

**Dragan Đuričin**

University of Belgrade  
Faculty of Economics  
Department of Business Economics and  
Management

**Iva Vuksanović**

University of Belgrade  
Faculty of Economics  
Department of Business Economics and  
Management

# HOW TO BE AHEAD OF THE CURVE: THE ROLE OF POLITICIANS IN SERBIA'S REINDUSTRIALIZATION

Kako biti ispred trenda:  
uloga političara u reindustrijalizaciji Srbije

## Abstract

The implosion of Yugoslavia and economic sanctions which were imposed to Serbia by international community automatically pushed the country into depression. With 60% drop in output and mega-inflation the economy in 1993 passed through near-death experience. The legacy of depression demonstrates its severity up to these days.

From Serbia's perspective the principal consequences of the implosion of Yugoslavia are as follows: deepening of old structural imbalances, population migration (including brain drain), and substantial damage to institutions (rules, systemic laws, regulatory bodies, prevailing behavior of economic agents, etc.). Epilogue was a long and deep transitional recession. Serbia's economic fact sheet shows that the economy is not sustainable. To escape a low-growth debt trap Serbia needs a spectacular turnaround. Without radical reforms the threat of default could develop into a full-blown crisis. Damage to the economy from a short shutdown is likely to be limited to economic risk. A longer shutdown could be quite harmful and extend to political and geopolitical risks as well.

When you lose confidence, bright people and institutions, turnaround asks for some forces to take the lead in providing a wide range of economic reforms. The role of politicians in that process is unavoidable. But, it is not a trivial task. It is exactly the challenge that makes the triumph of reforms so rewarding. Done well, undertaken with a clear vision and organically, the exercise of reforms becomes a venture that can renew both the economy and political leadership. In that context the key question for Serbia's politicians is: what is the strategy to resurrect the economy and restore its credibility in business community?

Money created by stimulus (or quantitative easing) is not applicable in the case of Serbia because it is not possible to refer to "too big to fail" argument in almost irrelevant and deindustrialized economy. Turnaround is a challenging request for politicians as initiators and facilitators of reforms because they must keep all parts of society in balance while switching toward the new trajectory of economic development.

The very first step in Serbia's reform journey is integration with the EU. For lower income economy like Serbia, compatibility with the EU opens the door to convergence effect. While Serbia is becoming politically closer to the EU, it is also becoming economically more vulnerable. As a consequence, a pressure on political leaders to make structural reforms is increasing.

Economic reforms need conceptually heterogeneous approach. Macroeconomics looks at the economy from a helicopter perspective. But, it is not the only relevant perspective. Business (or microeconomic) perspective also matters. This is especially true when we are in the process of closing the output gap as the main long-term effect of sustained disequilibrium. Exploring the idea exposed in our previous articles [2], [3] and [4] we focus on various aspects of the reindustrialization strategy. The purpose of this paper is shift to another perspective, the analysis of the role of politicians in this process.

What skills and mindsets do politicians need to possess to be initiators and facilitators of reindustrialization? First and foremost, they must be strategists. Their goal is to build something that is not there yet but it is achievable and effective.

Strategy is anchored in a clear and compelling vision (or purpose). National economies should exist for reason. But, vision is not a strategy. Strategy is more than a great idea what to do, more than inspiration or a dream. It is a system of activities, a set of mutually reinforcing components under the umbrella of vision. Success of strategy is not due to a host of one simple activity, but to the implementation of great idea in an intricately woven system of activities that work in concert. It is a way of implementation of *J. Schumpeter's* idea about creative destruction, to be "ahead of the curve".

How is the article structured? Before we elaborate arguments for reindustrialization, we seek to understand past mistakes in former economic policies to avoid repeating them again. The previous aspects

will be presented in introduction. Economic revival depends on new vision, on where we are heading. It is the principal point of two successive parts of the article dedicated to structural changes in the global economy and in Serbia, respectively. The fourth part provides proposals for reindustrialization as conceptual platform for economic revival. Before conclusion, the final part clarifies the role of politicians in reindustrialization of Serbia.

**Key words:** *reforms, reindustrialization, politicians, industrial policy, macroeconomic policies, Serbia*

## Sažetak

Raspad Jugoslavije i ekonomske sankcije koje je uvela međunarodna zajednica automatski su gurnuli Srbiju u depresiju. Sa padom proizvodnje od 60% i mega inflacijom Srbija je 1993. godine doživela iskustvo kliničke smrti. Posledice depresije osećaju se do danas.

Iz ugla Srbije, osnovne posledice raspada Jugoslavije su: produblјivanje starih strukturnih neravnoteža, migracija stanovništva (uključujući odliv mozgova) i suštinsko narušavanje institucija (pravila, sistemski zakoni, regulatorna tela, preovlađujuće ponašanje privrednih subjekata i sl.). Epilog je bila duga i duboka tranziciona recesija. Podaci govore da ekonomija Srbije nije održiva. Izlazak iz ovakvog stanja zahteva spektakularni preokret. Bez radikalnih reformi, opasnost od bankrota mogla bi eskalirati u najdublju krizu. Štete od kratkoročnog prekida funkcionisanja privrede verovatno bi bile ograničene na ekonomski rizik. Duži prekid u funkcionisanju mogao bi biti mnogo razorniji i proširio bi se na politički i geopolitički rizik.

Kada se izgubi poverenje, kvalitetni ljudi i institucije, preporod zahteva da određene društvene snage preuzmu vođstvo u sprovođenju svestranih ekonomskih reformi. Uloga političara u tom procesu ne može se zaobići. To nije trivijalan posao. U pitanju je izazov koji može da učini uspeh reformi veoma unosnim. Dobre reforme sa jasnom vizijom i sprovedene na širokoj osnovi, postaju poduhvat koji može obnoviti i ekonomiju i političko vođstvo. U tom kontekstu ključno pitanje postaje: koja strategija može pomoći da se obnove privreda i njen ugled u poslovnoj zajednici?

Politika upumpavanja novca monetarnim stimulansima (ili kvantitativno olakšanje) ne može se primeniti na Srbiju zbog toga što u njenom slučaju ne važi kriterijum "suviše veliki da bi bio likvidiran", a i privreda je deindustrijalizovana. Oporavak je izazovan zahtev za političare kao inicijatore i sprovodioce reformi zbog toga što moraju držati sve delove ekonomije u ravnoteži dok je prevode na novu putanju ekonomskog razvoja.

Nulti korak u reformama u Srbiji predstavlja integracija u EU. Za nerazvijene ekonomije kao što je Srbija, kompatibilnost sa EU otvara vrata delovanju efekta konvergencije. Dok Srbija postaje politički sve bliža EU, ona istovremeno postaje ekonomski ranjivija. Posledično, pritisak na političke lidere da sprovedu ekonomske reforme se pojačava.

Ekonomske reforme zahtevaju konceptualno raznovrsniju platformu. Makroekonomija posmatra privredu iz helikopter perspektive. To nije jedina relevantna perspektiva. Poslovna (ili mikroekonomska) perspektiva je takođe bitna. To je posebno važno kada treba zatvoriti output gap kao glavni dugoročan efekat permanentne neravnoteže. Opisujući ideju koji

smo razmatrali u našim prethodnim člancima [2], [3] i [4], možemo reći da smo se u njima fokusirali na različite aspekte reindustrijalizacije. Svrha ovog članka je da se pređe na novu perspektivu, ulogu političara u tom procesu.

Koje veštine i mentalitet treba da poseduju političari da bi mogli da iniciraju i sprovedu reindustrijalizaciju? Pre svega, oni moraju biti stratezi. Njihov cilj je da stvore nešto što ne postoji ali je unosno i moguće.

Sidro strategije je jasna i nedvosmislena vizija (ili svrha). Svaka nacionalna ekonomija postoji iz određenih razloga. Vizija nije strategija. Strategija je više od ideje šta da se radi, više od inspiracije ili snova. Strategija je sistem aktivnosti, skup međusobno podržavajućih elementa pod kišobranom vizije. Uspeh strategije nije posledica jedne aktivnosti, već primena ideje vodilje u međusobno povezanom sistemu aktivnosti koje skladno funkcionišu. To je način da se primeni *Šumpeterova* ideja "kreativne destrukcije", da se bude ispred trenda.

Kako je strukturiran članak? Pre kratkog elaboriranja glavnih argumenata koji govore u prilog reindustrijalizacije, nastojaćemo da proučimo zablude prethodnih ekonomskih politika kako bi izbegli njihovo ponavljanje. Ovaj problem biće razmatran u uvodu. Ekonomski oporavak zavisi od nove vizije, ili od toga ka čemu stremimo. To je glavno mesto u naredna dva odeljka koji tretiraju strukturne promene u globalnoj privredi i Srbiji, respektivno. Četvrti deo sadrži predloge za reindustrijalizaciju kao konceptijsku platformu ekonomskog oporavka. Pre zaključka, poslednji deo rasvetliće ulogu političara u reindustrijalizaciji Srbije.

**Ključne reči:** *reforme, reindustrijalizacija, političari, industrijska politika, makroekonomske politike, Srbija*

## Introduction

From the early 1990s Serbia has been faced with crisis because its leadership did not understand the context and leading trends in global politics and economics. During the first decade of transition, this process was slowed down due to geopolitical *status quo*. After political changes in 2000, transition accelerated but the economy remained heavily burdened by the effects of many misconceptions.

Meanwhile, global interactive trends, mainly radical and sometimes even contradictory in nature, led the world to the stage of universal transformative global discontinuity. The turn was triggered primarily by the China's embrace of economic globalization in the late 1970s, to be amplified by the effective reforms in Central and Eastern Europe (CEE) during the 1990s. The global financial crisis 2008- as a wrong man-made policy platform from advanced economies, have introduced new elements in the changing context that have created radically different environment for competition between the states, companies and people around the globe.

