs in previous years and had a great loss of 9 billion USD as a consequence of hyperinflation during the period of 1992-1994 (Radzic & Yuce, 2008). The first wave of privatization (until 2007) was successful. Firstly, the banking system shifted to private ownership (share of private banks increased from 4% in 2000 to 76% in 2007, while share of state banks declined from 65% in 2000 to 16% in 2007). Also, total number of banks decreased from 108, prior to transition process, to 35 in 2007. The result of reforms in the banking sector was the increase in overall confidence in the banking sector (total deposits amounted more than 12 billion EUR), consequently the increase in share of banking sector in total GDP (which amounted to two thirds of total GDP) and the increase in credit activity (amounted to 9.5 billion EUR) (National Bank of Serbia, 2009). However, the financial crisis negatively affected the banking sector in Serbia, leading to high deposit withdrawals amounting to 1 billion EUR (or 20% of total deposits). Capital market remained undeveloped in the observed period (European Bank for Reconstruction and Development, 2009).

October revolution in 2000 and participation of Serbia at the EU summit in Zagreb in November 2000 were marked as the beginning of the normalization of relations between Serbia and EU. Serbia was identified as a potential candidate for EU partnership during the Thessaloniki European Council summit in 2003. In April 2006 European Commission came to the conclusion that Serbia was ready to start negotiations to conclude the Stabilization and Association Agreement (hereinafter: SAA), which was argued in the feasibility study. This report was the first agreement between Serbia and EU, after that European Commission began official negotiations on the SAA with Serbia. However, SAA negotiations were cancelled since Serbia's co-operation with the International Criminal Tribunal did not improve (Serbia failed to deliver General Ratko Mladić and Radovan Karadžić). SAA was signed between Serbia and EU in Luxemburg in 2008, after Serbia showed demonstrated full cooperation with the International Criminal Tribunal cooperation with the International Country". Also, for the first time, Serbia created comprehensive contractual relationship with EU as an independent state in which the bilateral commitments were clearly defined (European Commission, 2010b).

Kosovo proclaimed independence in 2008, which heavily affected political situation in Serbia and returned the instability to the region. Despite all difficulties, in 2008 the European Partnership for Serbia was adopted, setting out priorities for the country's membership application (European Commission, 2010b).

During the observed period, the overall economic context of the environmental policy was improved. A great number of laws and strategies had been adopted, in the line with EU legislation, however, in context of instable economic and political environment Serbia allocated only 0.4% of budget to environmental protection (United Nations, 2007). After 2001 dozens of reforms have been adopted, but Serbia was still lagging behind its regional peers. From 2001 to 2008 more than 500 laws for market regulation were adopted and substantially harmonized with EU regulation. In line with a goal to attract more FDI inflows, in 2002 the government introduced at the federal level a new Foreign Investment Law, which equated the status of foreign and domestic investors and in 2008 Export Increase Strategy of the Republic of Serbia for the period 2008-2011. Also, a set of new tax laws was introduced with the aim of improving tax administration and regulation. In 2005, Serbia introduced VAT, replacing the sales tax. The main macroeconomic challenge was on the fiscal side, where there was still a need for controlling pressures for greater spending. Public finance management system was reformed and harmonized with EU, it introduced a reduction in corporate tax rate from 14% to 10%, which classified Serbia among countries with lowest rates. The government prepared several laws in the observed period, which improved the business environment. In 2005, a new Competition Law was adopted. Serbia had made substantial progress in harmonizing tariff rates. In 2004, Serbia adopted new Energy Law, which established an independent energy regulator. In 2008, the National Council for Infrastructure was formed in order to coordinate and manage projects in energy, telecommunications, roads and railways (European Bank for Reconstruction and Development, 2009). According to the Global Competitiveness Report (2017) Serbia ranked 85th (out of 134 countries) in 2008. Table 5 represents main events in Serbian economy in the period 2001-2008.

Year	Event
2001	Process of transition and reforms started
2002	New Foreign Investment Law
2002	Poverty Reduction Strategy Program
2003	Assassination of Zoran Đinđić
2003	Serbia granted status of potential candidate country
2004	Law on Energy
	Introduced VAT
2005	National Employment Strategy 2005-2010
	Competition Law
	Serbian Sustainable Development Strategy for the period 2006-2012
2006	SAA negotiations called off
	Montenegro proclaimed independence
2007	Between 2002 and 2007 a total of 1.737 companies were privatised for 1.88 billion EUR
2007	Stabilization and Association Agreement initialised
	SAA agreement was signed between EU and Serbia
2008	Exports Increase Strategy 2008-2011 Kosovo proclaimed independence
2000	Agreement on visa enters into force
	National Council for Infrastructure was formed

Table 5. Serbia in the retrospective in the period 2001-2008

2.3 Serbia after global financial crisis (2009-2016)

From 2008, Serbia was facing economic challenges driven both by external factors (global financial turmoil, Eurozone crisis) and internal factors (macroeconomic instability, an incomplete economic transition, floods). Gained economic growth in pre-crisis period changed structure of the GDP in favour of the service sector having the highest share in GDP creation as presented in the Figure 5.

During the period from 1995-2015 Serbia experienced trend of de-industrialization. Figure 5 shows that share of industry in creation of GDP decreased from 35.4% of GDP in 1995 to 28.6% of GDP in 2009. After the Strategy 2011-2020 was introduced in 2011, the share of industry in the creation GDP slightly increased, however it remained around 30% of GDP. Unfavourable structure of the domestic economy and high share of the service sector still characterizes Serbia's economy (60.5% in 2015).

Global financial crisis further worsened overall situation in the country. Also, the most European countries experienced deep recession after financial crisis which was consequence of unsustainable growth model that was mainly driven by FDI inflows and expansion of tradable sectors (the same as in Serbia). European Commission (2010a) highlighted importance of switching to new development model where industrial policy was at the centre of the stage.



Figure 5. Structure of Gross value added in Serbia in the Period 1995-2015, in % of GDP

Source: Ministry of finance Republic of Serbia, *Macroeconomic and fiscal data, December 21, 2016*, 2016, Table 1.

In the line with new paradigm of the importance of industrial sector, the necessity of improving competitiveness and fostering exports growth, Serbian government introduced the first document on industrial policy - Strategy 2011-2020 that was in the line with EU Strategy 2020. The new model of industrial growth was export-oriented and focused on privatization and restructuring of the corporate sector, dynamic investment growth, creation a competitive business environment and fostering the industrial sector and growth of industrial employment (Konstadinović, Kostić & Ilić, 2015).

In the period from 2009-2016 economy entered in three recessions (economy contracted in 2009, 2012 and 2014). Floods in May 2014 detracted output (industrial and agricultural) and exports. According to European Bank for Reconstruction and Development (2017) estimations, floods caused losses of around 1.5 billion EUR, or 2.5-3% of the GDP. In 2015 and 2016 moderate recovery was backed by increase in export (+7.8%) together with mild growth in consumption and fixed investment (+8.2%) (Table 6). Despite the fact that GDP growth in 2015 and 2016 was based on greater investments and exports (both necessary for sustainable growth), GDP was still below its pre-crisis level.

According to European Commission (2015), economic growth in Serbia is expected to be modest in 2017 and in the first half of 2017 GDP growth amounted to 3% (Table 6). Inflation was mostly volatile during this period. High inflation in 2012 was predominately a consequence of higher import costs, higher food prices and depreciation of exchange rate. In 2014 inflation declined sharply to 2.1% (at historically low level), which was below the lower bond targeted by National Bank of Serbia (4% +/- 1.5). In 2015 inflation continued to fall and

had been extremely low, which was a result of weak domestic demand, low international prices of primary commodities and delays in administration price adjustments. National Bank of Serbia intervened on the market with over 1.5 billion EUR, however the dinar continued to depreciate by almost 11% until August 2009. National Bank of Serbia had continued with interventions on the market, but the exchange rate was volatile through much of 2010 and 2011. The local currency depreciated from 94 Serbian dinar (hereinafter: RSD) for 1 EUR in 2009 to 123.1 RSD for 1 EUR in 2016. From 2013, National Bank of Serbia undertook strong relaxation of monetary policy with the decreasing of interest rates (restrictive monetary policy). These actions were perceived as a main drivers of lending activity, which was expected to influence economic recovery (National Bank of Serbia, 2016).

Indicator	2009	2010	2011	2012	2013	2014	2015	2016	H1 2017
GDP annual growth (in %)	-3.1	0.6	1.4	-1.0	2.6	-1.8	0.8	2.8	3.0
Inflation, consumer prices (annual %)	8.1	6.1	11.1	7.3	7.7	2.1	1.4	1.6	3.2
Exchange rate (RSD/EUR), average	94	103	102	113.1	113.1	117.3	120.7	123.1	124.0
Unemployment rate, total (% of total labour force)	16.6	19.2	23	23	23.9	22.2	17.7	15.3	-
Unemployment, youth total (% of total labour force ages 15-24)	41.6	46.1	51.8	51.8	51.2	49.5	47.4	45	-

Table 6. Main macroeconomic indicators in Serbia in the period 2009-2016

Source: Ministry of finance Republic of Serbia, *Macroeconomic and fiscal data, December 21, 2016*, 2016, Table 1.

During the entire observed period, Serbia had been facing with regional disparities. Almost three quarters of all investments were directed towards Belgrade and Novi Sad. In terms of GDP creation, Belgrade is the most dominant region and it created 38% of national GDP in 2015, followed by Vojvodina region (27%). The less developed region in South and South-East Serbia generate one sixth of national GDP (Statistical Office of the Republic of Serbia, 2016). The first strategic step related to the implementation of the new regional development policy was the adoption of the Regional Development Strategy for the period 2007-2012 and the Law on Regional Development 2009.

After signing the Interim Trade Agreement in 2008 and introducing Strategy 2011, exports of Serbia steady increased from 26.8% of GDP in 2009 to 59.9% of GDP in 2016. Serbia's main trading partner during the whole period was the EU with more than 60% share in both import and export. Even though export increased by more than 50% from 2009 to 2016, it was very low by regional standards (Figure 6).

Figure 6. Exports and imports of goods and services and current account deficit in Serbia in the period 2009-2015, as % of GDP



Source: National Bank of Serbia, Serbia's balance of payments, n.d.

The biggest exporters in period January - November 2015 in Serbia were FCA Serbia d.o.o. (1.093 million EUR), Železara Smederevo (295 million EUR) and Naftna Industrija Srbiije (270.4 million EUR) (Ministry of Finance, 2016). The most rapidly growing categories after 2008 are primary agriculture and machinery and transportation equipment. Export of services was growing at 4.7% annually after 2008. In 2015 the highest share of service exports was communication services accounting for 51% of exports. Bearing in mind the importance of communication services in promoting innovation in manufacturing this is a really strong competitive advantage that Serbia should improve and foster in the future (World Bank Group, 2014). However, in the long run the competitiveness of Serbian economy cannot be ensured with the existing economic structure and Serbian exports have to be more adjusted to the EU needs. After the crisis, the current account deficit dropped to 6.6 % in 2009, however in 2012 it increased again to 11.5%. Due to faster growth in export and weaker domestic demand and import the current account dropped to 4% in 2016. Outgoing structural reforms are expected to contribute to the increase in export competitiveness through curbing labour costs and improving productivity (Jakopin & Bajec, 2009).

