

The Economic Recovery, including SMEs Sector, is Secured

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Abstract: During the period 2009-2014 Serbia faced zero rate of growth. In the last two years it put the main economic problems, namely: the budget deficit, public debt and international debt, under control. At the same time international and domestic demand somewhat increased while inflation rate stayed at low rate and as a result it seems that economic recovery is now secured. Above all market reforms in some important areas got momentum. The reaction of small and medium scale enterprises and shops was positive and again more entrepreneurs started their business than quitted.

The aim of the paper is twofold: firstly, to illuminate what are the main reasons for overall positive economic trends especially in SMEE sector and secondly, to elaborate why is important now to introduce measures in order to improve competitiveness of Serbian SMEs and how to do so.

Keywords: SMEE, market reform, recovery, support

1 Introduction

Prior to the crisis, which negatively affected Serbian economy at the end of 2008 and the beginning of 2009, SME sector experienced fast development and became important economic subject. It created 40% of total GDP, employed almost 2/3 of total employment and contributed with 1/2 into total export. This encouraging

outcome was result of improved overall economic climate due to market reforms and supportive measures for SMEs strengthening.

During the crisis small and medium scale companies and shops (SMEEs) were affected more than large companies, because government support weakened, market reforms lost momentum, access to finance became more difficult and domestic and foreign demand shrank. It seems that 2011 was the worst, when for the first time during the transition period more SMEs and shops were closed than new established.

During 2015 and 2016 there are signs that economic recovery is secured, including SMEs. The main economic problems: unemployment, public debt and external debt still exist, but are put under control. Low inflation and stable FX rate make business condition predictable. Domestic demand and somewhat external demand are increasing. Balance of payment and FDI are improving. Market reforms in some important areas took place.

In spite of possible risks for growth, related to recovery in EU, public deficit and public and external debt, SMEs development in near future, is secured.

2 The light at the end of the tunnel – SMEs recovery is secured

The main problems which Serbian economy is facing with are: public debt and public deficit, external debt and high unemployment. During 2015 and 2016 those problems are put under control, and progress is more encouraging than projected.

	2009	2010	2011	2012	2013	2014	2015	2016
GDP (% p.a.)	-3,1	0,6	1,4	-1,0	2,6	-1,8	0,7	2,7
GDP € bill	30,7	29,8	33,4	31,7	34,3	33,3	32,9	33,8
GDP p.c. €	4.187	4.082	4,619	4.400	4.781	4.672	4.626	4.750
Inflation (% p.a.)	6,6	10,3	7,0	12,2	2,2	1,7	1,5	1,6
Current Account Deficit %GDP	-6,6	-6,8	-10,9	-11,6	-6,1	-6,0	-4,8	-4,0
Budget Deficit %GDP	-4,4,	-4,6	-4,8	-6,8	-5,5	-6,6	-3,7	-1,7
Public Debt %GDP	32,8	41,8	45,4	56,2	59,6	70,4	74,7	72,9
External Debt %GDP	72,7	79,0	72,2	80,9	75,1	77,1	80,1	76

Table 1.
Serbia – main economic figures 2009 – 2016
Source:[1]

At the end of third quart of 2016 external debt amounted 25,7 billion which was 0,5 billion less than at the end of 2015, due to repayment which was made by government mainly (374 mill while private debtors repaid 134 million). At the same time the share of external debt in GDP was 76%, which is encouraging improvement in comparison to its maximum (81% at the end of 2013)[1]. In 2016 Budget deficit was 1,7% of GDP (while was 6,6 and 3,7% of GDP in 2015 and 2014, respectively). Total public debt (internal and external) was 24,8 billion €, or 72,9% of GDP (while was 75% at the end of 2015)[1]. Total employment increased 3% in 2016, mainly in private sector (5,3 % increase). At the same time unemployment is still serious problem, especially among young generations, but with decreasing trend (13,8% in the third quart of 2016)[1].