The spillover of the 2008- crisis hit all parts of the global economy in one way or another hiking up the overall level of risk. This has been a period not only of economic disasters, but also of political and geopolitical disasters. It has been the period of intellectual disaster too because politicians around the world have failed in their efforts to implement effective anti-crisis policy measures. However, during the crisis some economists have learned a lot about what went wrong and what could be an adequate policy platform.

Namely, the last global crisis has forced politicians, thinkers, scholars and policy makers around the world to reexamine their old beliefs about economic theory and orthodox policy choices concerning “4Us” in terms of *universal* market deregulation (including capital market), *universal* cross-border integration, *universal* state withdrawal from the economy, and *universal* implementation of macroeconomic policy tools such as inflation targeting. Revisionists view in the post-crisis period about adequate policy choices does not mean that what we have learned from free market fundamentalists is completely incorrect. In fact, it suggests that our knowledge is incomplete. Missing ingredient is business (or microeconomic) perspective.

With a deeper sense of understanding of the substance and net effect of global trends, Serbia’s political leadership is now looking for its new place in a transforming world. Repositioning is not easy for a country which has not been regionally integrated yet, with significant debt burden, and, most importantly, without clear vision of future development. Being stuck in transition could force Serbia against the will of its citizens. Confusion about the way the system is heading is a sensitive political issue.

Almost a quarter of a century after the beginning of the former system reform triggered by the implosion of Yugoslavia and a gradual transformation of its republics into independent states, their transition toward the capitalism, and, most importantly, accession to the EU, Serbia is still in transition. The breakup of the former state and wars for its heritage were the worst disaster Serbia has ever suffered. During the transition Serbia lost almost 1/3 of its output, almost 1/10 of its population and almost 1/5 of its territory and natural resources.

The most dramatic decline in Serbia during transition was recorded in the real economy, especially in the segment of industrial production. The value of industrial production in the period 1990-2010 shrank by more than 60%, the share of industrial production in GDP fell from 31% to 15%, while the number of industrial workers declined from 1.03 million to 0.30 million. These trends are in stark contrast not only to regional trends, but also to the trends that existed in Serbia prior to transition. Indeed, in the period 1960-1990 the industrial production grew at an average compound rate of 8% and the economy manifested a solid degree of industrialization given that all core industries figured in its structure (e.g. steel, automobiles, basic and fine chemicals, manufacturing, etc.). What followed in the period after 1990 may freely be called deindustrialization. Figure 1 depicts two periods in the development of Serbia’s economy: the period of industrialization (1960-1990) and the period of deindustrialization (1990-2010).

After the serial shocks triggered by deindustrialization in the 1990s, in the following years Serbia’s economy continually stayed impotent. Also, it almost constantly demonstrated insufficiently strong growth dynamics. Moreover, the global financial crisis 2008- has deepened old fractures of the system. It was a “crisis within the crisis”. In spite of economic growth of 3.7% in 3Q 2013, during the last five years Serbia still has not attained the level of 2008 GDP. Impotent economy with notably weak growth dynamics is constantly showing competitive disadvantage and lagging behind the regional competitors. It is, actually, in regression.

The quest for crisis resolution requires a precise diagnosis of the type of crisis and critical success factor for its resolution. Our standpoint has two elements. First, Serbia’s crisis is multidimensional rather than simple, radical rather than incremental, structural rather than cyclical. The principal cause of such a crisis is output gap. Second, radical economic reforms are remedy for crisis. Escape from the crisis calls for adopting a systematic approach based on various activities in concert and guided by reindustrialization as the great idea.

Ignoring the crises could widen the gap between Serbia and other economies, both advanced and emerging. A multi-decade spree of wrong privatization, inadequate

development model toward the so-called “financialization” instead of reindustrialization, *status quo* in the state sector instead of radical reforms, macroeconomic policy platform focused exclusively on inflation (low and stable) rather than output gap (low and stable), and unsustainable borrowing are coming to an abrupt end. When an economy functions in soft budget constraints (micro and macro) mode, when macro double deficits (current account and budget) constantly appear and when they are financed almost exclusively with debt increase and privatizations proceeds, the risk of downsize scenario is increasing.

Does Serbia matter? Serbia is a microscopic economy. According to the IMF database [18], the share of Serbia in global GDP for 2012 is 0.053% and the projection for 2013 was 0.059%. The economy is weak, not vibrant. Serbia is landlocked country without significant deposits of natural resources and without demographic rent. Also, it is not regionally integrated which is partially a cause of its weak growth dynamics. As a consequence, economic fundamentals are inadequate and the economy is constantly running macro double deficits. A weak and unstable economy has no core advantage, nothing that is strong enough to counter the gravitational pull of universal transformative global discontinuity.

From financial perspective Serbia’s economy is on the brink of bankruptcy. From the global perspective, Serbia’s economy is irrelevant. If it disappeared today due

to default, the world would not be different tomorrow. But from internal perspective, this scenario is not irrelevant, especially for politicians who are the guardians of sovereign state.

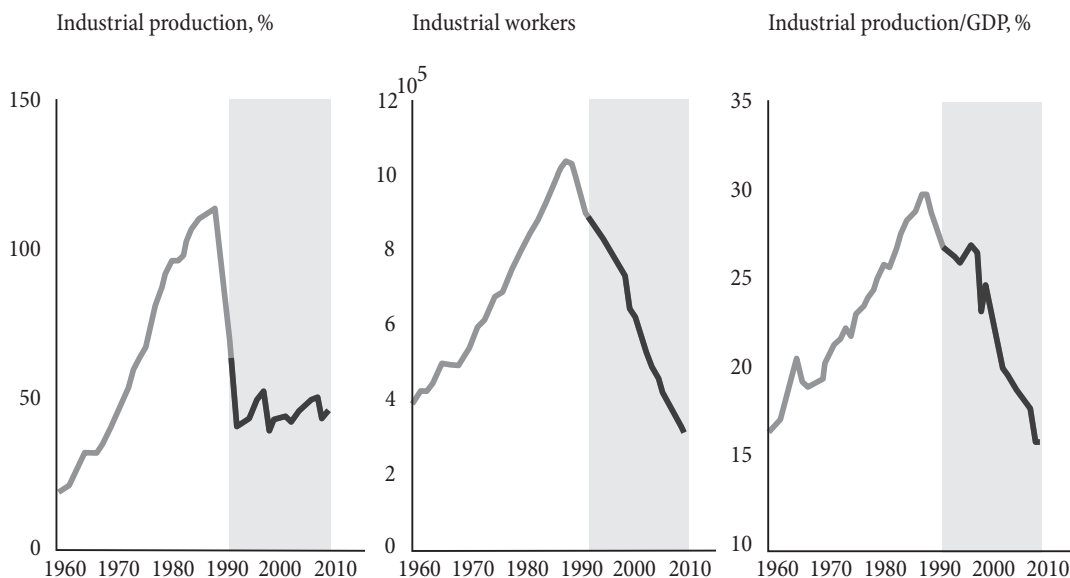
The threat of default places a terrible burden on the shoulders of politicians. After long-term geopolitical and macroeconomic mismanagement, Serbia’s politicians are still hostages of short-term problems with an unusually long list of open issues. A quest for solutions requires a global insight, understanding of the context and trends in the global economy and right prioritization of responses. It is a challenging process for politicians because they play a catalytic role in the process of transforming handicaps into opportunities by strengthening civic participation.

### Changes in global economy and the EU

First of all, let us start with an analysis of the context on the global level. In the global economy the last two centuries were characterized by the rise of Europe and North America and the decline, sometimes huge, of Asia. Europe was the economic center of the universe, North America was a follower in expansion, and Asia was in regression.

Concretely, in 1813 Europe participated with 20% in global GDP and with 20% in global population. By 1913 Europe catapulted its share of global GDP to 35%

**Figure 1: Two economic stages in Serbia: industrialization and deindustrialization**



Source: [16, p. 22]

with 20% share in population. In the same year Asia stayed poor and backward participating with 20 percent in global GDP and 50% in population. At the same time the share of North America stayed stable (15% in GDP and 5% in population).

After the World War II the Western world (Europe + North America) was in the driving seat of globalization. Especially Europe was the most progressive part of the world. The largest share in rapidly increasing global output after the World War II Europe attained in the early 1990s.

At the beginning of the 21<sup>st</sup> century we are experiencing quite the opposite trends. Asia is rising by acquiring a part of Europe's share of global GDP. A massive rise of middle-income earners is a consequence of the capitalization of demographic rent through industrialization which makes these nations wealthier, healthier and living longer lives.

The main characteristic of such a radical turn of the last century was a phenomenon of universal transformative global discontinuity triggered primarily by the China's embrace of economic globalization in the late 1970s. Given that China is the world's most populous country (1.3 billion), its choices in economy, international trade, geopolitics, environment, military etc. will have a major impact on the world. China that has successfully made the transformation in the last thirty years will serve as an inspiration both to its citizens and to other economies.