Since 2008, Serbia received around 16 billion EUR of FDI. Figure 7 shows that significant decrease in FDI inflow occurred in 2009 and 2010, as a consequence of the global economic crisis, which negatively influenced global investment trends in the whole region. In 2011 FDI reached 3.3 billion EUR, however in the next 5 years FDI inflows in Serbia amounted cumulatively 6.9 billion EUR. Current account deficit in 2015 of 4% of GDP was fully covered by net FDI inflows (European Commission, 2016).



Figure 7. Net FDI inflows in Serbia in period 2009-2016, in million EUR

Source: National Bank of Serbia, Serbia's balance of payments, n.d.

During the entire period Serbia prioritized attracting FDI by approving a package of incentives for foreign investments in June 2014 and a new decree on subsidies for direct investments in March 2015. The highest share of investments in 2015 was directed towards the energy sector (48%), followed by the manufacturing sector (20%) and trade (7%). According to the most recent available data, the number of greenfield projects in Serbia was 77 in 2015 and 53% of them were in manufacturing (United Nations conference on trade and development, 2017).

Strong fiscal adjustment during the 2015-2016 period reduced fiscal deficit from 6.7% of GDP in 2014 to 1.5% in 2016. Striving towards lowering fiscal deficit over a longer period of time, even in conditions of moderate growth will provide a decrease in public debt ratio to GDP. This is important, since a large number of empirical research have proven that high public debt adversely affect the growth of the economy. All in all, low fiscal deficit will positively influence other indicators of macroeconomic stability, such as inflation, external economic balance and interest rates (Arsić, Ranđelović & Nojković, 2017).

The result of cuts in public wages and pensions was the decrease in the budget deficit from 6.6% of GDP to 1.4 % of GDP in 2016 (Ministry of Finance of Republic of Serbia, 2016). The most significant fiscal trend in 2016 was the strong increase in the public revenue. Until 2017 the budget deficit is forecast to fall to 3.8% of GDP, predominately due to a large reduction in primary expenditures of 7.9% of GDP. However, further financial consolidation measures are necessary after 2017 in order reclaim debt sustainability (European Commission, 2016).

According to the Doing Business Report (2017), Serbia improved its overall position, from 54th to 47th place out of 190 countries. In the past year Serbia carried out reforms in three areas: starting a business, dealing with construction permits and registering property. The time

for the registration of a company decreased from 12 days to 7 days, which simplified process of starting a business. Serbia also started with the implementation of online system and streamlined the process of obtaining building permits, which reduce days for building a warehouse to 156 days from previously 327 days. Also, Serbia introduced effective time limits in order to simplify the process of property transfer.

In the following years economy was still facing with the same difficulties in the labour market (Table 10). Firstly, unemployment remained high. From an already high rate of 16.6 % in 2009, unemployment rate grew to 22.2% in 2013. In 2016 unemployment remains very high and despite the decrease to 19.7% it is still among the highest in the region. At 44.2% in 2016 youth unemployment remains one of the main problems in economy, education and skill gaps are still huge. A huge percentage of young people are either not employed nor in training or education, and with 22% Serbia has one of the highest rates in the world. As a consequence of gap between supply and demand of skilled workforce, long term unemployment rate also grew from 65.5% in 2009 to 78% in 2016. In addition, the main labour market programs remained unfinished and incomplete. Overall labour market opportunities worsened, especially for low income earners after 2008. The poor labour market performance affects the aggravation of social conditions in the country. Serbia is among the countries with the highest at-risk-of-poverty rate, amounting to 25.4% in 2015, which is highly above 17% of EU average (Statistical Office of the Republic of Serbia, 2016).

Process of transition is still ongoing. Until 2015, 3,047 enterprises had been privatized and achieved income of 3.7 billion EUR. In May 2015 the government adopted draft amendments to the Law on Privatization, which extended the deadline for the privatization of remaining enterprises (556 companies are in the process of privatization, out of which 161 companies were in the process of restructuring) (United States Department of State, 2015).

Serbia has taken some steps towards a strategic framework regarding the environmental protection and climate regulation in the recent years. The government adopted the National Renewable Energy Action Plan with the goal of increasing the amount of energy generated from renewables to 27% by 2020. Bearing in mind that share of renewables was at 21.2%, which is the same since adoption of Energy Strategy in 2005, important actions are expected to be taken in order to achieve the goals. However, environmental and climate legislation in comparison with EU legislative is still very weak. Serbia needs to improve in terms of waste and water management, nature protection, industrial pollution control and air quality. The major challenge is waste management, bearing in mind that level of recycling waste or re-use is only 4%. Also, water pollution is huge problem, and that is why Serbia needs a national water protection strategy. Serbia needs to develop and implement a national strategy for combating climate, which has to be in the line with EU 2030 Climate and Energy Framework. Policy in the energy sector has been focused on increased use of renewable energy sources, energy efficiency and cleaner development mechanisms. Bearing in mind its strategic goal -EU accession - Serbia needs to put more effort to catch up with European legislation and actions (European Commission, 2016).

Serbia continued to improve its international cooperation with EU and the world. On January 1st 2009 Serbia started to implement the Interim Agreement, which entered into force next year, on February 1st 2010. In the same year, 2009, Serbia signed a free trade agreement with EFTA countries. European Commission (2016) recommended to the Council of Ministers to grant visa-free access for the Schengen area for Serbia, which was approved in early 2010. On 1st March 2012, the European Council decided to grant Serbia the candidate status. Due to progress in the normalisation of relations with Kosovo, European Council opened negotiations with Serbia and the first inter-governmental conference took place in January 2014. In 2015 accession negotiations between Serbia and EU were successfully completed. EU accession remained the main strategic goal for Serbia, therefore, Serbia continued to align its legislation, with the good examples in areas, such as intellectual property, anti-trust and mergers and monetary policy. At the meeting in Brussels during the Accession Conference with Serbia, two more chapters were opened (Chapter 20 – Enterprise and Industrial policy and Chapter 26 – Education and Culture). Although in the observed period Serbia carried out significant institutional and structural adjustments in order to access EU, a wider range of structural reforms needs to be implemented in the future. Important changes have been made in the Competition Law and its harmonising with EU regulations.

The monetary policy framework that had been introduced in September 2006, and was adjusted in January 2009, when the National Bank of Serbia switched from targeting core inflation to target consumer price inflation. From 2013, National Bank of Serbia relaxed the monetary policy in order to increase credit activity and foster economic recovery. In January 2009, the government submitted to the European Commission an Economic and Fiscal Programme covering the period of 2009-2011. However, in the wake of a financial crisis and recession in the country, the government Plan for the Economic Stability of Serbia, adopted in early April 2009, was directed to cutting public spending, protecting living standards, encouraging economic activity and employment, and supporting public works and capital investments in infrastructure. Additionally, the government introduced a number of programmes and packages to mitigate negative effects and consequences of the crisis. Those programmes were mainly designed to increase the purchasing power of citizens, encourage domestic demand and production, to support social security of employees, preserving jobs and to encourage export activities (European Bank for Reconstruction and Development, 2009). Progress was also made in liberalising the telecommunications sector, when the new Law on Electronic Communications was implemented in 2010. A new Law on the Railways Sector was adopted in 2011 in order to ensure better competition and to improve services. Law on the Protection of Competition, Law on State Aid Control and Law on Securities Market significantly improved the business environment. Serbia is progressing in its fight against corruption with the implementation of national strategies on judicial reform and improvement in coordination of institutional leadership in this area (United Nations Office on Drugs and Crime, 2013). From 2010 social security reforms enabled a simpler procedure in exercising the right to compulsory social insurance. Due to structural problems with high unemployment rate and gaps in education and market needs, the government adopted in 2012 the Education Strategy that should improve the quality of education. In 2013 a few laws on higher education were adopted, which were aimed at recognising foreign diplomas and the improvement of transparency of the system. In the same year, through the Youth in Action Programme, young people were encouraged to participate in exchanges and European Voluntary Services in Europe. In 2013, a programme of judicial training was implemented (Grečić & Pejin, 2012). However, further reforms in the education system are necessary in the upcoming years. In the next period, European Commission (2015) suggested in its report that Serbia should focus on reducing the budget deficit and public debt, developing private sector through restructuring and privatisation of state-owned enterprises, fostering credit growth and reduce NPLs. Implementing public administration reform is also necessary, which is still moderately prepared for the developing of a functioning market economy. The government submitted the Economic Reform Programme 2015-2017 in March 2015 with the main aim to achieve macroeconomic stability and growth, to improve competitiveness (United States Department of State, 2015).

The role of state remained powerful in creating conditions in the economy after global financial turmoil. By introducing a number of laws, programmes and strategies, the government made some progress in improving the macroeconomic environment. Some steps were successful regarding the budget deficit, labour market and improvements in the business environment. After eight-year period, public debt decreased and amounted to 72.9% of GDP. Further reduction of fiscal deficit and primarily reduction of current public expenditures are necessary in order to restore fiscal sustainability and support future economic growth. According to Doing Business Report (2017), Serbia was among the global 10 improvers in average. Further improving business environment through simplifying administrative procedures, reducing corruption, improving competition policy, strengthening financial discipline and regulation of property rights, are among the goals determined within the new Strategy 2011-2020 (Strategija i politika razvoja industrije Republike Srbije od 2011. do 2020. godine, Sl.g. RS, no. 55/2011).

The process of re-industrialization proved to be complex, requiring synchronized operation of economic policy and compliance of judicial reform and education, supporting infrastructural projects and appropriate environmental regulations. So far, Serbia achieved limited progress towards fostering industrial sector, and because of that the government adopted Strategy for the Development and Support to SMEs, Entrepreneurship and Competitiveness for the period of 2015-2020. The process of re-industrialization and fostering medium and high tech industrial production are priorities for future sustainable growth (Pokrajac, Nikolić, Filipović, Josipović, & Vasić, 2016). On the other side, Serbia still suffers from strong fiscal imbalances, high level of non-performing loans, undeveloped private sector, administrative and regulatory barriers in business, poor infrastructure, low investment, large informal economy and insufficient competition in some sectors (European Commission, 2016).

Despite the occasional improvements in the recent period, the overall picture shows that Serbia still hasn't managed to achieve macroeconomic balance. Serbia's crisis started in 1980, when country was part of SFRY. However, in the last 25 years Serbia passed through period of dramatic changes in all areas, numerous elections, external and internal imbalances, sanctions and wars. After extremely unfavourable general environment during the 1990s, Serbia recovered in the first eight years of 21st century. Although in the recent years some fiscal adjustments and macroeconomic indicators had been improved, the overall economic activity is significantly below its potential level and macroeconomic environment is volatile and unstable (International monetary fund, 2017). Main events during the period 2009-2016 are presented in Table 7.