Inflation rate after years became comparable to EU level. Inflation rate was 1.6% in 2016 (1,5 % in 2015 and 1,7% in 2014). Moreover it was less than the lower limit targeted by National Bank of Serbia, as target was $4 \pm 2\%$, so it was corrected down to $3 \pm 1,5\%$. Low inflation rate was result of low inflation pressure related to internal and external factors as well, namely oil prices, prices of agricultural products, low domestic and EU demand. Central Bank (NBS) additionally decided to put interest rate (referent interest rate is interest rate on state bonds repurchased in one week) down to 4%, as a part of monetary relaxation from May 2013 in which interest rate decreased by 7,75 pp[2]. FX rate of Dinar was stable as it depreciated 3,5% in the last four years, which was outcome of low inflation rate, high volume of FDI (1,6 bill € in 2016 and 1,8 bill € in 2015), stand - by arrangement with IMF, improved risk position of Serbia VS foreign creditors and more than enough FX reserves of NBS for intervention on FX market (amounted 10,2 billion€ at the end of 2016)[2].

During the period 2009-2014 Serbia was faced with zero rate of GDP growth. Economic activity is now 2,4 % higher in comparison to pre - crisis period. In 2016 growth of economic activity was 2,7 % due to increase in industrial production (increase 4,7%), services (volume of retail trade increased 7,5% and tourism 13%), investment activities and export [1]. Projection of growth of GDP in 2016 was corrected upward, because of increase in economic activities and Balance of Payment improvement. In 2016 export volume was higher for 11,5 % and import 6,1 %, with increasing cover of value of import by export (77%). Trade balance was at the same time 4% of GDP and completely was covered by inflow of FDI.

Market reforms got momentum in recent period, especially in some important and sensitive areas. Namely, getting of construction permit is now improved, necessary time to get it is 30 days and procedure is in e-form. In the past it was one of the main obstacles in business, with time frame of more than one year. The Labor legal framework became more flexible, with more precise evidence of (un)employment and more powerful labor inspection. The Fiscal restructuring for the first time became strict and, although very painful, succeed to stop increase of public debt [3].

In spite of bright signs that economic recovery is secured and economic trends better than projected, there are some risks for growth in the next period. GDP increase in

2017 is projected to 3% [2]. Serbian main trade partners are from EU countries, former republics of SFRY and Russia. Euro zone is facing with difficulties, like Brexit is (pool decision of Britain to leave EU). EU GDP growth for 2017 is projected to 1,7 %, mainly due to policy of monetary easing of European central Bank (ECB) from the 2015. The risks for projection of growth are also related to the prices of oil on the global market (somewhat stabilized due to OPEC agreement of volume of production) and to different monetary policies of central banks (contrary to ECB, FED for the second time increased its interest rates, after six years of stable almost zero rates). The main test for successful Serbian recovery is related to domestic factors: readiness for fiscal restructuring, as Serbian public deficit is higher than EU average (3,8 and 1,4% of GDP in 2015 and 2016) and public debt also (75% and 73% of GDP in 2015 and 2016).

3 The development hindrances and low competitiveness of SMEs

Serbia has started process of transition as the last among countries of Eastern and Central Europe. The development of SMEs sector was very fast in the period 2001-2008 due to the market reforms and encouraging business environment combined with government support. The goal was to establish as much as possible new business unites, namely SMEs, and the goal was achieved, as maximum was 13 thousands of new SMEs per year. As a result SMEs sector became important economic agent. According to number SME amounted 99,8% of total economic entities, their contribution to total employment was 2/3 and 1/3 to GDP formation. Their share was 64% in total turnover and 56% in total Gross Value Added (GVA) [4][5].

	2008	2009	2010	2011	2012	2013	2014	2015
SMEE Number 000	303,4	314,8	318,5	319,3	317,1	315,4	324,2	324,6
SMEEmployees 000	940	873	815	787	782	769	762	802
SME GVA million €	10.289	8.282	7.933	8.614	8.637	8.521	8.777	9.084

Table 2.
Serbia – SMEE, main figures

Source: [4]

The Overall economic crisis negatively affected Serbian economy from the end of 2008 and at the beginning of 2009. SMEs were affected especially because of decreasing domestic and external demand, worsening business environment, lesser support from government and difficult access to financials[6]. At the beginning of the crisis SMEs were resistant to cut number of employees, but with weaker economic performances they had to do so. Micro and small companies were severely affected because of lack of financial assistance from banking sector. In spite of difficulties among SMEs only fast growing companies and gazelles continued to grow [5].