The implosion of the Soviet Union, transition in CEE toward the capitalism and accession to the EU as well as structural reforms in emerging and developing economies such as South Africa, Korea, Brazil, Turkey, etc. supported

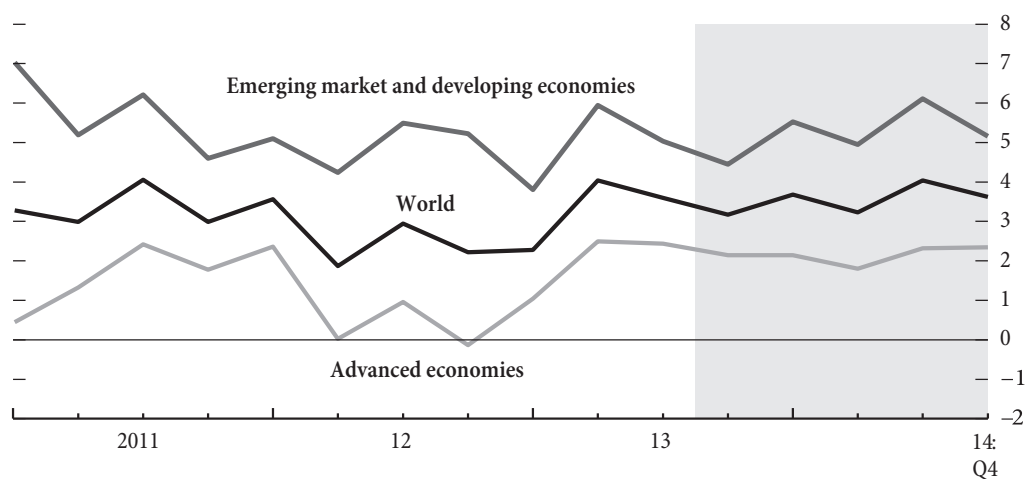
globalization too. Today, all national economies around the world are pushing toward participation in global markets. We are leaving in a globally integrated world which, in spite of being disruptive, can also be productive.

What was surprising is that the share of Europe in global GDP did not much change in the last two centuries, despite two world wars, revolutions, civil wars and radical reforms like transition. But, at the beginning of the 21<sup>st</sup> century the EU has already seen very large reduction in its share of global GDP. It is now down to 20%. It is forecasted to drop to 15 percent by 2030. Population share is estimated to drop to 7% by 2050. If downward trend in performance persists, the EU is going to be a "museum of the world".

Following the IMF data base [9, p. 2], we see that in advanced economies the output in 1H 2013 was 2.5%. Growth in core countries of the EU is about 1%. But, the growth in the EU was held back by the very weak economies from its periphery. Emerging markets and developing economies are projected to expand by about 5%. In short, the global growth is in low gear and downside risks persist because old risk factors largely remain and new risk factors have come to the fore. Namely, compared to the previous year, developed economies gained some sluggish speed, while emerging and developing economies have slowed. But, the latter group of countries, however, accounts for the bulk of global growth (see Figure 2). For example, China as the world's second largest economy projects 7.5% growth for 2014.

Asia is going to be the center of the universe. Shift in the balance of power raises a new question about the

Figure 2: Global growth prospects



Source: [10, p. 3]

impact of the emerging world (Asia primarily) on what is happening in Europe. It is quite the opposite in comparison with the question relevant a century ago about the impact of Europe on what was happening in the world. But, like Europe a century ago, Asia is beset with lots of fault lines, turbulences and disputes which could trigger a reverse domino effect. Maybe the provocative question would be: Does Asia 2014 turn into Europe 1914, when turbulence such as assassination in Sarajevo precipitated the world into the global turmoil?

### Is Serbia back?

For almost a whole transition period Serbia's economy has been behind the curve. Currently, all components of transition including geopolitical, economic and political are still unfinished. Being stuck in transition prevents convergence effect. By contrast, the EU enabled a great majority of transitional economies from CEE to achieve a robust growth in the context of price stability as the core benefit which conventional structural policies usually provide. In the same period Serbia was in regression due to enormous variety of experiments that did not even tackle the old fractures of the system. In the meantime, some new downside risks have come to the fore, while old risks largely remained.

What happened in 2013? Surprisingly, macroeconomic fundamentals are doing pretty good. The data has beaten the majority of analysts' expectations. Macroeconomic indicators are much better than a year ago. Growth rate

for 3Q 2013 was 3.7%. Inflation (CPI base) dropped from 12.2% in 2012 to 4.9% in 2013. In short, recovery in the context of relative price stability is there.

Unfortunately, the previous data shows dual nature of Serbia's economic reality, the shining upside and the complex and unpredictable downside. The progress on the export side is clearly insufficiently strong to offset highly depressed internal demand. Also, in the background, other legacies of the transitional recession still linger and may come back to the fore. A great deal of the recovery is based on export, while jobless rates have increased even more. Jobless recovery is a threat of new relapse of long-term regression. Paradoxically, state sector as the largest contributor to the GDP is most vulnerable. The worst performers are state-owned companies in the sectors with large growth potential (particularly in energy sector, telecommunications, infrastructure and agriculture). The situation is slightly different in the financial sector (state-owned banks and insurance companies), but a general trend is the same.

Can we support the previous qualification with fact sheets? The key macroeconomic indicators for the last twelve years are presented in Table 1. A general impression is that the recovery from transitional recession is gradually progressing, albeit too weakly. In the economy with output gap, the whole period is marked by macro double deficits, high unemployment and growing indebtedness. System with such performances is unsustainable.

Another aspect of unsustainability is the absence of reserves that could be used if some stress factors start to operate. Table 2 provides an overview of vulnerability

**Table 1: Serbia's macroeconomic indicators, 2002-2013**

Indicators	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	Q3 2013
Real GDP growth rate	4.3	2.5	9.3	5.4	3.6	5.4	3.8	-3.5	1.0	1.6	-1.5	3.7
Consumer price inflation, in %	14.8	7.8	13.7	17.7	6.6	11.0	8.6	6.6	10.3	7.0	12.2	4.9
Unemployment rate	13.3	14.6	18.5	20.8	20.9	18.1	13.6	16.1	19.2	23	23.9	20.1
Balance of payments overall, in mil EUR	996	827	343	1,647	4,269	742	-1,687	2,363	-929	1,801	-1,137	-190
Current account balance	-671	-1,347	-2,620	-1,778	-2,356	-5,052	-7,054	-1,910	-1,887	-2,870	-3,155	-1,114
Capital and financial account	1,516	2,305	2,791	3,828	7,566	4,739	7,146	2,034	1,819	2,691	2,872	948
Current account balance, in % of GDP	-4.2	-7.8	-13.8	-8.8	-10.1	-17.7	-21.6	-6.6	-6.7	-9.1	-10.5	-2.0
Budget deficit, in % of GDP	-4.3	-2.4	-0.2	0.7	-1.7	-1.1	-1.9	-3.3	-3.5	-4.1	-5.7	-5.6
Public debt, in % of GDP	72.9	66.9	55.3	52.2	37.7	31.5	29.2	34.7	44.5	48.2	60.0	61.7
External debt, in %	58.7	55.9	49.8	60.1	60.9	60.2	64.6	77.7	85.0	76.7	86.9	81.9
FX reserves, in mil EUR	2,186	2,835	3,104	4,921	9,020	9,634	8,162	10,602	10,002	12,058	10,914	10,444
FDI, net in mil EUR	500	1,194	774	1,250	3,323	1,821	1,824	1,372	860	1,827	232	517
RSD/EUR FX rate (period average)	60.69	65.12	72.69	82.99	84.11	79.96	81.44	93.95	103.04	101.95	113.13	114.18

indicators. It gives insight into the capacity of the economy to mitigate negative effects of various stress factors. Specifically, almost all components of operational performances fall below the reference point, financial performances are weak but gravitate around the reference point, and competitiveness is far below the level of peers (the SEE countries).

Let us drill down into vulnerability data. The first warning sign is transitional output gap. The level of GDP in 2013 (at constant prices) compared to its level in 1989, i.e. the last year before the start of transition, is by 29% lower. In the same period, former transitional economies experienced a significant increase in output level of over 40% on average. Direct consequence of transitional output gap is secular inflationary pressure.

Long-lasting deindustrialization is the main cause of transitional output gap. The 2008- crisis exacerbated that tendency. In last two years the economy is gradually strengthening but the level of industrial production in 2013 remains slightly below 2008. It is well-known that in lower income countries the manufacturing sector is the most important tradable sector. Policy makers must emphasize industrial output if they are interested in balancing current accounts in the long term and maintaining external liquidity in the short term. In high income countries a relatively small manufacturing sector is not

so problematic because they have viable service sectors. Moreover, export of services and capital inflow can help balancing current account deficit. Taking a broader view, structural reforms are urgently needed to invigorate the anemic growth potential.

Related problem is output gap, i.e. the level of economic activity which is below its potential level. Output gap is a consequence of high economic risk (unemployment and underemployment). Unemployment rate is high. In 3Q 2013 it dropped to 20.1% from 24.1%. Youth unemployment (15-24 years) is approaching to an unacceptably high level of 50%. Excessively high structural unemployment threatens to create a lost generation. *A. Okun* index (unemployment + inflation) of 25% exceeds by far the reference point. Another indicator of vulnerability is the ratio of active population to dependents. It stands at 1.1 (=1.1/1.0). This ratio has an adverse effect on functioning of the state (pensions, health care, education, science, culture, etc.)

Consequence of output gap is also unsustainable current account. Serbia continually had runaway deficits in the current account because it did not manage to build sufficiently large tradable sector that enables balance in the current account. This part of recovery is still a long way off. Reindustrialization offers a possible way out.

**Table 2: Serbia's vulnerability indicators, 3Q 2013**

Indicators	Value	Reference point	Type of vulnerability
Transitional output gap	29%	0%	OPERATIONAL
Okun index (inflation + unemployment)	25%	<12%	
Macro deficits			
• Current account	2.0%	<5%	
• Budget	5.6%	<3%	
Dependency index	1.1	>2	
Youth unemployment	50%	<20%	
Indebtedness			FINANCIAL
• Public debt/GDP	61.7%	<45%	
• Foreign debt/GDP	81.9%	<90%	
• Foreign debt/Export	185.8%	<220%	
NPL ratio	21.1%	<10%	
Credit rating			
• S&P	BB-/negative	investment ranking > BB	
• Fitch	BB-/negative	investment ranking > BB	
Export (goods)/GDP	33.7%	>50%	COMPETITIVE
Currency change (3Q2013/3Q2012)			
• Nominal	2.4%	<-5%	
• Real	8.0%	<-3%	
Global competitiveness index	101st of 148	65-SEE average	
Corruption perception index	72nd of 177	59-SEE average	
Ease of doing business	93rd of 189	60-SEE average	
Economic freedom index	95th of 178	62-SEE average	

A serious warning sign comes from export figures (magnitude and pattern). Generally, Serbia’s economy is suffering from weak export performance. For 3Q 2013 Export/GDP ratio was 33.7%. Situation is slightly better than in the previous year. Current account deficit dropped from 10.5% in 2012 to 2.0% in 3Q 2013. Current account improvement is a direct consequence of export hike thanks to FIAT project. But the threat of unsustainable growth stays unbeaten. Namely, in the period of anemic growth in an economy with output gap industrial production is shrinking even more than GDP. That said, the other alert in the current account refers to an overall fall of imports. Namely, in recession the level of industrial production is declining rapidly and this usually results in strong reduction of imports. This situation leads to further output gap increase.