Table 7. Serbia in the retrospective in the period 2009-2016

Year	Event
	Plan for the Economic Stability of Serbia Interim Agreement and signed a free trade agreement with
2009	EFTA
	European Commission and Economic and Fiscal Programme (EFP) 2009-2011
	Visa-free access for the Schengen area
2010	Law on Electronic Communications
	Social Security Reforms
	Strategy and Policy of Industrial Development of the Republic of Serbia for the period 2011-2020
2011	Law on Protection of Competition
2011	Law on State Aid Control
	Law on Securities Market
2012	European Council decided to grant Serbia the candidate status, Education strategy, National
2012	Renewable Energy Action Plan
2012	National Bank of Serbia relaxed monetary policy in order to increase credit activity and foster
2013	economic recovery
2014	Floods IMF-supported program aimed to restore fiscal imbalances and foster growth
2015	By 2015 3.047 enterprises were privatised with the achieved income of 3.7 billion EUR
2013	Economic Reform Program, Strategy for Development and Support to SMEs, Entrepreneurship and
	Competitiveness for the Period 2015-2020
	Two more chapters were opened in negotiations with EU (Chapter 20- Enterprise and Industrial
2016	policy and Chapter 26 -Education and Culture; Strong fiscal adjustments during 2015-2016;
	Entrepreneurship year in Serbia

3 ANALYSIS OF INDUSTRIAL POLICY IN SERBIA

After the dissolution of SFRY, Serbian government faced with strong imbalances as consequences of wars, sanctions, frequent elections which caused sharp decline in industrial production. Transition growth model (2000-2008) resulted in expansion of tradable sector and GDP growth that was backed by domestic consumption and inflow of FDI. Even before financial crisis 2007 Serbia experienced the trend of deindustrialization which continued also in the following years. In line with European strategy - Europe 2020, Serbia's government conducted the Strategy 2011-2020. This was the first document on industrial policy in Serbia which main goal was sustainable growth backed by exports, FDI inflows (but predominately allocated in non-tradable sectors as well as greenfield investments) and fostering industry sector in order to catch up with developed countries.

In this chapter of the paper, a variety of industrial policy measures used in the period from 2000-2016 will be briefly described. Main policies based on Stiglitz and Greenwald (2014) to support economic growth and catching up to the developed economies are presented in Table 8.

Measure target	Policies implemented
Maaraaaanamia	Unstable macroeconomic environment; in the period from 2001-08 growth was
onvironment	supported by expanding service sector and domestic demand; from 2009 shift
envir omnent	towards industry and export
	At the beginning of the transition period, the exchange rate is a nominal anchor
Exchange rate	policy; after 2006 floating exchange rate regime (market-based); stimulation of
	export after currency depreciation
Tariffs	Tariffs higher than EU tariffs; the highest protection of clothing
State aid	Non-consistent policy; Regional state aid dominant in structure of total state aid
Export	Goods dominate; low-value added products
Industry	De-industrialization; manufacturing in GDP decreased by 30 %
Foreign direct investments	FDI focused mainly on non-tradable sector
Small and medium sized	More than 99 % of enterprises are SMEs, accounting for 56 % of GDP; various
enterprises	supporting systems

Table 8. Industrial policy measures implemented in Serbia in the period 2000-2016

3.1 Exchange rate

Exchange rate affects the economies in many different ways and has various impacts on the macroeconomic environment. The direct correlation between inflation and exchange rate is especially prevalent in developing countries, which implies that the increase in general price levels causes the increase of exchange rate This correlation is graphically illustrated in Figure 8 for the period from 2002 – 2016. Bearing in mind that Serbia is highly import-depended country, psychological factors boost the relationship. This psychological factor is especially present in developing countries, creating a currency crisis, which in the last instance negatively affects export competitiveness of the country. Combined effects of trade balance and psychological factors create depreciation pressure, which often leads to inflator pressure (Marković & Marković, 2014).

As Nikolić (2010) claims, the depreciation of the national currency lowers the price of exports (denominated in foreign currency), which encourages exporters by reducing price of their products in foreign markets. It should then positively impact the current account deficit (increase in export and decrease in import) with positive effects on domestic production. However, monetary instability in developing countries, also in Serbia, is the main reason why this effect of reducing of national currency does not have impact on increasing export and reducing current account deficit. Additionally, depreciation of national currency led to the increase in import, because there are no domestic subsidies of some products (energy, computer technology and other industrial products), which at the last instance influence the increase in current account deficit. However, it also affects increase in production costs,

which affects the increase in inflation. Since Serbia is highly import-dependent, there is no positive effect of depreciation of national currency, due to low competitiveness of Serbian export.



Figure 8. Exchange rate growth and inflation in Serbia in the period 2002-2016, in %

Source: Ministry of finance Republic of Serbia, *Macroeconomic and fiscal data, December 21, 2016*, 2016, Table 1.

In Serbia has always been a tendency of using fixed nominal exchange rate policy, despite the practice of many countries that confirmed that this policy only provides short term-results in terms of financing quasi fiscal deficit. At the beginning of 21st century, the macroeconomic situation was not favourable and was characterized by the weak financial system, high inflation and little confidence in national currency. From 2000, National Bank of Serbia used the exchange rate to achieve macroeconomic stability and reduce inflation (Milenković, 2012).

In the period from 2000 to 2016, three sub-periods of exchange rate regime could be identified (Allegret, Beker & Josifids, 2009). In the first sub-period, from 2001 to 2003, Serbia had been using conventional fixed peg. This proved to be successful since inflation had been brought sharply down and exchange rate was stable and amounted around 60 RSD for EUR. In 2003 the dinar started to depreciate, which was in line with growing difference in inflation between Serbia and EMU. After 2003 National Bank of Serbia officially abandoned the exchange rate as a nominal anchor, and the second sub-period (2003-2006) was characterized by using crawling peg. During this period, the dinar depreciated strongly (from 65.1 RSD for 1 EUR in 2003 to 84.1 RSD for 1 EUR in 2006).

In accordance with the situation in which Serbia started its process of the higher degree of opening to the EU and high degree of "eurisation", National Bank of Serbia agreed on a new

monetary framework that was applied from September 2006, at that time National Bank of Serbia announced the preparation for full-fledged inflation targeting. From the end of 2005 until the beginning of 2008, the value of RSD appreciated to EUR by 9.6 p.p. as a result of creating an exchange rate in fluctuating regime. Additionally, privatization inflows, state and private sector loans, as well as foreign inflows in this period, reduced inflation pressures with a lower exchange rate.

When the financial crisis escalated, followed with a big fall in foreign capital inflows and increase in capital outflows, the exchange rate depreciated by 22.4 p.p. In the same period, the National Bank of Serbia frequently intervened in order to maintain the current value of the RSD and in only 6 months IMF approved stand-by credit arrangement of 2.9 billion EUR to provide stability of financial system and increase the amount of foreign reserves. After 2009 light depreciation begun and in 2011 the dinar weakened to Euro by 5.9 p.p. (Todorović & Veličković, 2010). From 2009 National Bank of Serbia has been applying the fully fledged inflation targeting, which constitutes the third sub-period. In a National Bank of Serbia report it was emphasized that the goal will remain unchanged and total to four plus or minus 1.5% for the following 2017, 2018 and 2019 (National Bank of Serbia, 2016).

The nominal exchange rate is still considered to be the anchor to control inflation. However, targets were not achieved during the entire period, since inflation was above permitted deviation (National Bank of Serbia, 2016). One of the main reasons for the constantly high inflation is a great presence of monopolies and cartels. On the other side, in case of industry, the dinar exchange rate policy can do very little to foster export.

Empirical research suggests that the solution to larger exports of the industrial sector does not lie down in the exchange rate depreciation. In principle, in the short-run it stimulates exports, but only when the country has competitive production, which by its structure, quality, series, and technological standards meets foreign demand and when the demand is constantly rising. According to Todorović and Veličković (2010) a big domestic demand had a much stronger impact on import than exchange rate emphasizing above 80% of import, consisted of equipment and raw materials, whose impact was determined by production needs of the economy, not by the level of exchange rate.

Yet the exchange rate policy is highly political. It is chosen by policy-makers, often concerned about the impact of currency policy on electoral conditions, and pressures from special interests and mass public opinion that can affect its course profoundly. Inadequate economic policy focused on inflation, leading to the syndrome of a "strong currency in a weak economy", is seen as one of the main reasons for the limited development of the tradable sectors and thereby exports (International monetary fund, 2017). In case of Serbia, the exchange rate did not have an impact on exports and exchange rate.

According to a National Bank of Serbia report (2016), the monetary regime will stay the same in the following years, which means it will target inflation and pursue managed floating

exchange rate. As Jovović (2006) claims, the economy of Serbia is characterized by extreme lack of competitiveness and insufficient export, therefore, the regime of controlled flexible dinar exchange rate, with regular adjustments by the National Bank of Serbia to the movements of the market, is so far the best option. On the other side, the appreciation of the dinar constantly keeps going on and National Bank of Serbia justifies it by the expensive borrowed funds.

Growth of the economy has to be result of productivity growth and not backed by spending foreign exchange reserves. Regarding this, Marković and Marković (2014) suggested that the role of the National Bank of Serbia in foreign exchange market has to be reduced and limited to occasional interventions in order to prevent only extreme fluctuations in the exchange rate.

3.2 Tariffs

Stiglitz and Greenwald (2014) claim free trade is desirable in the perfect market and learning externalities. However, they emphasized that trade policy does not necessarily lead to growth. Tariff system has to be optimized for creating learning society, since too high tariff rates allow the inefficient sector to continue producing at the expense of increasing consumer prices. On the other side, governments' in developing countries tend to use trade policy as a tool to raise revenues and protect domestic economy. Generally speaking, most studies proved that tariff reduction had a positive influence on developing and developed countries on promoting growth, increase in per capita income and FDI inflows (Love & Lattimore, 2009).

After the war (1990-2000), Serbian foreign trade system was non-transparent. Constant changes in the tariff rate, complicated system and license regimes created poor import possibilities and deteriorated competitiveness of the country. The turning point was year 2000, when country started to open its economy and liberalize its foreign trade policy. On its new path towards EU, numerous steps towards trade integration have been made, since the trade policy is generally seen as a tool to enhance the process of Stabilization and Association.

Along with process of EU integration, Serbia signed a number of customs free-regime trade agreements. They include agreements with EU countries, United States of America, Russia etc. with the main goal of expanding the trade in goods and services, and eliminating trade barriers. The Free Trade Agreement with Russian Federation signed in 2000 and the list of products excluded from this agreement is revised every year. In 2006 Serbia entered The Central European Free Trade Agreement (hereinafter: CEFTA), and in 2011 signed agreements on free trade with Belarus and Kazakhstan. Although Serbia applied for the World Trade Organization (hereinafter: WTO) membership in 2004, it was not even awarded with membership in 2017. In 2009, Serbia signed a free trade agreement with European Free Trade Association (hereinafter: EFTA). All these agreements and reforms resulted in decrease in average protection and eliminated most non-tariff barriers in the recent years (United States Department of State, 2013).

So far, Serbian government has introduced a few strategies to foster trade activity: National Action Plan for the Development of Organic Farming in Serbia, Strategy for Export Improvement of the AP Vojvodina 2011-2015, etc. As a consequence, Serbia drastically opened its economy (from 23.2% of GDP in 1995 to 103.1% to GDP in 2015) as the liberalization and structural reforms were implemented (European Commission, 2016).

Still, the Serbian tariff structure measured by the average tariff rate is among highest in the region. The average tariff rate in EU was 5.3% in 2011, while in Serbia was 7.4%. There was significant difference between the level of rates for industrial and agricultural products for both, EU and Serbia. In 2011 the average tariff rate for agricultural products in EU was 13.9% and for industrial products around 4%. On the other side, in the same year the tariff rate on agricultural products was 14% and on industrial products 6.2% in Serbia. In 2016 tariff rate on agricultural products increased to 17%, while tariff rates on agricultural products decreased to 4.2%. The most protected product category in Serbia is clothing (with the rate of 10%) (Global Enabling Trade Report, 2016).