Good insight into business environment, business chances and job creation one can get from business demography. From 2008 on one can recognize two opposite trends: number of newly established companies and shops is decreasing, while at the same time number of those companies and shops which terminate their activities is increasing. It seems that 2011 was the worst, when for the first time during the transition period net effect was negative (number of closed was higher than number of new established)[7]. One can recognize that during the last two years (2015 and 2016) there were some positive signals regarding business demography, as result of somewhat improved conditions for business.

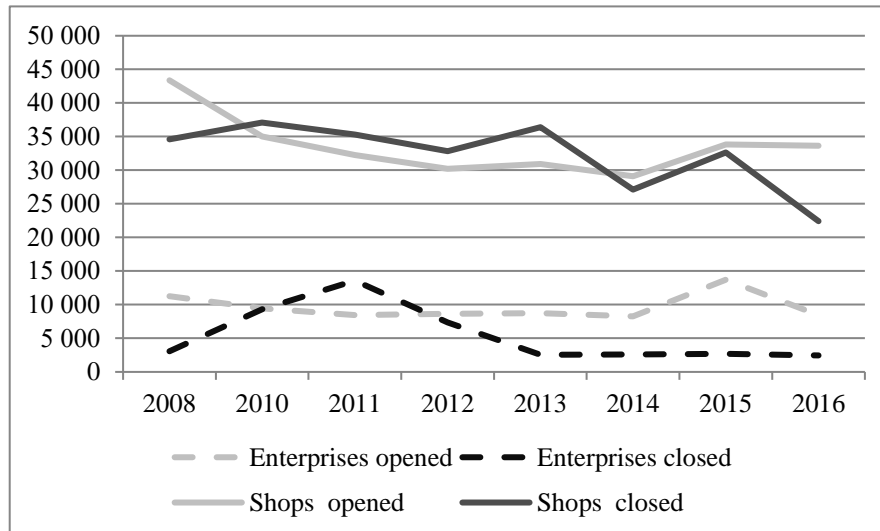


Chart 1.
Serbia – Opened and closed companies and shops

Source: [7]

Overall business environment is improving step by step during the recent period, which is important for those potential entrepreneurs with idea to start up business. It can be seen from global investigation on Global Entrepreneurship Index (GEI) [8] calculated for each country as indicator of quality of entrepreneurship,

individually and institutionally, especially for innovation and effect of entrepreneurship [9]. Serbian GEI value is 23,1, ranked as the 72nd, which is two places better than the year earlier. Comparing to other countries within the Region of South East Europe Serbia is behind Montenegro and in front of FIROM. According to the investigation Serbia has comparative advantages related to better knowledge of entrepreneurs - beginners, linkages between entities and implementation of innovation and new technologies. Its drawbacks are: fewer chances to start business, low share of SMEs in medium and high tech sectors, low quality of human sources, scarce venture capital and low level of internationalization of SMEs [9].