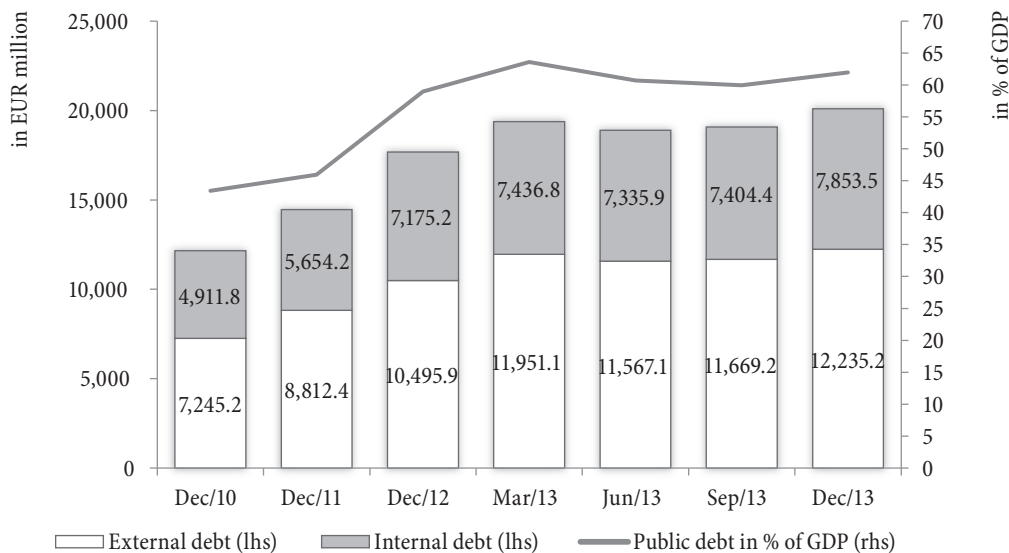
Another warning sign of current account unsustainability is the level of FDI. After FDI plummeted in 2012 to EUR 231.9 million, in 3Q 2013 it slightly recovered reaching the level of EUR 517 million. Notably, it is insufficient for sustainable development. The other side of the coin is sectorial allocation of FDI. Before 2008- crisis there was strong investment in financial sector, wholesale, retail trade and commercial real estate, while too little was invested in manufacturing and infrastructure. By contrast, in emerging countries from CEE a sizable part of investment went into manufacturing and infrastructure [4, p. 294].

Another layer of the onion is indebtedness. Serbia’s position as regards the debt level is so far so good. Public debt reached 62% of GDP in 2013. This level of debt substantially exceeds the reference point of 45%. But, the level of total debt of 82% is still below the reference point of 90%.

A more cautious look at this subject reveals that there is no room for complacency. As presented in Figure 3, the trends in all three categories of debt (internal, external, and public) demonstrate visible deterioration. Compared to 2010, external debt is almost 70% higher today, while internal debt stays at 60% higher level. Along with alarmingly high public debt, such an exposure to expensive debt undoubtedly signals apparent unsustainability of the system, and, most certainly, high probability of default. Thinking that these trends will slow down or come into reverse would be unrealistic, since there are no other sources for maintaining the functioning of economy.

In the last year debt inflow was intensified through three channels: emission of repo papers and government bonds (new debt is 4.3% of total debt), emission of Eurobonds (new debt is 8.9% of total debt), and credit from Russia (new debt is 1.1% of total debt). Different financing channels have different cost of capital. For repo papers it is 10.64% on RSD nominal value, for euro denominated repo papers and government bonds it is 4.4%, and for central bank Eurobonds it is 5.4%. Intensive debt inflows and relatively high cost of capital raise the question of debt

Figure 3: External, internal and public debt tendencies



Source: Ministry of Finance of the Republic of Serbia; Economic Research of Hypo Alpe-Adria-Bank



sustainability. Credibility of the country in terms of debt repayment depends on the difference between growth rate and interest rate. If interest rate is much lower than growth rate, lender is in a risk-free position because for debtors it is easy to repay the loans from their rising income.

In commercial banks the borrowing system is on the brink of collapse because there is a sizable gap in the other direction, not only because the level of cost of debt is unreasonable high, but also because profit is rising more slowly than the cost of borrowing. Consequently, it is a new warning sign indicating that some debt may not be repaid. The level of NPL officially is 21.1%. In reality, it is approaching 1/3 of total gross loans released from the banking sector. It is above the average level in the EU.

The attractiveness of central bank's short term securities has fallen. During 2013 one-week repo rate decreased from 11.5% to 9.5%. Moreover, the interest rates on deposits have been failing primarily due to the fall of prime rate and obligatory reserve.

Large portions of debt inflows went into the government debt. In the segment of private debt a large portion consists primarily of household borrowing. This situation is quite the opposite in comparison with emerging transitional economies from CEE in which private debt dominates over government one, and company debt over household one.

The latest figures for 2013 demonstrate the credit crunch in corporate and household debt which led to final and investment demand squeeze. This fact is in line with the good economic intuition telling that economies with higher level of corporate debt have more negative investment growth during the crisis and that household spending also suffers from the strong decline of household debt.

Additional problem related to investors' expectations is a high level of dependency (more than 80%) in business transactions on the euro. We still do not know what to do in the countries that are irreversibly dependent on the euro, those that have pegged their FX rate to it (FX correction based on inflation differential, or the difference between inflation in a country in question and the Eurozone).

Looking into structural imbalances we see FX rate as a significant factor. The central bank's policy of FX rate constantly encourages floating rate of domestic currency

(RSD) which is not connected with inflation differential. As a consequence, FX rate is significantly overvalued. For example, cumulative inflation in the period 2002-2013 was 198%. In the same period, nominal devaluation of RSD was 91.5%, and real appreciation was 20.4%. Since the introduction of inflation targeting in 1H 2006 respective data is: cumulative inflation 75%, nominal FX rate devaluation 32.2%, and real FX rate appreciation 13.1%. Overvalued FX rate hits profitability of exporters. Also, it increases importers' expectations and erodes the sustainability of current account.

Interestingly, in the last year FX rate appreciated in both terms (2% nominally and 8% really). Namely, RSD has been beneficiary because the money created by stimulus from developed countries has flowed as investors sought out higher returns in emerging markets. But withdrawal could prompt a reverse in those flows and put RSD under the pressure.

By definition, in an economy in which import is greater than export, FX rate serves as an important tool of price control. However, the problem with this policy is the absence of an economic anchor in determining FX rate (inflation differential relative to the Eurozone, for example). Besides, interventions in the foreign exchange market are the manifestation of the voluntarism of the NBS in using currency reserves, which leads to really appreciated RSD.

Economies that have floating FX rate are quite distinct from those that have fixed rates. A fixed FX rate provides investors with a feeling of security because it eliminates the currency risk.

The current state of money and capital markets is also a matter of concern. They are far from a good shape. They are shallow and in retreat. Money and capital markets, as the central nervous system of emerging capitalism, have been perverted and deformed. Bank-centric financial system leads to largely unsustainable current account. The level of capitalization of the Belgrade Stock Exchange is about EUR 7 billion. During 2013 the market capitalization slightly decreased. In the period of rapid privatization 2003-2007 the capital market was in expansion. In that period transitional recession was transformed into brief remission. The policy makers with exclusive focus on

inflation (low and stable) instead on output gap (low and stable) lost momentum for reindustrialization. As a consequence, inflation targeting supported by monetary measures pushed the economy back into recession. Global financial crisis 2008- only amplified this tendency.

In the period 2001-2008 Serbia had a high degree of economic openness, especially in the financial sector. In that period domestic financial intermediaries almost disappeared. Recapitalization of the subsidiary banks with capital adequacy problem is the obligation of mother bank, not local regulator and government. The banking crisis in the EU provokes heightened caution because banks are trying to fix their balance sheets and get rid of credits through deleverage.

Normally, the corporate sector is net borrower because companies borrow to finance investment. But during the 2008- crisis, as a consequence of demand squeeze, many profit making companies and banks started saving more than investing, reinvesting in surrounding markets or simply transferring the capital out of the country through capital hedge. The withdrawal of capital is significant, both in financial sector and real economy. In that way, capital account further exacerbates the unsustainability of balance of payment.