Therefore, Serbian government stimulates some sectors with favourable tariff rate system, which protects domestic economy and companies from foreign competitors (agricultural products and clothing). On the other side, tariff rates on industrial products were significantly lower in comparison with agricultural products. However, protectionism policy has a high cost, which in the end is covered by consumers (Love & Latimorre, 2009).

Although Serbia as developing country needs assistance of the government to create macroeconomic stability, its role in the economy should be limited in terms of a protectionist policy (European Commission, 2016).

3.3 Subsidies

Governments can create an environment in the country by using state aid as an instrument of industrial policy by supporting certain branches, sectors or companies. Stiglitz and Greenwald (2014) emphasize that there are a lot of successful experiences in developed countries which have been using industrial policy (subsidies, low exchange rate, regulations and tariffs) when developing. Although EU with the SAA protects free competition and prevents governments from granting state aid, which may distort competition, Serbia's government allocated much higher amount of state aid in recent years compared to EU countries.

During the observed period, the average share of state aid in percentage of GDP in EU was stable and around 0.5, with the exception of 2008 and 2009. In order to overcome negative effects of the financial crisis, EU members allocated significantly higher amounts of state aid to support and help some sectors in their economies. On the other side, before the crisis, Serbia allocated under 2% of state aid to GDP. When the crisis started, Serbia began to allocate higher amounts of state aid, but this increment was not as dramatic as it was in EU (Prokopijević, 2013).

According to the most recent available data, the government allocated 2.6% of GDP on state aid, which is high above the average of EU countries with 0.5% (Figure 9) (Republic of Serbia Commission for state aid control, 2016; Republic of Serbia Commission for state aid control, 2013; Republic of Serbia Commission for state aid control, 2007). Despite the difference in amount, state aid provided in Serbia differs in structure and objectives in EU countries. The first report on state aid granted in Republic of Serbia was made in 2006 and it represented report on allocated state aid for 2004, 2005 and 2006. In line with EU requirements for Serbia's accession, in 2009 with the adoption of the Law on State Aid Control State Aid Control was established (Republic of Serbia Commission for state aid control, 2015).



Figure 9. State aid granted in EU and Serbia in the period 2005-2015, in % of GDP

Source: Republic of Serbia Commission for state aid control, *Report on state aid granted in the Republic of Serbia in 2006*, 2007, p. 11; Republic of Serbia Commission for state aid control, *Report on state aid granted in the Republic of Serbia in 2009*, 2010, p. 11; Republic of Serbia Commission for state aid control, *Report on state aid granted in the Republic of Serbia in 2012*, 2013, p. 11; Government of Republic of Serbia, *Report on State Aid Granted in the Republic of Serbia*, 2015, p. 11; Republic of Serbia Commission for state aid control, *Report on State Aid Granted in the Republic of Serbia*, 2015, p. 11; Republic of Serbia Commission for state aid control, *Report on State Aid Granted in the Republic of Serbia*, 2015, p. 11; Republic of Serbia in 2015, 2016, p. 11.

In 2015 the total amount of granted state aid reached 863 million EUR. State aid in Serbia is allocated depending on the objectives and according to the main three categories: regional state aid, horizontal state aid and sectoral state aid. In Figure 10 we can see that Serbia's government did not have a clear and uniform strategy on state aid allocation, since during the entire period funds in all of three types of state aids significantly changed (Commission for the state aid control, 2015).

In 2015 the government allocated 197 million EUR (or 21.4% of state aid) to the agriculture sector, while the remaining amount of 665.8 million EUR (78.6%) was granted to industry and services.





Source: Republic of Serbia Commission for state aid control, *Report on state aid granted in the Republic of Serbia in 2006*, 2007, p. 13; Republic of Serbia Commission for state aid control, *Report on state aid granted in the Republic of Serbia in 2009*, 2010, p. 13; Republic of Serbia Commission for state aid control, *Report on state aid granted in the Republic of Serbia in 2012*, 2013, p. 13; Government of Republic of Serbia, *Report on State Aid Granted in the Republic of Serbia*, 2015, p. 13; Republic of Serbia Commission for state aid control, *Report on State Aid Granted in the Republic of Serbia*, 2015, p. 13; Republic of Serbia Commission for state aid control, *Report on State Aid Granted in the Republic of Serbia*, 2015, p. 13; Republic of Serbia in 2015, 2016, p. 13.

In order to get a broader picture of how the government allocated state aid and which sector found it most suitable to get funds, the structure of the horizontal and sectoral state aid will be presented.

Figure 11 represents the share of horizontal state aid in the period from 2005-2015. The highest share of funds prior to the crisis (2005-2008) was directed towards SMEs (36% in 2007) and Restructuring (35%). As the crisis escalated, the government allocated significant amounts of state aid to Employment (23.3% of funds of horizontal state aid). In the following years, Restructuring remained the dominant receiver of state aid and around 30% of horizontal state aid was directed towards it. After 2009 funds towards SME dramatically decreased and in 2015 amounted to 0.1% of share in horizontal state aid. In the recent years, Culture received significant amount of state aid in Serbia. Share of horizontal state aid towards from 0.1% in 2010 to 27.4% in 2015 (Republic of Serbia

Commission for state aid control, 2016; Republic of Serbia Commission for state aid control, 2013; Republic of Serbia Commission for state aid control, 2010; Republic of Serbia Commission for state aid control, 2007).



Figure 11. Structure of horizontal state aid in Serbia in the period 2005-2015, in % of all horizontal state aid

Source: Republic of Serbia Commission for state aid control, *Report on state aid granted in the Republic of Serbia in 2006*, 2007, p. 18; Republic of Serbia Commission for state aid control, *Report on state aid granted in the Republic of Serbia in 2009*, 2010, p. 18; Republic of Serbia Commission for state aid control, *Report on state aid granted in the Republic of Serbia in 2012*, 2013, p. 18; Government of Republic of Serbia, *Report on State Aid Granted in the Republic of Serbia*, 2015, p. 18; Republic of Serbia Commission for state aid control, *Report on State Aid Granted in the Republic of Serbia*, 2015, p. 18; Republic of Serbia in 2015, 2016, p. 18.

During the entire period, the dominant structure for sectoral aid was transport (Figure 12). In 2005 one third of all sectoral aid was directed towards railway traffic. In 2009, the government designed a project for improvement of the building of wagons, with the aim of modernising the Serbian Railways. Since 2010, European Bank for Reconstruction and Development also granted four loans to Serbian Railways. In July 2013, the Russian government granted 800 million EUR and signed a modernisation agreement with Serbian Railways (European Bank for Reconstruction and Development, 2017). In 2015 Transport received 50% of funds within Sectoral state aid in Serbia while in Mining and Steel government allocated the following amount of 50% of horizontal state aid (Republic of Serbia Commission for state aid control, 2016; Republic of Serbia Commission for state aid control, 2007).

Huge amounts of funding were directed towards Serbian Railways during the last decade. Mostly, it was unsuccessful, since Serbian trains are slow, old and uncompetitive when compared to EU. Also, subsidies and funding received in the last decade were not directed towards modernisation. There is a lot of room for improvement in the system of control of state aid, where transparency and punishment for funds misappropriation have to be in focus, and Commission for State Aid Control has to change the normative solutions for future control on allocation of state aid (Praščević, 2013b).



Figure 12. Structure of sectoral state aid in Serbia in the period 2005-2015

Source: Republic of Serbia Commission for state aid control, *Report on state aid granted in the Republic of Serbia in 2006*, 2007, p. 22; Republic of Serbia Commission for state aid control, *Report on state aid granted in the Republic of Serbia in 2009*, 2010, p. 22; Republic of Serbia Commission for state aid control, *Report on state aid granted in the Republic of Serbia in 2012*, 2013, p. 22; Government of Republic of Serbia, *Report on State Aid Granted in the Republic of Serbia*, 2015, p. 22; Republic of Serbia Commission for state aid control, *Report on State Aid Granted in the Republic of Serbia*, 2015, p. 22; Republic of Serbia in 2015, 2016, p. 22.

Regional disparities in Serbia are among the highest in Europe, which further deteriorated macroeconomic stability. In addition, since Serbia strives to become member of EU, intervention towards overcoming economic differences among regions are more than necessary, to prepare country for structural and cohesion funds. Despite strategies and laws that had been adopted, starting from 2010, the government has allocated significantly higher amounts of state aid to regional aid. As Prokopijević (2013) claims, through regional state aid the government supports less developed and undeveloped regions. However, supporting regional areas in such scope is not in the accordance with EU guidelines. In the period from 2007 to 2015, the share of regional aid among EU members was 18% on average for regional development. In the same period the government share of regional aid was 27.1%.

Big companies have been supported over the next decade with subsidies during the entire period. According to study conducted by Laketić (2015) only one in ten companies that received subsidies from the state made a profit that exceeds amount of received subsidy. Four

of them ended with net loss, while five of them gained net profit (but less than the received assistance). In 2013 Serbian government allocated 81 billion EUR subvention for big companies. In Table 9 only companies which received above 850 million EUR in 2013 are presented. Fiat received the highest subsidies (45.8 million EUR) and made less profit then amount received (10 million EUR). The weakest result in the business was realized by the American company Cooper Tire. This company received 980 million EUR and at the end of 2013 ended up with loss of slightly below 7 million EUR.

The most successful company in the list is Confezioni Andrea, which received 1.1 million EUR of subsidies, and made a profit of 1.8 million EUR (Laketić, 2015). Generally, supporting big companies in economy is not supported by many of authors. In case of Serbia, supporting national champions, which despite governments' support incur losses, only worsened overall macroeconomic situation it the country (Praščević, 2013b).

Company	State aid	Net gain/Net loss
FIAT Automobili Srbija	45,800,000	10,000,000
Aha Mura	3,300,000	-2,200,000
Gorenje	2,500,000	115,000
Grundfos	1,500,000	1,300,000
Benetton	1,400,000	440,000
DAD Draxlmaier automotive	1,300,000	-25,000
Trendetex	1,200,000	52,000
Confezioni Andrea	1,100,000	1,800,000
Cooper Tier Rubber	980,000	-6,700,000
Schneider Electric	855,700	-3,204,000

Table 9. Allocated state aid and net gain/loss for ten big companies in Serbia in 2013, in EUR

Source: M. Laketić, Dobili državnu pomoć, a "proizvodili" gubitke, 2015.

In accordance to European Commission (2010a) suggestions, the state's role should be oriented towards supporting all regions, not only central (Belgrade), which could diminish regional disparities that are significant in Serbia. There are a few agencies that support regional development and also the government adopted Strategy on Regional Development in the 2007-2012 period. However, there are still huge disparities within regions, indicating that set strategies were not successfully implemented. Measured by the national income per capita, as many as 29 municipalities had values below 50% of the average of the Republic of Serbia. The most densely populated are the cities Belgrade, Novi Sad and Niš, while the South cities are mostly poor, less educated and unpopulated (Grečić & Pejin, 2012).