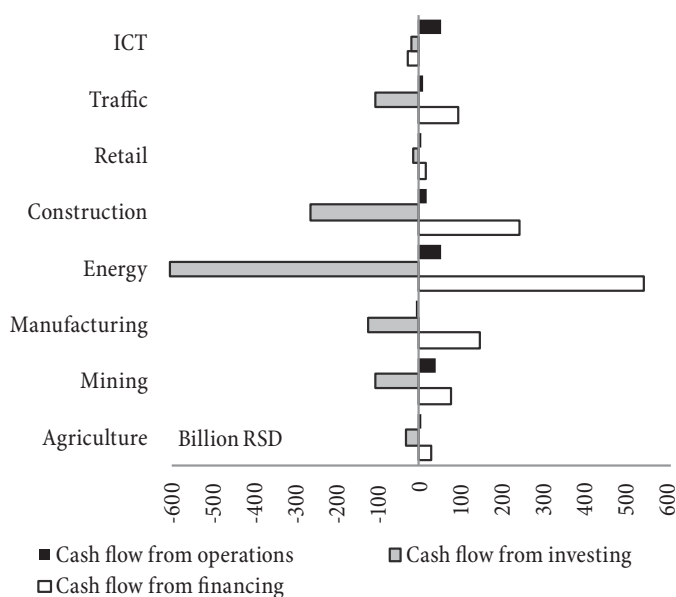
Unfortunately, the majority of corporate sector is loss making or constantly struggling not to fall into that group. In regular circumstances such situations are the

consequence of competitive disadvantage. In Serbia, it is predominantly a result of adverse institutional settings (FX rate and cost of capital) and inadequate economic policies (inflation targeting). The final consequence is permanent illiquidity and lack of suitable financial sources to overcome it. When debt is costly and operations do not produce enough liquid funds, investment activity dies away.

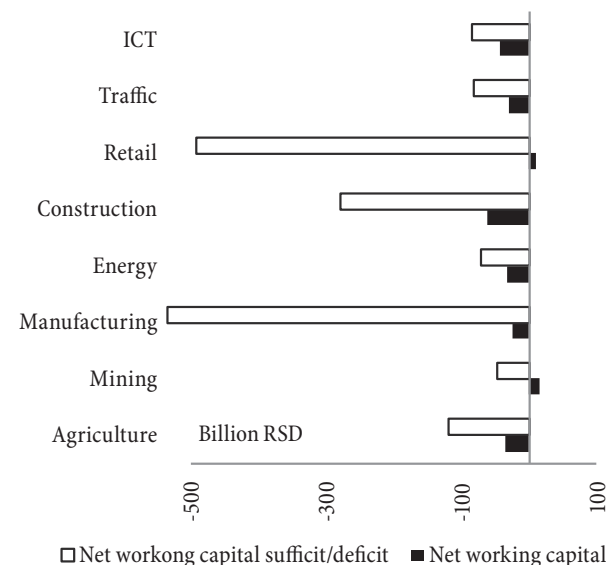
Figure 4 depicts previous claims. It is obvious that the cash flow from operations is insufficient to provide debt repayments and investments. The amount of investment cash outflow matches the financial cash inflow, which means that the only way to finance growth is through borrowing channels. According to [12, pp. 45-8] the net working capital deficit is the reflection in the mirror of illiquidity. All sectors to various extents share the problem of lacking operating assets necessary to service short-term obligations. The result is additional unfavorable borrowing or downsizing which further erodes the competitive position of companies and, at the end of the day, increases the output gap.

Debt increase has been used primarily for monetization of double macro deficits. Therefore, it enabled politicians to enjoy “deficits without tears”, buying the time during the political cycle and avoiding the great risks related to structural reforms. In effect, with the new debt the government continually patched a hole in the economy’s

Figure 4: Corporate sector liquidity problem



Source: [12, p. 45]



Source: [12, p. 48]

boat. This staggering debt burden increased over the levels that had been proven to be prudent, healthy and sustainable.

So, where is Serbia's economy heading? Instead of swiping growth aimed at closing the output gap, in 1Q 2014 Serbia's economy might face the twilight of debt deflation combined with struggle to restore liquidity (external and internal). The formal start of accession process to the EU at the beginning of 2014 enables Serbia's politicians to refocus themselves from geopolitical and political issues to economic reforms. Economy is a driving force in political development. Sustainable growth is the most efficient way to navigate different financial and political stress factors.

### **Reindustrialization strategy: The great idea for turnaround**

One policy implication of the previous analysis could be the shift from economic growth based on FDI towards the economic growth based on the industrial policies formulated for priority sectors of the economy. The most pressing task at the moment is to stimulate reindustrialization as a remedy for serious current account and liquidity problems. An absolute must is to create a viable tradable sector with anti-import and export goals.

But, industrial policies have a bad reputation in the circles of economics scholars from the West. They are viewed mainly as a problematic choice because they lead to misallocation of resources and encourage corruption. Mainstream economic doctrines (Keynesian encourage fiscal state, monetarists, and proponents of supply-side economics) share a similar view about arbitrary choice of industrial policy. Also, they had deep predilections about any anti-crisis program ("let the markets take care of themselves") treating the role of industrial policies in sustainable development as marginal compared to market forces. Eventually, when the Wall Street (financial sector) is in trouble policy makers could unwillingly prescribe, in the name of the Main Street (predominantly manufacturing and infrastructure) prosperity, active financial measures (bailout, financial support, fiscal stimulus, quantitative easing, etc.).

Nowadays there is almost a universal acknowledgement in mainstream economics that the crisis 2008- cannot be overcome by undertaking the measures that were its direct causes (deregulation, deindustrialization, securitization, and outsourcing), and that the momentum to conceptualize new economic policy platform must be maintained. When market forces fail, government comes in to pick up the pieces.

Moreover, there is firm evidence that some economies have achieved sustainable growth by implementing industrial policies [17]. Emerging and developing economies successfully direct investments towards the tradable sectors, capitalizing on comparative advantage (in the earlier stages of economic development) or competitive advantage (in the later stages of economic development). Our proposals of the reindustrialization strategy presented in [4] are conceived bearing in mind a positive experience with industrial policies in the emerging economies like BRICS<sup>1</sup> and "next 11"<sup>2</sup>.

In new approach, instead of inflation (low and stable) as a dominant tenet of economic policy, some other tenets should also be taken into consideration including output gap (low and stable), sustainable employment, GDP structure (emphasis on the real economy), price parity of other types of assets (first of all, FX rate), and establishment of dynamic equilibrium between the real economy and financial sector (instead of insisting exclusively on financial system stability). In order to successfully achieve the extended list of tenets, the central bank will have to renounce a part of its independence. Namely, the new structure of tenets requires a close cooperation between the central bank and the government. Also, the new conceptual platform of economic policy is conceived as a combination of industrial policies and new macroeconomic policies that are based on the automatic stabilizers, especially in monetary and fiscal spheres. As a result, industrial policies lead, and macroeconomic policies follow.

As far as problem of bad governance is concerned, in the current stage of accession process to the EU it is reasonable for Serbia to combine three elements: (i) the EU support

1 BRICS – Brazil, Russia, India, China and South Africa

2 Next 11 – Bangladesh, Egypt, Indonesia, Iran, Mexico, Nigeria, Pakistan, Philippines, Turkey, South Korea and Vietnam

in setting up an effective strategy of reindustrialization inspired by the EU technological platforms, (ii) making the disbursement of the EU funds conditional on the progress in implementation of the reindustrialization strategy, (iii) and efficient governance of industrial policy portfolio on a sector-by-sector basis.

In a time of slow and fragile recovery in the EU, Serbia's economy will have to rely more on domestic demand. However, the latest fractures in the financial system (NPL hike, primarily) make the launch of sizable investment in the private sector almost unfeasible. On the other hand, in current circumstances international financial markets are very sensitive and governments do not have much leeway to raise money for big projects in state-owned enterprises. Therefore, financial strategy of the government in the following period should be fairly conservative and cautious. Joint-ventures with strategic partners in priority sectors, concessions (BOT versions) in the sectors where Serbia has comparative and/or competitive advantages and public-private-partnership in utilities seem like feasible alternatives for financing reindustrialization.

Reindustrialization means not only rebalancing growth away from demand towards investment. It also introduces a radical change in conducting hard economic policies. Appropriate policy mix and the pace of adjustments are determined by the level of output gap, nature of vulnerability, inflation pressure, central bank credibility, and room for fiscal policy maneuvering. Specifically, Serbia has some policy priorities. First, FX rate should better respond to macroeconomic fundamentals and competitiveness and provide a strong nominal anchor. Second, it is necessary to match income and expenditure (the principle of hard budget constraints) by implementing austerity measures on the expenditure side, at the same time eliminating output gap by increasing investment spending, which, in turn, fuels the revenue growth. These processes are interrelated. Namely, in maintaining liquidity (external and internal), apart from cost reduction, the expansion of the production of tradable goods and services is the best way to reduce import and increase export, and consequently, to achieve net positive effect on current account and repay the

outstanding debt. Third, prudential actions should be taken to safeguard financial stability, bearing in mind legacy risks from former credit boom (level of NPL) and new risks from capital outflow.

The ultimate goal of reindustrialization strategy is to increase density of relevant economic subjects. In the global world sustainability and prosperity of each economy depend on density of relevant economic subjects even more than on institutional settings and strategy of industry leaders. The economy in which the prosperity is associated with tabloid media, gambling, plastic surgery and similar businesses cannot be sustainable.

In new policy platform FDI is not considered as a basis for sustainable development, since in the medium term it adversely affects growth due to the effects of transfer pricing, profit repatriation and potential gap in case of exit strategy. It is hard to think of any other solution that can replace missing FDI with industrial policies. New financial arrangements should enable investment without further increase in debt. The arrangements that meet the previous criterion are: (i) joint ventures up to 50 percent of ownership for foreign partner (no casting vote JV), primarily in the sectors where Serbia has comparative advantage (energy, ICT and manufacturing), (ii) concessions, with a special emphasis on the types of arrangements such as build-operate-transfer (BOT) in infrastructure, metallurgy, transportation, logistics, and tourism, and (iii) private-public-partnerships (PPP) in utility companies and public services. A particular focus should be put on financing by sovereign wealth funds (SWF) from the countries with immense foreign currency reserves. Today's global investment arena is marked by a dominant role of SWF over FDI.