The government has been using variety of instruments for the distribution of state aid (Figure 13). However, in the period form 2005-2014 subsidies were most commonly used, followed by tax incentives and favourable loans. There was sharp increase in 2014 in amount of funds that that the government allocated through subsidies (80%), in comparison to 2013 with 63%. However, in 2015 subsidies returned to 60% of all state aid. In 2015 subsidies were mostly

directed towards the SME sector (about 70%) and Culture and Information (about 12%) (Republic of Serbia Commission for state aid control, 2016; Republic of Serbia Commission for state aid control, 2013; Republic of Serbia Commission for state aid control, 2010; Republic of Serbia Commission for state aid control, 2007).



Figure 13. Instruments of state aid in Serbia in the period 2005-2015

Source: Republic of Serbia Commission for state aid control, *Report on state aid granted in the Republic of Serbia in 2006*, 2007, p. 24; Republic of Serbia Commission for state aid control, *Report on state aid granted in the Republic of Serbia in 2009*, 2010, p. 24; Republic of Serbia Commission for state aid control, *Report on state aid granted in the Republic of Serbia in 2012*, 2013, p. 24; Government of Republic of Serbia, *Report on State Aid Granted in the Republic of Serbia*, 2015, p. 24; Republic of Serbia Commission for state aid control, *Report on State Aid Granted in the Republic of Serbia*, 2015, p. 24; Republic of Serbia Commission for state aid control, *Report on State Aid Granted in the Republic of Serbia*, 2015, p. 24; Republic of Serbia in 2015, 2016, p. 24.

During the observed period, Serbia allocated great amount of funds to state aid, predominately subsidies. However, it has been proven that subsidies to restructuring or picked companies in Serbia were always connected with corrupt behaviour (Praščević, 2013b) As Serbia granted the status of candidate country in March 2012 it government has an obligation to, in agreed rhythm and volume, harmonize its legal system with EU, also with regards to the issue of state aid. EU 2020 strategy proposes a different amount and structure of state aid, and therefore, Serbia needs to follow those guidelines. Regarding this, it is expected that in the future the government will support more horizontal objectives (European Commission, 2016).

3.4 Foreign direct investments

There is a widespread belief among policymakers that FDI enhances a productivity of countries and promotes economic development. This belief is supported by the fact that FDI not only provides direct capital financing, but also creates positive externalities via the adoption of foreign technology and know-how. Successful transition countries such as

Poland, Czech Republic and Hungary have reduced the level of the deficit of the external sector, and came closer to realization the external equilibrium with the help of FDI inflows in a relatively short period of time (Alfaro et al., 2006). Following the examples of successful transition countries, attracting FDI was classified as one of the main goals of economic development in Serbia after political changes in 2000. The strategy of attracting FDI was focused on changes in regulations, reforms of business environment and creating fiscal and financial stimulus for foreign investors. In 2006, Serbia's government adopted Strategy for Attracting FDIs and in 2001 maintained a specially established Serbian Investment and Export Promotion Agency, whose main task was to administer the investor incentive programs. In comparison to Slovenia (1.1 billion EUR) and Croatia (1.6 billion EUR), Serbia attracted more FDIs in 2016, amounted to 1.9 billion EUR. On the other side, Czech Republic attracted 6.5 billion EUR FDIs, followed by the Slovak Republic with 3.7 billion EUR of FDI in 2016 (World Bank Group, n.d.).



Figure 14. FDI inflows in Serbia in the period 2001-2016, in million EUR

Source: Ministry of finance Republic of Serbia, *Macroeconomic and fiscal data, December 21, 2016*, 2016, Table 1.

As shown in the Figure 14, the inflow of FDIs in Serbia in the period from 2001 to 2016 was uneven. However, the observed period could be divided into two-sub periods, first one from 2001 to 2008, which was the period of increase in FDI inflows, and the second one after 2008, when FDI inflows sharply decreased primarily due to the financial crisis, but also due to political instability in the country, undeveloped institutions and rule of law. In such conditions, the largest part of the foreign capital was directed towards sectors, which were expected to return profit fast (privatization).

After the few years of adjustments to the new conditions on the market, the first significant investment was in 2003, when Smederevo Steelworks - Satid was sold to US for 23 million

EUR. After several years of successful business activities, when US Steel become a leader in exports, US Steel decided to sell Satid to Serbia at a symbolic price of 1 EUR. The record of inflow of FDI was achieved in 2006 (3.323 million EUR), primarily due to the sake of Mobtel, Hemofarm, Vojvođanska Banka and Panonska Banka. The largest investors in the observed period (2001 to 2016) were Fiat, Stada, Telenor, Michelin, Coca Cola, Microsoft, Gazprom, Intesa Sanpaolo, Siemens and others. After 2006, the inflow of FDI started to decrease, both due to the financial crisis and internal factors in economy. In 2009 FIAT invested 940 million EUR and founded FCA Serbia d.o.o. in Kragujevac. In 2011 FDI inflows increased to 3.320 million EUR and the largest investment in this year was from Delhaze from Belgium, which bought Delta Maxi for 930 million. In the following years, the amount of FDI inflows increased at lower rate and in 2016 reached 1.861 million EUR. Given the regional allocation, Belgrade attracted 23 investments out of 150, followed by Inđija (18), Novi Sad (11), Subotica (11) and Niš, Stara Pazova and Pećinci (together 14) (Radenković, 2016).

Until 2006, the highest share of FDI inflows was from Germany. After 2006 the greatest investors were investors from Austria, Norway and Greece. The greatest Austrian investment was in 2006, when Telecom Austria Group bought VIP mobile for 633 million EUR, which is still the greatest greenfield investment. Norway invested 1.6 billion EUR in Telenor and that is why this country is in the second place according to investments. The third largest investor is Greece, which invested mainly in the banking sector (Pireus, Vojvođanska Banka, Alfa and Eurobank EFG). Italy invested 940 million EUR in FIAT, and also in the banking sector (Intesa Bank, Unicredit Bank, Findomestic bank). In addition to EU countries, USA and Russia also invested in Serbia. One of the first investments was the privatization of Smederevo Steelwork from US Steel. Philip Morris invested 733 million EUR in Niš Duvanska Industrija. Russian company Gazprom invested 947 million EUR in the privatization of Naftna Industria Srbije, which was the second largest investment in Serbia (after FIAT). Also, two ex-Yugoslav republics invested in Serbia: in 2014 Agrokor (Croatia) invested in 614 million EUR in Idea, Frikom and Dijamant, and Mercator (Slovenia), which invested 544 million of EUR in the retail sector (Development Agency of Serbia, 2017b).

Figure 15 presents the sectors in the economy which received the highest amount of FDI inflows in the period from 2005-2016, measured in percentage of all FDI inflows. Until 2008, banks had attracted the most FDIs due to the huge demand for capital. Manufacturing is in the second place, however, it is evident that the highest amounts of FDI in the recent years was directed to this sector. In the observed period, the services sector received about half of all investments. In addition, Serbia lacks in receiving greenfield investments, bearing in mind that on the list of 20, the most significant foreign investors only five were greenfield investments (Mobilkom – VIP mobile, Raiffaisen bank, Merkator, BIG shopping Center and Fondiaria SAI). None of these greenfield investments are in manufacturing sector, but in telecommunications, banking, trade and real estate (National Bank of Serbia, n.d.). In the future, greenfield investments are necessary in the manufacturing sector, which will create

new jobs and stimulate the export of goods and services. Although data from United Nations conference on trade and development (2017) emphasized that Serbia attracted 14 projects (100% of total announced greenfield FDI projects in SEE), which was four projects more in comparison with 2014 there is a still need for improvements in this area because greenfield investments have multiple positive effects on creating sustainable growth. In the future, greenfield investments are necessary in the manufacturing sector, which will create new jobs and stimulate the export of goods and services (Radenković, 2016).





Source: National Bank of Serbia, Serbia's balance of payments, n.d.

During the observed period, Serbia Investment and Export Promoting Agency was working on fostering the FDI inflows in the country. From 2016 Serbia Investment and Export Promoting Agency was formally closed and its function, goals and mission took over Development Agency of Serbia. The scope of activity is the promotion of sectors and professional assistance to investors in order to foster investment activity. One of the main goals of Development Agency of Serbia is equal development of Serbia and improvement overall position of the country in the region (Development Agency of Serbia, 2017a). Serbia opened its economy during the observed period with the intention of creating a businessfriendly environment for foreign investors. Finally, according to Doing Business Report (2017), Serbia improved its business position from the 92nd place in 2006 to 47th place in 2017 out of 189 countries. This report, however, does not take into account political instability of the country, which seems to be one of the greatest deficiency of this analysis. Additionally, Serbia ranked bottom of the table when it comes to the category "obtaining permits or building permits" (186th out of 189 countries, or 264 days for getting permit). This great obstacle is especially important from the aspect of greenfield investments, where it is necessary for the investor to obtain building permits. Despite improvements in regulation and higher degree of openness of the country towards foreign capital, it is impossible to realize

positive impact of FDI in the country, which does not respect the rule of law and where economic freedom is limited by the local leaders (Ernst & Young Global Limited, 2016).

Serbia was lagging behind regional peers in terms of FDI inflows also in 2016. As written in the Strategy 2011-2020, the government will strive to create a more open economy and stable market environment for attracting more FDIs in the future. In order to attract more comprehensive FDI, structural reforms at all levels in the country are required. Serbia also needs to simplify the administrative procedures, reduce corruption, improve competition policy, strengthen financial discipline and regulate property rights. Another obstacle is the inadequate structure of workface, which calls for necessary reform in education system (Strategija i politika razvoja industrije Republike Srbije od 2011. do 2020. godine, Sl.g. RS, no. 55/2011).

3.5 Exports

Many experiences of developed countries and former transition countries indicate that the development of strong and competitive export-oriented sectors are one of the main factors in achieving sustainable economic growth. Participating in international trade has proven to be essential for former transition countries to finish its process of transition and catch up with developed world. For such a small open economy as Serbia, geographically located near a large market, exports are the most promising solution for sustainable growth (World Bank Group, 2014).

After political changes in 2000, the government strived to fully harmonize its external trade regulations and practices with EU and WTO rules. After the dissolution of Yugoslavia and strong imbalances during the 1990s, Serbia's share of export to GDP was 10 % in 1995. The process of opening of economy started after political changes in 2000. In the following years, Serbia adopted two development strategies (2006 and 2011), where the government put EU integration and opening economy to the world as one of the main priorities of the country. The country has signed multilateral FTAs with CEFTA (since 2007) and EFTA (for 2010-2014), preferential trade agreements with EU (under the SAA export to the EU market and free-of-customs for all basic agricultural products, except for baby-beef, sugar and wine) and US (Generalized System of Preferences - duty free for around 4.650 products, mainly semifinished and finished products). Serbia has signed three bilateral FTAs with Russia (since 2000), Belarus (since 2009), Turkey (2010-2015) and Kazakhstan (since 2010) and is now on undergoing negotiations with Ukraine (United States Department of State, 2013).

In 2016 Serbia exported 13.4 billion EUR, which is an increase of 56% since 2009 and 85% since 2001. Based on the statistics from the International Monetary Fund's World Economic Outlook Database, export accounted for about 14.6% of total economic output of the country in 2016. The trade deficit in 2016 was 4.3 billion EUR. From the perspective of main traders, this category has been changing also as a consequence of policy that the government was implementing after 2000. Based on the data from the Statistical Office of the Republic of

Serbia (2017c), Serbia's main trading partner in 2000 was EU (51.5% share of exports), followed by CEFTA members (32.3% share of exports), while export to Russia was 5.5% of all exports. This situation has changed in favour of EU countries (EU accession, trade agreements, EU support strategies and assistance to Serbia), whose share to Serbian export had increased (65.7%) in 2015. This was followed by signatories to the CEFTA agreement with 21.7% of total export. Share of export to Russia stayed at the same level (5.4%). In exports, the main foreign trade partners in 2016 were Italy (2 billion EUR), Germany (1.8 billion EUR), Bosnia and Herzegovina (1.1 billion EUR), Romania (790 million) and the Russian Federation (740 million EUR) (Crnomarković, 2010).

Changes in the structure of exports by sectors according to Standard International Trade Classification (SITC) are illustrated in Figure 16. We can observe that the structure of export in 2001 qualitatively worsened when compared to the 1990, due to significant decrease in share of machinery and transport equipment (SITC 7), while the share of agro-food category had increased (SITC 0+1). On the other hand, dominance of different finished products is recorded, both in 1990 and 2001 (SITC 6+8), primarily for clothing, footwear and metals. Distribution of export remained pretty much the same in 2008, with the highest share of different finished products (SITC 6+8). In 2008 the share of machinery and transport equipment increased when compared with 2001, while share of agro-food category remained the same (National bank of Serbia, n.d.).



Figure 16. Structure of Exports in the Republic of Serbia according to SITC in the period 1990-2016, in %

Source: National Bank of Serbia, Serbia's balance of payments, n.d.

The most significant shift was from 2008 to 2013 in terms of share of machinery and transport equipment and the share of different finished products in total exports. In fact, the share of machinery and transport increased to 31%, while the share of different finished products decreased to 32% of total exports. Share of agro-food category remained slightly higher in 2013. A significant year for economy was 2008, when FIAT took over the lumbering Zastava factory for 940 million EUR, when the factory was completely overhauled for the production of the new brand-new Fiat 500L mini MPV. Also, from 2009, when Serbia signed SAA, its economy was regulated by suggestions, assistance and guidance from European Commission, whose influence could also be seen from export distribution in the observed period. In 2016, although share of different finished products had the highest share of export, the share of machinery and transport equipment remained at high level (one third of total export) (Crnomarković, 2010).

Figure 17 shows top 6 export categories that contribute to export in the sector of manufacturing in Serbia during the 13-year period. In 2004, the highest share in category of manufacturing belonged to the subcategory of manufacture of basic metal and subcategory manufacture of food product (19.8 % and 18.8%, respectively), while subcategory manufacture of vehicles and the manufacturing of electrical equipment had minor share of exports (2.1% and 2% respectively). Vehicles were the fastest growing export subcategory among top 6 categories, from only 2.1% of share in category Manufacturing in 2004 reached 14.5% of share in 2016. On the other side, share of manufacture of basic metals and export of chemical and chemical products decreased in the observed period (Figure 17).

Figure 17. Distribution of top six categories within export of Manufacturing products in Serbia in the period 2004-2016, in %



Source: National Bank of Serbia, Serbia's balance of payments, n.d.

Exports in Serbia are still characterized by unfavourable sectoral structure and dominant products are mainly raw materials and semi-finished products (which accounted for more than 50% of total exports) (National bank of Serbia, n.d.). Despite improvements over the last several years, Serbian exports are lagging far behind regional peers bearing in mind that in Slovenia export to GDP in 2015 was 77.9 % and in Croatia 49.4%. It is also lagging far behind Slovakia (93.5%), Hungary (90%), Czech (80.3%) and Bulgaria (64%), which share of export in GDP was higher than 60% in 2015 (Exports of goods and services (% of GDP), n.d.).

The government needs to engage in a strong and coordinated push to improve trade position. Serbia has great potential in developing exports. However, export of goods and services accounts currently for 46.7% of GDP, which is far behind in comparison to advanced transition economies (this ratio is above 80%). Serbia has strong export potential in some sectors, like the automotive and chemical industry, which is in the line with EU 2020 strategy of fostering industry sector. Also, Serbia has a great potential in agribusiness and service sector. Strengthening export is one of the main goals in Strategy for 2020. Achieving the share of exports of goods at the level of 47.1% and increase the export of the products in the processing industry are projections that are planned until 2020. Those will result in reducing the trade deficit, which will open economy more towards the other countries (Dobromirov et al., 2012).

3.6 Small and medium sized enterprise (SMEs)

Small and medium-sized enterprises are the backbone of modern economies, as they account for over 90% of companies and provide more than 85% jobs in EU. SMEs are main players in the market, having substantial influence in creating GDP and added value. In their book, Stiglitz and Greenwald (2014) emphasize that the SMEs are the engine of the economic growth with positive effects on the entire economy and society in the country.

According to the recent data, the SME sector in Serbia is dominant in terms of number of enterprises, employees, turnover and added value in comparison with big entities. As presented in Table 10, the number of SMEs increased in the observed period and the majority of enterprises in 2015 operated in trade (29.1 %), while only 0.1% of them were present in the manufacturing sector. On the other side, the number of big entities in the observed period had decreased (from 504 to 494) and in 2015 they were present in the manufacturing sector (41.3%) the most, followed by trade (14.9%), information and communication (4.1%) and Agriculture (2.83%). The SME sector accounted for 66% of the country' employment and created 56% of added value. Majority of employed people in 2015 worked in manufacturing sector, those who operated in this sector created 25% of added value and had 1.421.201 million RSD of turnover. This sector is mainly driven by the automotive industry, and had great possibilities to foster economic growth and sustainable development of the country. Big

entities were mainly operated in manufacturing and had a turnover of 1.342.27 million RSD. SME that operate in the manufacturing sector earned 1.5 billion EUR in 2010, which doubled in 2015 and amounted to 3.1 billion EUR. In 2015, the highest share in export of manufacturing from SME accounted for paper products and manufacturing paper, rubber and plastic products (Kovačević, 2017).

	Small and medium-sized enterprises				Big enterprises			
Indicator	2010		2015		2010		2015	
	Number	%	Number	%	Number	%	Number	%
Number of enterprises	318,540	99	324,600	99	504	1	494	1
Manufacturing	429	0.13	447	0.14	215,000	42.66	204	41.30
Wholesale and retail								
trade; repair of motor	98,550	30.94	94,220	29.03	68	13.49	74	14.98
vehicles and								
motorcycles								
Information and	7 308	2 29	9 975	3.07	15	2.98	20	4.05
communication	7,500	2.29	9,975	5.07	15	2.90	20	4.05
Agriculture, forestry	5 913	1.86	5 756	1 77	14	2 78	14	2.83
and fishing	5,715	1.00	5,750	1.77	17	2.70	14	2.03
Persons employed	814,585	66	801,719	66	412,966	34	418,538	34
Manufacturing	235,134	28.87	224,075	27.95	139,163	33.70	139,857	33.42
Wholesale and retail								
trade; repair of motor	234 853	28.83	223 395	27.86	48 997	11.86	58 091	13.88
vehicles and	234,033	20.05	223,375	27.00	40,777	11.00	50,071	15.00
motorcycles								
Information and	22 269	2 73	26 111	3.26	16.075	3 89	17 807	4 25
communication	22,207	2.15	20,111	5.20	10,075	5.07	17,007	т.23
Agriculture, forestry	26.611	3 27	22 786	2 84	13 327	3 23	11 946	2.85
and fishing	20,011	3.21	22,700	2.04	13,327	5.25	11,740	2.05

Table 10. Main indicators of the SME sector in Serbia for 2010 and 2015

Source: M. Kovačević, Preduzeća po veličini i preduzetnici u Republici Srbiji 2010-2015, 2017, pp. 16-99.

According to the SBA (2016) profile, SME sector in Serbia was not in the line with EU average and it performed in almost all aspects below the EU average in 2015. The main obstacles are within section "administration", "access to finance", "internationalization "and "skills and innovation". Serbian economy is characterized with long and complicated administration. Number of taxes that has to be paid within year is much higher that EU average hire time needed for paying tax is almost 50% longer than EU average. Another obstacle in developing this sector is access to finance. According to SBA profile, Serbia's performance in this aspect is way bellow EU average. In Serbia, bad debt loss amounts to 10% of total turnover, which is significantly higher that EU average of 4%. Respondents in Serbia cited access to public financial support as one of greatest problems in the development of this sector (Organisation for Economic Co-operation and Development, 2013). Serbian SME sector performed way below average when it comes to sections such as: time and cost of import and export documentary compliance.

Serbia adopted several policy measures in order to facilitate access to finance for SME, such as the Law on Factoring, APEX loan (which is favourable loan for exporting SMEs) and access to funds of the Western Balkans Enterprise Development and Innovation Faculty. Although interest rates for loans in this sector decreased, it remained high. Also, with only 0.1% of state aid directed towards this sector, the alternative sources of financing this sector should be developed. When it comes to skills and innovation, Serbia has a problem with the "brain drain" of the skilled population (World Bank Group, 2012). Number of SMEs that had introduced a product, process, marketing or organizational innovations increased and remained close to EU average. Serbian investment and export promotion agency supports the visibility of Serbian SMEs on foreign markets, however the number of document required to export or to import and associated costs are significantly higher than EU average (European Commission, 2015).

A number of steps has been taken in the past, as Serbia adopted the European Charter on Small Enterprises in 2003, with the aim of supporting the economic reforms process by promoting development of the SMEs. In 2008, the government adopted a key document in this sector, the Strategy for Development of Competitive and Innovative Small and Medium Enterprises for the period 2008-2013, which fully respects the guidelines presented by EU. In that document, the government defined the strategic objectives and directions for the development of SMEs. In addition, supporting private sector and privatization of state-owned enterprises are recognized in Strategy 2011-2020 as key priorities for Serbia in the future. Also, in March 2015 the government adopted Enterprise and Industrial Strategy for 2015-2020, which was in the line with the principles of Small Business Act (SBA). In 2015 new Law on Investment had been adopted with the aim of improving the institutional framework. The year 2016 was a year of entrepreneurship, and Serbia joined Competitiveness of Enterprises and Small and Medium-sized Enterprises (COSME), which is an EU program encouraging entrepreneurship and improving business environment. The government established the Serbia Investment and Export Promoting Agency and then Development Agency of Serbia in order to support this sector more. However, there is still a lot of place for improvement and the main problem in development of SME sector is access to finance. Although in 2016 budget, the financing of this sector has increased, as 33 different assistance programmes for SMEs had been introduced, this sector needs more support of this kind from the state. Reducing and simplifying the regulatory system is also necessary in the future (Erić, Beraha, Đuričin, Kecman, & Jakšić, 2012).

3.7 Industry

Like many EU countries, Serbia experienced a trend of de-industrialization in the last three decades. War conflicts, the UN sanctions, NATO bombing and economic and political crisis hit the economy hard, especially the industry sector (Stevanović, Milanović & Milačić, 2013). After the dissolution, Serbia experienced an extreme process of de-industrialization, with very

fast expansion of the services at the expense of industry and agriculture. The trend of industrial production is shown on the Figure 18.



Figure 18. Index of Industrial production in Serbia in the period 1989-2016, index 1989=100

Source: S. Milivojević, Reindustijalizacija Srbije u cilju jačanja srpske privrede, 2014, p. 555.