Reindustrialization includes developing and implementing strong industrial policies, supported by specific measures. Each priority sector deserves industrial policy with specific measures. For example, the key measures in the energy sector are as follows: full-cost pricing, feed-in tariffs corrections, selection of strategic partners, establishing corporate governance in state-owned companies, and introduction of stimuli for the development of new energy and efficiency technologies. As far as pricing policy is concerned, the convergence of electricity price towards the EU average would automatically

cause an increase in value of state-owned company Electric Power Industry of Serbia (EPS).

To illustrate the previous point we made *ad hoc* valuation of EPS based on publicly available data and documents. The valuation is performed by using two period DCF method. To get as conservative as possible valuation we used the following assumptions: (i) projection period 2013-2022<sup>3</sup>, (ii) electricity consumption is expected to grow at average 0.9% rate p.a., (iii) electricity price forecast is taken from U.S Energy Information Administration, (iv) all certain and predictable investment projects for the projection period are included, (v) cost of equity and debt-to-equity estimates are based on *Damodaran's* database, (vi) cost of debt is based on NBS official interest rates for nonfinancial sector, (vii) operating margin and net working capital are projected to pass through two sub-periods (median level and approaching to industrial average), (viii) for terminal period growth rate is projected at 1.2% and cost of capital at 11%.

*Ad hoc* valuation of EPS is presented in Figure 5. The company value is EUR 3.5 billion (according to the current value of company debt, equity value approaches EUR 3 billion). Hypothetically, if strategic partner intends to reach 50% ownership it should increase the equity by exactly the same amount. This amount is almost five times higher than the amount of FDI in 2013.

## The role of politicians on the road ahead

There are three different characterizations of the role of politicians in Serbia's economic future. The author of the first one is a famous professor of economics *Lj. Madžar*<sup>4</sup>, whereas the second one comes from a book of well-known economic journalist *M. Brkić*<sup>5</sup>. The third one, by colleagues of ours, is presented in the strategy of reindustrialization [4].

Our characterization is based on addressing the question: Whose job is to find a solution to the possible

default of Serbia? In our view, it is a job of politicians. Let us reiterate that almost each new government in Serbia had a near-death experience. Risk of default creates a situation where potential flashpoints are so many and are likely to grow. Many relevant people could be involved in finding exit strategy. But whether that strategy is available and where it is heading is primarily a responsibility of politicians.

For a long time Serbia has been living below the trend. Fractures of the system from the past are so powerful and destructive that the shift from "as-is" towards "to-be" situation requires strategic shift. Exit strategy enables the economy to be not only in harmony with global settings, but also to be ahead of the local trends.

What skills and mindsets do politicians need to possess to be strategists? That is, first and foremost, strategic sense. In connected and mutually interdependent world, strategic sense is the core competence of modern politicians. The implosion of Yugoslavia is an example that it takes forty five years to build a confidence in one national economy and five minutes to ruin it, all because politicians made some bad choices. But to avoid an eerie sense of *déjà vu* considering the former state and its position in global politics and economy, the idea that a small and open economy might drive or heavily influence the external world or even its own performance should be definitely put out of modern politicians' minds. These days a success of a national economy depends predominantly on the context and competitive forces beyond control of local political leadership. Strategic audit matters a lot. Politicians as proactive leaders and believers in the power of politics (as the art of possible) need to focus on what they can control, while ignoring or underestimating what they cannot. The integration into the EU and implementation of radical economic reforms should be at the top of the agenda of Serbia's politicians.

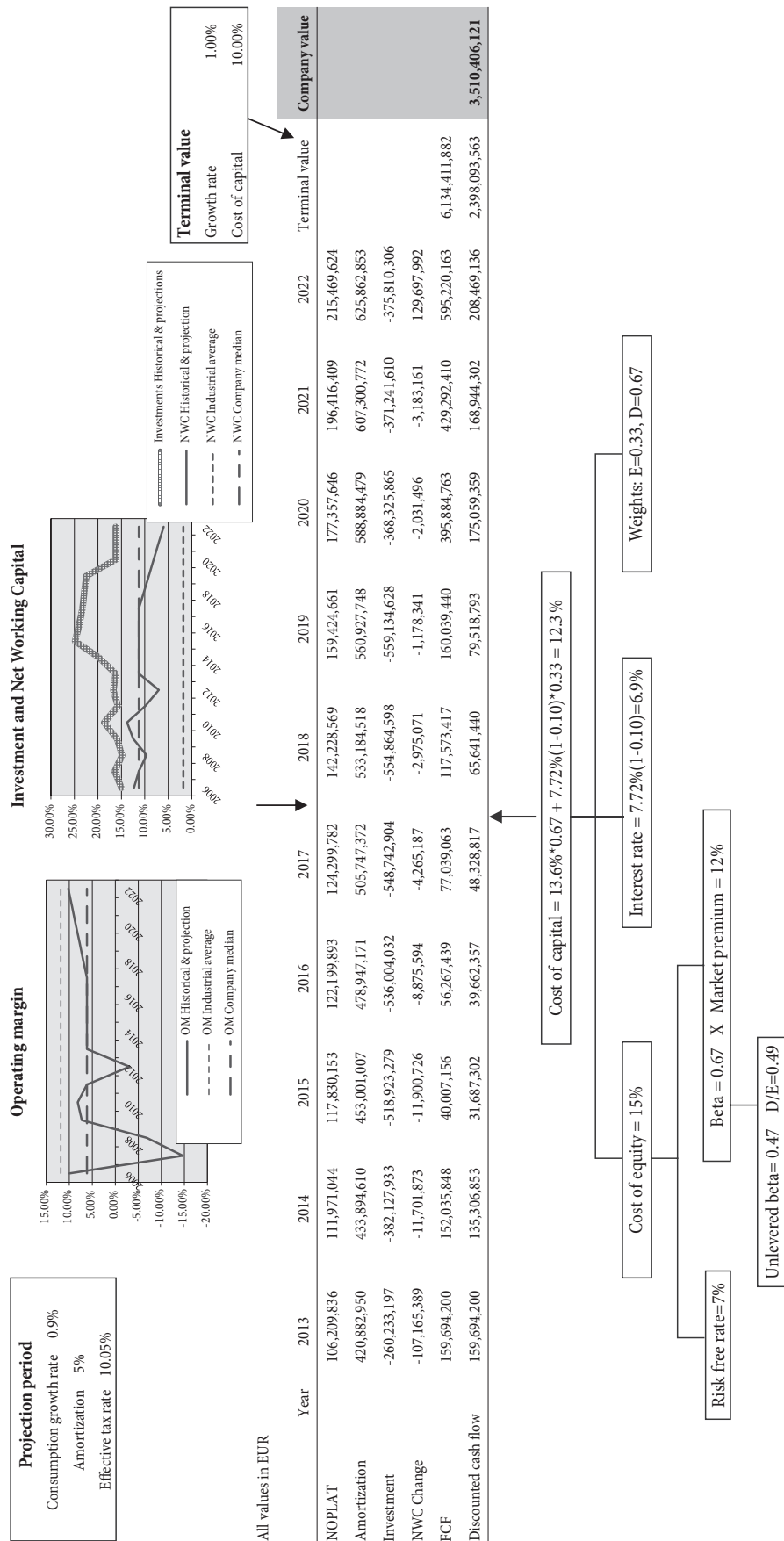
The previous reflection may be seen as eureka moment. It is the fundamental lesson of a paramount importance for politicians in Serbia. For ensuring a great positioning they must, first of all, understand the context and trends. The way they respond to them makes the strategy. That means if they fail to grasp the importance of core movements, their strategy is based on luck and

3 We started with the year 2013 since there were no financial statements available at the moment of valuation so that it was not possible to include this year in historical performance.

4 Agents authorized to formulate public policy which provides institutional shifts or steady and persistent tendencies of change that increase the level of business optimism and spur up the animal spirit [11, p. 169]

5 Accountability for the achievement of social tenets [1]

Figure 5: EPS *ad hoc* valuation



Source: Authors' calculation

hope. But, even if they understand context and trends, the trick is to find a way to deal with them in the most effective way. Understanding the context is followed by skillful positioning, deliberate efforts to counter negative forces or exploit favorable ones, or even a timely exit.

In the modern world it is more important to whom you are connected than who you are. Accordingly, there are gains to be made for an economy from additional integration. The accession to the EU is a good vision for Serbia. The EU is reasonable destination, among other things, because most of Serbia's exports go there.

Currently the EU is in regression stage. It has already seen a significant reduction in its share of the world's GDP. It is now down to 20%. There is a forecast saying that it will shrink to 15% by 2030. For Serbia's economy it is also of interest to start doing business with faraway countries rather than to focus exclusively on the EU and the former Yugoslav republics. Consequently, some politicians should not be antagonized by other politicians when looking to emerging economies such as Russia, China, Korea, Gulf states, Nigeria, etc.

More integration creates a need for more opening. The new challenge for Serbia's economy is how to improve its chances of penetrating the new markets that are growing at faster pace than those on which it has been traditionally focused. A current level of integration in the global economy is not final [7]. This is, maybe, an opportunity for new geopolitical deals.

Also, leadership matters. Desired result of leadership is the vision, something that is not already there. Vision and advantage could be used in conjunction with each other. Strategy focuses on capitalization on comparative advantage or development of competitive advantage. Comparative advantage is based on natural resources, labor, position rent (near to market), etc. Competitive advantage is a long-run sustainable advantage, one that accumulates such a powerful lead over competitors based on innovation that no one can catch up.

Strategic sense and leadership are inseparable. Step into the shoes of leading politicians of trend-setting countries such as the U.S., Germany, Russia, China or troublemaker ones such as Italy, Greece, Spain and Ukraine. For right positioning you must have strategic sense in terms of

global view, imagination and foresight. Also, you must be inspired by the change imperative. Leader is someone who understands the context and prevailing trends but does not accept reality as it is and has capacity to create and cultivate an original vision for repositioning.