During the 2000-2008 period, economy grew at 5% annually, driven by expansion of services, while at the same time the rate of growth of industrial production was around 1%. From 2000, Serbian government accepted a new concept of development – the Washington Consensus in order to achieve macroeconomic stability. With this new paradigm, which was based on deregulation, liberalization and privatization, economy become more suitable for the expansion of service sector. During the first decade of 21st century, de-industrialization continued. Such de-industrialization was not recorded in any of the EU countries after World War II, where industrial production in 2016 was only 38.6% of achieved in 1989. In 2016, Serbian economy was characterized by a large service sector and a very low share of manufacturing added value. With the share of manufacturing industry of GDP in 2016 below 20%, Serbia is lagging behind the most CEE countries (Hungary 25%, Slovenia 24%, Slovak republic 23%) (Manufacturing, value added (% of GDP), n.d.).

Process of reindustrialization and opening up economies could lead also to some negative effects. Firstly, the more the economy is open, the more it becomes sensitive to the external shocks (financial crisis 2007). Secondly, trade and openness requires from countries to adjust the business structure, wages and costs. This is why developing countries in order to gain a price advantage and attract foreign capital, cut costs and wages. All of this negatively affects economies. A significant trend of establishing corporate farms in developing countries opens up the question about pollution and environment protection. It has been proven that developed countries ignore costly environmental standards in host country which result in environmental pollution (Kedaitisa & Kedaitieneb, 2014). The recovery of the industry leads to the decrease

in employment, drop in earnings, decreasing exports and instability in international relations. Fostering industry could have negative impacts on inflation, deficit in the budget and deficit in the current balance of payments. Foreign debt, as result of many measures and activities in the country, could be increased and could further stir up economic stability and growth. Regarding this, social and political problems are more likely to happen. Chmielewski (n.d.) points out that negative effects of opening the countries to the world and industrialization are more visible in developing countries.

However, reindustrialization, as a method and policy for development, has proven to speed up the economic development of the former socialist country economies'. It has been proven that focusing on industry and fostering this sector has a positive spillover effect on the whole economy. This is also confirmed by the positive experiences of the East European countries (examples of Czech Republic, Slovakia and Hungary), which have already gone through the phase of development in which Serbia currently is.

4 EVALUATION OF THE INDUSTRIAL POLICY OF THE REPUBLIC OF SERBIA AND FUTURE DEVELOPMENT

Serbia's economic policy before the crisis was unsystematic and mainly focused on achieving short-term goals. Due to frequent elections in the period 2000-2008, most of government actions were characterized by great dependence on political factors. Former "model" of economic development brought large internal and external imbalances in the economy, great presence of corruption while both economic and political institutions were underdeveloped. As financial crisis escalated and previous model of growth proved unsustainable, a new Strategy of development become necessary in Serbia (Praščević, 2013a).

Since Serbia's main strategic goal is EU integration, it strives to align legislative, policy and regulation with the EU. In 2011, the Serbian government introduced the Strategy 2011-2020 which was fully aligned with the European Strategy 2020. This was the first development document on industrial policy in Serbia which emphasizes (1) importance of a structural shift with a focus on industrial growth, investment and exports and (2) accelerating reforms and European integration (Strategija I politika razvoja industrije Republike Srbije od 2011. do 2020. godine, Sl.g. RS, no. 55/2011).

The final goal of the Strategy for 2011-2020 is to increase employment, the development of the industry and changes in the industrial structure in favour of high-tech industry, increase in exports and foreign trade surplus and thus achieve and maintain macroeconomic stability as the first precondition for the sustainable growth of the economy (United States Agency for International Development, 2010).

There are five main measures and activities highlighted in the Strategy 2011-2020 (Strategija I politika razvoja industrije Republike Srbije od 2011. do 2020. godine, Sl.g. RS, no. 55/2011):

- Strengthening the institutional framework and stable business environment,
- Fostering competitiveness and productivity,
- Supporting of entrepreneurship,
- Effective restructuring and privatization,
- Encouraging certain sectors recognized as competitive by using horizontal and vertical measures.

Main macroeconomic indicators of achieved results in 2016 and projections for 2020 presented in the Strategy are shown in Table 11.

Table 11. Main economic indicators in Serbia - projections and achieved results, 2016 and 2020

Indicators	Projections for 2020	Achieved by 2016			
		GDP growth in 2016 was 2.8% which			
GDP growth (in %)	Increase 5.8% annually	is still not at the pre-crisis level (in			
		2008 GDP growth was 5.8%)			
GDP per capita (in EUR)	8,000	4,821			
Employed people	3,000,000	1,921,000			
Employment in industry (%)	26.4	19.1			
Monetary policy Focus on reduc	Focus on reducing inflation	Inflation was sharply reduced from			
	Toeus on reducing initiation	12% in 2011 to 1.2% in 2016			
Government expenditure to GDP	12.4	40.9			
(% of GDP)	12.1				
Current account deficit (% of GDP)	3.3	4			
Fiscal deficit (% of GDP)	1	3.7			
Public debt (% of GDP)	40	72.9			
	Cumulative net inflow of 22.7	Cumulative net inflow of 10.3 billion			
Foreign direct investments	billion EUR in the period				
	2011-2020	in the period 2011-2010			
Share of exports of goods and	65	50.9			
services (% of GDP)					
Share of exports of goods (% of	47 1	39.2			
GDP)		57.2			
Trade deficit (% of GDP)	12.4	11.6			
Share of industry in GDP (% of	19.1	31.20			
GDP)	17.1	51.20			
Share of service in GDP creation	52.9	60.5			
(% of GDP)	52.7	00.5			

Source: Strategija i politika razvoja industrije Republike Srbije od 2011. do 2020. godine, Sl.g. RS, no. 55/2011.

Over the past two decades, Serbia has been facing with unstable institutional development. Politically motivated policymakers are the limiting factor and despite the progress in certain areas, competence and motives of certain policymakers in the country are questionable. Serbia suffers from a lack of major institutional solutions for overcoming systemic corruption and preventing rent seeking activities. Although the government adopted Law on Public Procurement in 2012 with an aim of preventing corruption, this still remains the key issue in Serbia (European Commission, 2016).

As Praščević (2013b) claims, corruption in Serbia is the result of the abuse of power by government to getting their own benefits. In this regard, resources are redirected to rent seeking activities which in turn impair efficiency and cut down growth. Motivation for rent seeking is often connected to politicians, who as policymakers create conditions to come to power or stay at that position by redistributing resources. Generally speaking, the state often encourages corrupt behaviour through spending for subsidies and incentives and manipulation of interests group or individuals. This is why building a market economy should be focused on reducing motivation of those economic agents who accept to be corrupted. In the future, the improvement of institutions and institutional framework should be the backbone of economic development and competitiveness of the country.

Overall, Serbia has improved its business environment over the last two decades. According to Doing Business Report (2017) Serbia increased its position from 47th in 2017 from 88th in 2010 (out of 190 countries). The main improvements were simplifying the process of starting businesses and property transfer. Also, in 2016 Serbian government implemented online system which reduced time for dealing with construction permits (World Bank Group, 2017). This report, however, does not take into account the political instability of the country, which seems to be the greatest lacking in this analysis. However, Serbia ranked at the bottom of the table when it comes to the category "obtaining permits or building permits" (186th place out of 189 countries, or 264 days for getting permit). This great obstacle is especially important from the aspect of greenfield investments because one of key processes for investors is to obtain building permits.

From 2011, Serbia's economy experienced two recessions (economy contracted in 2012 and 2014). As presented in Table 11, Serbia's growth in 2016 was 2.8% of GDP which was not even at pre-crisis level and it was far below predictions for 2020 of 5.8% of GDP (or 52.7 billion EUR which is 8,000 EUR per capita). Poor economic growth in Serbia is partially a consequence of the financial crisis, however, political instability and errors in economic policy in the past resulted in overall adverse economic trends. Growth is burdened with elections, large financial debt, actions from politically motivated government and populism. According to the Strategy 2011-2020, Serbia's government is committed to growth based on FDI inflows and fostering export. The state has undertaken some steps for realization set goals (visa-free access for Schengen area, signed agreements with EFTA, Law on the Protection of Competition and about 300 contracts on the granting of incentive funds were signed to attract investors.). Although some improvements have been recorded in business environment,

Serbian environment is still characterized by high levels of uncertainty, red tape and informal economy. Additionally, corruption highly discourages foreign investors to invest in Serbia since corruption is present also at the lowest level of government. Absence of right conditions on market enables private companies to be productive and profitable (United Nations Office on Drugs and Crime, 2013).

All this contributed to the sharp decline in FDI inflow after 2011. During the period 2011-2016 only 10.3 billion EUR of FDI was attracted to Serbia. In order to achieve the ambitious plan set by Strategy that by the 2020, Serbia shall attract 17 billion EUR of foreign investments, overall economic and political situation in the country has to be improved and corruption eradicated (Table 11). Also, much more investments should be directed toward the manufacturing sector as learning benefits of FDI are greater than in any other sector. Slowdown in economic activity affected export due to global reduction in demand. Share of exports in GDP had increased for more than 50% in the period from 2008-2016 and in 2016 amounted to 50.9% of GDP, however, Serbia is still lagging behind regional peers. As a small country whose internal market is not sufficient to fuel economy, for Serbia it is extremely important to become more open and achieve goal set by Strategy 2011-2020 of 65% of GDP of exports of goods and services while 45% of that should be only exports of goods which will reduce the trade deficit to 11.6% of GDP (Table 11). According to relevant data, it is expected that the share of export of GDP will amount 65% up to 2020. On the other side, unfavourable structure of exports where more than 50% of export is composed of semifinished products (United States Agency for International Development, 2013).

During the entire period, Serbian government was focused on price stability, therefore on monetary policy. From 2011 the inflation was stable and at historically low levels. So far regime of inflation targeting and flexible exchange rate have proven to be unsuccessful. In developing economies with unstable monetary policy (as Serbia) it has been proven that depreciation of exchange rate will not result in the increase in export and reduction of current account deficit. The reason is low competitiveness of those economies, which in turn used to experience only increase in prices (i.e. inflation) and the increase in imports with final result of the increase in current account deficit. As discussed in the second part of the paper, with Serbia as highly import-depended country there are no positive effects of the depreciation of national currency predominately due to low competitiveness of Serbian export (Nikolić, 2010).

Praščević (2013a) asserts that focus should be more on the financial side. In this context, consolidation of public finances should be the first task for the future. There is a positive correlation between public debt and degree of political polarization and fiscal developments and situation in Serbia's fiscal policy proves this. Polarized policymakers used to stimulate Serbian economy during the crisis however those stimuli have often been related to abuses of economic policy and it has been proven that fiscal policy in Serbia differs in the pre-electoral period and in election years. In their study, Ebeke and Ölçer (2013) have proven that during election years there is a significant increase in public investment, subsidies and lending since

voters prefer quick and easily visible results especially in poorer countries. In the line with that, in 2012 when Serbia held parliamentary elections, uncontrolled government spending resulted in the increase in public and external debt.

In 2015 and 2016 Serbia achieved strong fiscal adjustments and fiscal deficit was reduced to 1.5% of GDP in 2016. However, fiscal adjustments were achieved by reducing salaries and number of employees in public sectors and increasing taxes (Arsić et al., 2017). Ambitious projections published in the Strategy 2011-2020 (government expenditure at 12.4% of GDP) are hardly achievable by 2020 with the past practice and actions undertaken by government (Table 11).