Vision is important manifestation of leadership. Vision is a clear sense of why economy matters. Every single activity of strategy is aligned with vision, so all of them and related resources must work in concert to support this vision. Namely, implementation is important for turning vision into reality.

Defining a sound and distinctive vision which enables sustainable development is essential for Serbia. It is the politicians' way to stake a claim. With it, the other subjects have earned the right to play, to take part in the game. But winning the game requires more.

Some people believe that the exclusive task of politicians consists of thinking and charming other people with their visions. Equally important task of politicians is implementation of vision, setting an agenda and putting in place the system to carry it out.

A primary task of a leader is to direct attention. To do so, leader must cultivate a triad of awareness - focusing of himself, focusing on others, and focusing on the world [8, p. 52]. Inward focus and focus on others help leaders cultivate emotional intelligence. Outward focus can improve leaders' ability to formulate great vision.

Vision is where performance differences start. Nothing else is more important to the survival and success of Serbia's economy than why it exists (to support welfare state or to enable sustainable growth), and what otherwise unmet needs (on internal and global markets) it intends to fulfill. According to [13, p. 50], vision is about choice, and real choice contains, both positive ("we do this") and negative ("by implication, then, we don't do something else") elements. In the reindustrialization strategy the vision is defined for priority sectors (with comparative and competitive advantages). From the perspective of "positive" element, hard budget constraint (macro and micro) in providing finance policy in country with such debt burden makes sense. Looking for strategic partners in state-owned network technologies and natural monopolies also makes sense. "Negative" element in this process would

be, for example, offering more than 50% ownership to strategic partner.

Thinking of strategy as a system of activities driven by vision underscores the point. It is the bridge between lofty ideas and action. Every politician in Serbia must ask themselves whether his or her strategy is based on a clearly defined vision to escape default and backed by a set of mutually reinforcing activities. If not, it is the time to build a new strategy for survival.

Anchored by compelling vision, strategy is actually a campaign of national economy in the marketplace (global and local), the domain in which it competes, how it competes, and what it wants to achieve. Reindustrialization strategy is strongly dependent on industrial policies for priority sectors. Priority sectors are tradable sectors that serve to anti-import and export goals.

Strategy is a roadmap. It needs continuous, not intermittent, leadership. The strategist is the one who must shepherd this ongoing process, who must stand watch, identify and weight, decide and move, time and time again. The strategist is the one who must decline certain opportunities and pursue others.

The strategy of reindustrialization is a system of activities that underlies Serbia's economy competitiveness and uniqueness. It is the system of activities that evolves, moves, and changes throughout three parallel processes: fiscal consolidation, elimination of output gap, and industrial development [4].

Great strategies and politicians that capture them set direction, establish priorities and guide activities. They help communicate strategy externally. It is also a matter that influences perception about economy and its credit rating as well as the way to attract investors.

In strategy formulation a clear priority list is important. Excellence comes from well-defined efforts. The first step in the implementation is translating great idea into the system of actions, where efforts are aligned and mutually reinforcing. Also, good metrics make sense. Global performance measures like growth rate of GDP and vulnerability indicators like the level of NPL indicate whether strategy is working, but the key performance drivers, tailored to reindustrialization strategy, such as export growth of high-ends, reduction of youth unemployment

rate, are better indication where strategy is directed to. They break big aspiration into specific, measurable goals, and guide behavior toward what matters.

Strategy must tackle balancing interests. According to [15, pp. 139-140], balance means a "fragile integrity". Politicians cannot remove unmanageable chances from human life. But, they can leave the unmanageable chances while going from more confident to less confident wisdom. By doing that, politician cultivates flexible responsiveness, rather than rigid harness. This requires shift from absolutism (including enlighten absolutism) to democracy by letting go of a range for control and being open to rethinking and refashioning the elements of strategy through holistic process.

Implementation of the previous concept in Serbia is burdened by some prejudices. We know from the history of our nation that when we are in regression stage, we tend to look at those who have different strategy (offensive or defensive) and think that they must be responsible for what is happening to us. When exist a nebulous enemy, we should worry about resolution.

As a consequence, politicians who are following a spirit of nation are too reluctant about reforms. Serbia desperately needs politicians with reform mindset, true believers in the future, ready to take the risk and write the pages of history by making brave decisions. Instead of politicians that do politicking, Serbia needs strategists with the vision who have understood the position of Serbia in modern history, and, more importantly, have the idea how to participate in it.

People should not be trapped by the myth of super-politicians. The myth of super-politicians arises from the sense of omnipotence, the belief that no situation is too complex or too unpredictable to be brought under control of politician. This tendency is almost regularly followed by the dramatization of problem and glorification of the role of politicians. Double macro deficits? Great! New labor law? Wonderful! Restructuring of public sector? Terrific! Corrupted high level politicians? Fantastic! Seemingly, there is nothing of system's fractures and fault lines that could not be overcome or turn into advantage by politicians. This is the myth of the super-politicians in full force.



Advisors providing valuable perspectives and data can help politicians develop crafting strategy. But, in the end, it is the politician who bears the responsibility for setting the country's course and making the choices day after day that continuously refine that course. In the absence of the evolution of leading politicians' competence even the wisdom of international advisors with reputation for brilliance is not sufficient to improve the rating of the economy with bad reputation.

The engagement of super-politicians backed up by super-advisors in finding solutions for almost unsolvable problems may be the reason for returning to politicking, or simulated activism in the implementation of reforms. Also, it may be an alibi for unconventional solutions out of good economic intuition. This fault line could blame democratic process. In an extreme case it could lead to absolutism (almost certainly) or, eventually, to enlighten absolutism (with smaller probability).

Each strategy for economic revival, including reindustrialization, is a politically unprofitable venture not only because the effects are uncertain, but also because it occurs in the time horizon that is longer than the usual political cycle. Even more, it supposes that there are enough politicians with strategic sense, unstoppable energy and spot-on sense of style, which for economic turnaround of Serbia is not enough. According to [13, p. 131], the reason is the existence of profound paradox many strategists must manage: stay on the track and reinvent yourself. Namely, leading strategy is nonstop responsibility. Only sustainable strategy is the one that anticipates change. The only way to solve this problem is engagement of institutions and expertise in finding sustainable solutions. In short, to serve as conceptual platform for economic revival, strategy of reindustrialization should be prepared under the lead of the Government, and adopted by the Parliament.

Whatever they do, politicians should not underestimate the power of context and leading forces. Also, they must concentrate on the creation of feasible strategy that matters, by creating an economy that could be sustainable in their mindset.

Mindset is important. But mind setting is critical. Reindustrialization strategy emphasizes a few things that politicians could do to change current mindset and

align it better with the imperatives of the future economic development.

*First*, whatever they do, politicians should promote the sense of reality. What Serbia really needs, it is realism instead of empty rhetoric. Our mindset might have something to do with perception, how vulnerable our economy really is. Right diagnosis is the first step in promoting optimism. Napoleon put it this way "Define reality, give hope". If you accept previous, it follows that the place to start is inside us. We need to change our mindset before we negotiate the EU accession road map, establish new institutional settings and economic policy measures which foster reindustrialization.

Sense of reality is important for goal setting. *S. Milosevic's* vision for Serbia as "Switzerland of the Balkan" in the early 1990s and *Z. Djindjic's* vision of post-industrial society one decade later have evolved in the meantime into "transitional Greece" (IMF) and "by-the-way economy" (Anonymous), respectively. Statements of the great majority of Serbia's politicians are not anchored in reality, being mostly without strategic sense, generic by nature, and uninspiring for relevant people (technocrats). Anchored by clear and compelling purpose, politicians in Serbia must leave their background and empower themselves by expertise of knowledgeable people and relevant institutions.

*Second*, politicians must be aware of the choices they are making. They need to start with the facts about the EU when they begin to negotiate the integration process. In economic policy choice the key issue is the compatibility argument. If you are in the accession process to the EU, you must have some monetary and fiscal alignments (for example, stable and competitive FX rate). Also, technological development should be complementary with the EU technological platforms. This is really important.

In today's 18-country Eurozone approaching toward the banking union the main pillars of economic policy platform are as follows: global market integration through regulatory set-up, financial market regulation, active role of the European Central Bank in consolidation and stability of financial system, and more active role of the state in inclusive economic development (primarily in technological

development). In new context, for approaching to the EU the inflation targeting is not enough.

But integration is not panacea for our structural imbalances. Without understanding of the principal causes of crisis, vulnerability of our position and feasible solutions, politicians just engage themselves in stereotyping and exaggeration. That usually does not help at all. Attempting to do too many things at once makes it difficult to do any of them well.

*Third*, they must be solution providers. Unspecified view is not trucking solution. Speaking about reforms politicians eagerly tell you the “what” but forget the “how” – the critical activities and resources that enable the economy to realize its comparative and competitive advantages. It is by looking at the “how” that ordinary people gain confidence in what politicians are doing. The strategy, moreover, is not about writing a statement that sounds good. It is writing a statement that is good, that really captures future and which is feasible.

The shortage of technocratic elite, particularly in natural monopolies and network technologies, is a matter of fact. Few state-owned companies from these sectors are explicit about the future goals. In what markets will they operate? To what extent and how quickly can they grow? How will they differentiate themselves?

Solutions depend on circumstances. If you are from a small country with a lot of emigrants, you should think of your diaspora as a valuable asset. For example, the top people from ICT industry have spent significant time living and working in the US and Canada. What seems to be missing is that these repatriates could be used for strategic purposes as cross-border connectors and deal makers, not as the sources of funds and/or top level politicians.