One of the greatest weaknesses of Serbian economy is education system and the labour market. Although the education system in Serbia had at least twenty reforms in the last three decades, those were partial and did not meet requirements of the market. According to data from the Statistical Office of the Republic of Serbia (2017a) number of persons having attained higher education in Serbia is growing each year (from 238 thousand students in 2006 to 252 thousand of students in 2016). However, the greatest problem in the education system is the quality of education and lack of a good strategy, making graduates unresponsive to labour market needs. Regarding this, each year in Serbia there are more students enrolling in private universities where the quality of studies is low. Also, mismatches in workforce and needs of the economy create a mismatch of supply and demand which creates a bottleneck in the growth of Serbian economy. Serbian education system does not prepare students for future actual work. There is a very small number of training, practices and study cases where students can upgrade their theoretical knowledge and improve their employment prospects. So, the general observation is that the Serbian education system needs to cooperate with entrepreneurships, needs to encourage innovation and development of knowledge based economy and support more work-based learning (Strategija i politika razvoja industrije Republike Srbije od 2011. do 2020. godine, Sl.g. RS, no. 55/2011). Another problem is that a huge number of young people enrol social sciences such USAID as law or business sciences (20.9 % of adults) while only 7.7% of enrolled students in 2016 studied information technology and computing. Employment policy creates experts in the fields which are not needed on the labour market and still does not take into account the situation that the unemployment rate of graduates in fields of economics and law is among highest in the country. Additionally, more than 85% of unemployed people acquired high level of education diploma. In 2015 about 43% of people up to 24 years who hold tertiary education diploma were unemployed. On the other side, there is a lack of professionals such as welders, moulder and bricklayers and primary school graduates have not been interested to enrol in school for these professions for many years (Grečić & Pejin, 2012). Regarding this, Serbian government could through a budget-funded strategy promote some professions in order to meet the market needs.

According to the most recent data, public expenditure on Serbian education was 4.3% of GDP in 2015 which is in the line with EU average, however, the quality of education is way below

EU average. The general observation is that education has to correspond more to market needs, that industry and education has to be more correlated and related. Students need more practical and useful knowledge that will make them competitive on market. Knowledge is the basis of modern economies and so in Serbia government has to focus on implementing strategies, coordinating institutions and supporting this sector which represents a main fuel of economic development (Strategija i politika razvoja industrije Republike Srbije od 2011. do 2020. godine, Sl.g. RS, no. 55/2011).

The overall situation of the labour market is catastrophic in Serbia. Unemployment in Serbia is two times higher than the EU average (19.4% and 9.6% in 2016, respectively). Ongoing reforms of the education system did not yield the expected results. Emigration of young people is high and large number of experts (predominately medical students and IT students) leave the country which is an irrecoverable loss for the country. Ambitious projections for 2020 are hardly achievable (3 million of employed people with share of employment in industry at 26%) without actual governments' commitment (European Commission, 2016).

Presence of the state is high in Serbia. The role of state has been directed mostly towards supporting SOE through huge allocation of subsidies and state aids while policymakers create economic policy and overall macroeconomic environment through monetary and fiscal policy (European Commission, 2016). As Praščević (2013b) claims, policymakers in Serbia and their actions have often been interconnected with polarized motives. According to the Strategy, the government is committed to a wide range SOE reforms in regards of cutting direct and indirect subsidies, limiting insurance of new subsidies as well as improving transparency and better monitoring of those companies. Still, huge amounts of state aid (2.6% of GDP) were allocated in 2015, and most of it was directed towards restructuring of enterprises, through subsidies. As discussed above, one of the main obstacles of economic development of Serbia is the great presence of corruption and rent seeking activities. Despite limited process in some cases, policymakers have not still presented institutional solutions to reduce corruption and prevent rent seeking activities. The overall negative trends during and after the financial crisis put a great deal of responsibility to policymakers in Serbia, whose actions has always been connected towards their own interests and holding power.

In the Strategy 2011-2020, Serbian government recognized five sectors as a priority for development: Agri-food, Auto-transport, Information and Communication Technologies (hereinafter: ICT), Metal industry and Pharmaceutical industry. According to the most recent available data, ITC sector grew from 280 million EUR to 410 million EUR in the period from 2005 to 2014. This sector in 2016 employed about 15 thousand workers in private sector while the unemployment rate in ICT sector is 0%. Salaries are more than attractive bearing in mind that they are among highest in Serbia with 1.000 EUR for junior programmers and more than 2000 EUR for senior programmers (which is more than four times above average salary in Serbia) (Serbia Investment and Export Promoting Agency, 2015). IT sector plays a significant role in Serbia's export. Infrastructure for the ICT sector has been highly improved in the last years with an aim to catch up to the level of EU countries in the following years.

Also, cooperation on national and international level has been improved as a number of clusters had been established in Serbia (NiCat Cluster, ICT Net, Vojvodina cluster) (United States Agency for International Development, 2013). Serbian government fosters the ITC sector by stimulating ITC companies' fair attendance and increasing the University enrolment quotas. Due to very good cooperation between Universities and the private sector, ICT sector absorbs a majority of ICT graduates. Furthermore, government conducted the Development Strategy and Support to the Information Technology Industry in 2013 and adopted number of regulations in this sector in order to make better a climate for the development of the ICT sector. Automotive industry has a long tradition and great potential to be further developed. In 2016, the automotive industry contributed to Serbian export with 15.9% which is for 7.2% higher than in 2015. In 2015 the total turnover of automotive industry was 2.5 billion EUR. FIAT Chrysler Automobiles Serbia produced over 100,000 FIAT 500L vehicles and generated almost 1.4 billion euros of turnover, which took the first place on the list of the biggest exporters in Serbia (Development Agency of Serbia, 2017b).

On the other side, due to good climate and fertile soil, Serbian food industry is recognized as one of the strongest points of Serbian economy. Bearing in mind that trade balance of agricultural products is in constant surplus (in 2016 it amounted to 1.6 billion EUR). Serbia is the biggest exporter of food products among CEFTA countries. Fruit production is significant, bearing in mind that in 2015 Serbia accounted for 21% of the whole world raspberry production. Altogether, export of Serbian fruits in 2016 amounted to 573.4 million of EUR. Measured by value, plum and apple are the most dominant, accounting for 463.115 tons of plum and 328,369 of apples. This industry employs about 4000 people (Development Agency of Serbia, 2017a).

The development of these sectors can support Serbian future growth and catching up with developed countries. In addition, it is also in line with EU strategy of creating knowledge based economies. Further fostering of these sectors will create new jobs and reduce the huge unemployment rate especially among young people. Then, creating favourable conditions for the IT and automotive industry development could kept a lot of quality young people in the country. Due to its large share of export, it could contribute to sustainable growth of the country in the future. ICT and automotive industry also have an impact on industrial structure of the country which should be changed in the favour of industry. Development of ICT and automotive industry are drivers of smart and sustainable growth and competitive environment (Katić, Milošev & Raletić, 2013).

Overall, Serbian economy has been facing strong trends of deindustrialization even before the global crisis. Government in its Strategy 2011-2020 is committed to a new growth model based on industry, however, so far it lacked realization. In addition, the structure of Serbian economy slightly changed in favour of the industry sector: creation of industry in GDP has increased from 29.5% in 2011 to 31.3% in 2016 while total industrial production in this period was pretty much on the same level (in 2016 was only 38 % of achieved in 1989). According to projections, the share of industry in GDP creation by 2020 should be 19.1%

while share of the service sector should decrease to 52.9% (Table 11), which, based on previous analysis, is hardly achievable. In the structure of Serbian economy, the labour-intensive sub-sector prevails. Employment in industry had decreased in the same period from 26.8% to 24.4% (2011 and 2015, respectively). About three quarters of employed work in low-tech and medium-low tech sub-sectors (Bošković, 2011).

CONCLUSION

Sustainable development growth became important in Europe after the financial crisis escalated. Regarding this, many theorists and policymakers gave their vision of how EU economies should be developed in the future. There are three main approaches to industrial policy in theory (Stiglitz and Greenwald, Aghion, and Spector), which are applicable to different countries, depending on their level of development. However, it is extremely important to emphasize that there is no one model that should be followed that would produce favourable results.

Before and after financial crisis, politically motivated policymakers created strong internal and external imbalances in Serbian economy. Regarding this, the first strategic document on industrial policy in Serbia was introduced in 2011 with a main goal to catch up with developed world. In this document, the government presented a new model of growth based on exports demand, industrial production and investments in tradable sectors. Despite some improvements made in the macroeconomic environment in recent years, Serbia failed to achieve macroeconomic stability until 2016.

Based on the analysis that was done for Serbia, we made some conclusions and recommendations for the future development considering the following points:

First of all, Serbia opened its country more and become more export oriented. In recent years, the economic growth was backed by the increase in exports, rather than domestic consumption, which is fully in the line with new growth model. Further simplification of business conditions and informational support to domestic companies about potential exports market are important requirements for the further facilitation of exports.

Secondly, Serbia has a great potential in ICT and automotive sectors. Further development of those sectors is the main driver of smart and sustainable growth, which could finally contribute to creating new jobs and increase in exports. Fostering of ICT and automotive sector will have an impact on industrial structure of the country, which is expected to turn more towards knowledge and sustainable development of the country.

Thirdly, Serbia made limited improvements in the business environment. In recent years, Serbia simplified the process of starting up a business and property transfer. Since the precondition for getting greenfield investments is obtaining building permit, Serbia was ranked low among countries when it came to time required to get permits, the government should focus more on simplifying and speeding up this procedure in the future.

Fourth, economic growth and inflow of FDI are burdened by an unstable political situation, large fiscal imbalances and corruption. Market economy should be focused on reducing motivation and chances of all forms of corrupted and polarized behaviour and rent seeking actions. Consequently, fiscal imbalances will be easier to keep under control and improve through monitoring with business and tax procedures. In the future improvement of institutions and institutional framework should be the backbone of economic development and competitiveness of the country. It is necessary for Serbia to build a good relationship between public and private sectors, as well as among different industries to overcome issues, such as the lack of information for business.

Fifth, the presence of the role of the state in creating conditions for the economy is high. The government supports large companies through state aid (subsidies). However, this was proven to be inefficient and the government should not repeat the same mistakes. The government should allocate financial funds towards scientific institutions and faculties, which could contribute to developing new technologies and knowledge. This is why the government's presence in the education system is essential, in creating adequate supply for market needs. Additionally, the government should support competitive sectors because they can contribute to sustainable growth and building a knowledge based economy.

Last but not the least, industrial strategy implementation in the period 2011-2016 was to some extent a waste of time and financial resources. Overall, we can conclude that Serbia has designed strategy on development professionally, but the process of implementation failed to achieve set goals and actions. The overall structure of the economy has slightly changed, however, Serbia needs more aggressive shift towards the industry sector in terms of higher share of exports, FDI, employment and creation of GDP. To succeed, the strategy has to be supported by the government at every level and at the end of the process it has to be evaluated. Only good cooperation between the private and public sector, and real support from the government, can create conditions for the successful implementation of a well-designed strategy in the future and achievement of the set objectives.

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