*Fourth*, politicians must relieve themselves of balkanization syndrome. They must be integrator, not disintegrator. Balkanization syndrome is key explanatory element of national culture in Serbia. Political party balkanization is not exception to the rule. Particularly, balkanization is evident in its full capacity in coalition government. For example, the main political parties from the last government offered extremely different views about the role of the state in the economic future of Serbia. On the one hand, there is a strong intention that the state should continue to

provide a platform for social protection. Unfortunately, this view drives the economy into conundrum because double deficits after double deficits in the long period of time are in contradiction not only to sustainability of welfare state, but also to sustainability of any other development models. On the other hand, there was strong intention from other partner that the state as transformative leader is the only way for economic revival and sustainable development. But the latter view, requires not only a political consensus, but also a comprehensive program of reforms.

*Fifth*, politicians must increase the level of transparency. Relevant people and institutions have the right to understand key decisions and be involved in decision making process. In that context, transparency is not simply sending and receiving, nor exchanging data and opinions. Namely, transparency forces politicians to listen. In connection with the previous is the elimination of the arrogance without substance usually coming from the top level of state bureaucracy. What politicians should be trying to do is to inspire the people who are interested in implementing systematic view in building viable, feasible and resilient economic policy platform complementary with the EU we are striving rather than tearing down the present one.

A lot of work in neurology and behavioral sciences suggests that what really transforms people is networking, or having personal interactions rather than just reading about other people’s standpoints and trying to understand them.

Reform mind setting provides that reform process passes smoothly and with minimum resistance. On the other hand, politicians have to embrace the role of catalysts of reform. Namely, politicians should act as a magnet for people ready to involve in implementation of necessary reforms. Politicians are responsible for agglomeration of relevant people into reform teams in a way that creates critical mass of expertise and enthusiasm that enable industrial policies formulation and implementation for tradable sectors.

As a consequence, we should not go on with the previous way anymore when defining economic policy platform. Also, no trade-offs in new policy. You cannot be everything to everybody, although a lot of weak strategies and strategy statements implicitly claim to be that. It simply doesn’t work. To avoid the previous approach,

industrial policies must be defined for priority sectors and with the great sense for details. Neoliberal doctrine and its supporters could be no more an alibi for inactive government in the field of economy as well as platform for fully independent central bank.

## Conclusion

If we exclude Kosovo issue, probably the most frequent subject matter for top Serbia's politicians in the period between two Kopaonik forums was fair and equal treatment of all citizens. Standard wisdom says that a cosmopolitan politician is somebody who treats all people equally, irrespective of whether they are entrepreneurs, workers, pensioners or unemployed people.

We thought it would be interesting to look at the manifestation of constant bias of Serbia's politicians toward employees in the state sector and pensioners. The whole discussion about equality treatment strikes as a missing point after the question: What is going on with people most relevant for economic revival such as entrepreneurs, thinkers, scholars, and unemployed youngsters? The previous leads to semi-philosophical reflection. Politicians cannot carry out only what the majority of people wish for, but also what is viable for the country's future in the process of its reshaping through entrepreneurship, education and employment.

Reform-minded climate largely depends on strategists and their readiness to first and foremost consider the consequences of political decisions, giving priority to the return on investment (ROI) over the return on voters (ROV). Time horizon of strategists is much longer than horizon of standard political cycle in Serbia. Weak reform mindset and focus on short-term issues are typical of frequent election countries. From the introduction of multi-party democracy in 1990, Serbia has passed through ten elections and seven of them were premature.

Instead of politicians that do politicking, Serbia desperately needs strategists with the clear and feasible vision for sustainable economic development. No matter how solid is their political support, or how equitable their motives, if they do not get economic reforms right, everything else they do is at risk.

In an economy with double macro deficits, continuous issuing of debt instruments is not sustainable. It cannot eternally compensate for the output gap and fault lines in economic policy. Also, it is politically counterproductive that the deficits made by one generation are constantly debt-financed and thus transferred to the next generations and/or re-inflated, i.e. lead to redistribution in the same generation between those who save and those who spend more than they could.

The future of our future must be brighter than the time we are facing today. The exit strategy from crisis should not propose redistribution of wealth and factors of production, but rather value creation. It will not be easy because we must simultaneously eliminate the burden from the past and adapt our economy to the nexus of transformative global discontinuity challenges.

Reindustrialization as a possible way out from transitional recession should be seen as critical not only from economic, but also from political perspective. The economy is the foundation of a society. Experience shows that sustainable economic development and political stability at this level of economic development are based on the real economy and industrial development.

Naturally, the implementation of reindustrialization requires a more complex economic policy platform that would create new level playing field for the handshake between the government's visible hand (industrial policies for tradable sectors and automatic stabilizers in monetary and fiscal spheres) and invisible hand of the market providing efficient selection environment for all economic agents. In new context entrepreneurs can flourish and they are not penalized for failure but can actually learn from it.

Our proposal is an attempt to restore balance between market and government with greater transparency and accountability, with short-run actions consistent with long-run vision, without irreversibility and asymmetries. Reindustrialization is a more dynamic and more sanguine way for deepening domestic market and penetrating external market niches. It unlocks opportunities for sustainable growth.

Reindustrialization is a way to solve the crisis of confidence by enabling Serbia to successfully return to industrial economy development model. Without this,

economics in Serbia will keep the status of “gismo science”, a toy in the hands of politicians.

Do we have bright economists? Yes and no. Probably, yes. Do we have strategists? We have to see.

## References

1. Brkić, M. (2013). *O učincima slabih institucija*. Beograd: Centar za primenjenu evropske studije.
2. Đuričin, D., & Vuksanović, I. (2012). How macroeconomic policies erode business competitiveness: Serbia's experience. *Zagreb International Review of Economics and Business*, 15(Dec), 19-34.
3. Đuričin, D., & Vuksanović, I. (2013). Risks of delayed reindustrialization. *Ekonomika preduzeća*, 61(1-2), 1-18.
4. Đuričin, D., & Vuksanović, I. (2013). Reindustrialization strategy for Serbia: How to get it and how to use it. *Ekonomika preduzeća*, 61(5-6), 289-309.
5. European Bank for Reconstruction and Development. (2012). *Transition report*. Retrieved from <http://www.ebrd.com/pages/research/publications/flagships/transition/serbia.shtml>
6. European Commission. *Eurostat database*. Retrieved from <http://epp.eurostat.ec.europa.eu/>
7. Ghemawat, P. (2011). *World 3.0: Global prosperity and how to achieve it*. Boston: Harvard Business Review Press.
8. Goleman, D. (2013). The focused leader. *Harvard Business Review*, December, 51-60.
9. International Monetary Fund. (2013, October). *World economic outlook: Transitions and tensions*. Washington: IMF.
10. International Monetary Fund. (2014, January). *World economic outlook update: Is the tide rising?* Washington D.C.: IMF. Retrieved from <http://www.imf.org/external/pubs/ft/weo/2014/update/01/pdf/0114.pdf>
11. Madžar, Lj. (2013). Institutional dynamics as a determinant of economic development - with reference to China. *Ekonomika preduzeća*, 61(3-4), 163-173.
12. Malinić, D. (2013). Insufficiency of Serbian economy's operating performances: Manifestations, causes and main guidelines of recovery. *Ekonomika preduzeća*, 61(1-2), 41-62.
13. Montgomery, S. (2013). *The Strategist*. London: Harper Collins Publishers.
14. National Bank of Serbia. *Data and statistics*. Retrieved from <http://www.nbs.rs/>
15. Nussbaum, M. (2001). *The fragility of goodness: Luck and ethics in Greek tragedy and philosophy*, Cambridge: Cambridge University Press.
16. Petrović, P. B., & Milačić, V. R. (2011). National technology platforms of Serbia. In *Proceedings of 34th International Conference on Production Engineering* (pp. 15-25), Faculty of Mechanical Engineering, University of Nis.
17. Rajan, R. (2010). *Fault Lines*. Princeton: Princeton University Press.
18. World Bank (2013). *Global economic prospects: Assuring growth over the medium term*. Washington D.C.: WB. Retrieved from [http://siteresources.worldbank.org/INTPROSPECTS/Resources/334934-1322593305595/8287139-1358278153255/GEP13AFinalFullReport\\_.pdf](http://siteresources.worldbank.org/INTPROSPECTS/Resources/334934-1322593305595/8287139-1358278153255/GEP13AFinalFullReport_.pdf)



### Dragan Đuričin

is a Full Professor at the Faculty of Economics, University of Belgrade. He teaches courses on Strategic Management and Project Management (graduate studies), Business Strategy and Strategic Finance (postgraduate studies), and Economics of Strategy (doctoral studies). He wrote a dozen of books in the fields of strategic management, project management, and economic transition. He was a visiting professor at the University of Venice as well as a fellow of Fulbright Foundation. He is the editor in chief of *Ekonomika preduzeća*. He is the executive chairman of the Kopaonik Business Forum and cofounder of the SEE Management Forum. He has been working for Deloitte for almost two decades, and since 2007 he has held the position of chairman of Deloitte Serbia. He is also a member of the Council for Economic Recovery of the Government of the Republic of Serbia. He was president of the Serbian Association of Economists for fifteen years. He was a member of the Economic Council of the Government of the Republic of Serbia. He is/was a member of the board of directors in several organizations such as Metalac, Sintelon (Tarkett), Apatinska pivara (Molson Coors), Imlek (Danube foods), Hypo Alpe Adria Bank, Messer Tehnogas and Cardiovascular Institute of Dedinje.



### Iva Vuksanović

is a Teaching Assistant at the Faculty of Economics, University of Belgrade. She received her master degree in Strategic Financial Management in 2009 from the Faculty of Economics, University of Belgrade. Currently, she is a doctoral student in the field of risk management in the energy sector. She is the editorial coordinator of *Ekonomika preduzeća*. She also works as a research associate at Centre for Scientific Research of the Faculty of Economics. Her other interests refer to risk management, corporate governance and compensation policy. She wrote numerous papers related to the previous topics.