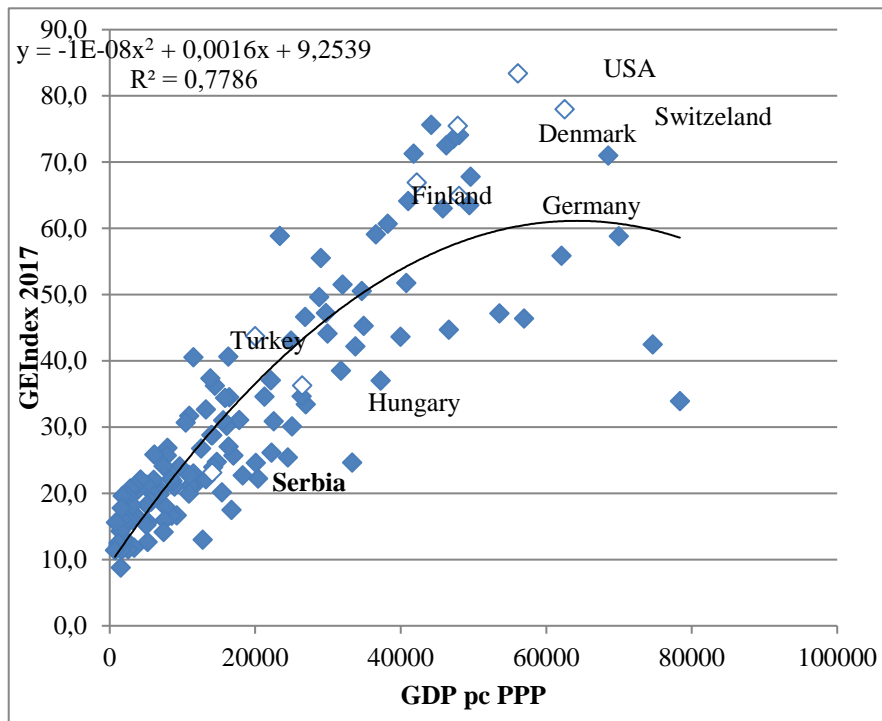


Chart 2.
 Global Entrepreneurship Index

Source: [9]

According to Doing Business Report 2017 Serbia belongs to top ten countries in market reforms [10]. It was ranked as the 47th while the year earlier was ranked as the 54th. The improved (e-form) and shorten procedure for construction permit was accessed as the main step forward (according to this Serbia improved its position from the 152nd to the 36th). The land registry was improved (Serbia moved from the 72nd to the 56th position) and business registry, as well (Serbia moved from the 62nd to the 42nd position). However, at the same time the Report labeled the legal

environment and administrative procedures as bottlenecks (a contractual execution and electricity acces) [10].

In order to speed up and secure economic recovery the analysis of the main development hindrances was made [11]. In spite of improving business environment step by step and speeding up market reforms strong development hindrances still exist. The assumption is that sustainable growth and development are driven by private investments. So, the point is to find out what is constraining domestic private investment in Serbia. Firstly, administrative and regulatory burden toward private business are strong. Secondly, regulatory uncertainty is also important issue. Thirdly, information externalities prevent economic diversification and strengthening competitiveness. Fourthly, Access to finance is weak, especially for SMEs and start ups. Fifthly, human capital is constraints for knowledge intensive industries[10].

To check weather business environment is really improved, in which areas and how much, the best way is to ask entrepreneurs. It was done during September and October 2015 with thousand companies and shops [12].The survey included questions related to business results in the past and projections for near future, with important part related to market reforms realized in meantime. The main finding is that business environment is improved in some areas very much, in some areas improvements were modest, but in some areas there were backward steps.

Considerable improvement	Improvement	No Improvement	Worsening
Tax and related duties on wages Construction permit Permit to start business Inspection control Court execution process GVA payment Corruption Inflation FX rate	Court procedure Para-fiscal duties Admin procedures Custom procedures Payment Public procurements Interest Credit issuing Collateral Informal economy Reform publicity	GVA rate Custom duties Credit issuing timing Bank reporting Fiscal admin	External financing Banks' loans Banks servicing Excise Real estate prices

Table 2.

Serbia - Improvement of business environment 2011-2015

Source: [12]

According to Serbian businessman encouraging improvement were made in construction permit procedure, executive procedure efficiency and procedure to establish business (28%, 55% and 25% negative answers in 2015 respectively, while 43%, 66%, and 35% were negative in 2014). Considering the entire period 2010-2015 encouraging improvements were made in areas as follows: construction permit, business establishment, fiscal and other duties on wages, inspection control, court executive procedure, GVA payment, corruption dismantling, FX and price stabilization. At the same time modest improvements were made in: level of fiscal and related duties, court, custody and admin procedure, labor legal frame, procedure and duties related to crediting. No improvement was pointed in: GVA and Custom duties level, fiscal administration and credit procedure. At the same time backward steps were made in some areas: excise, price of real-estates and access to finances. As can be seen, businessman optimism was increased, as result of reforms, which speed up in the recent period. According to the investigation more entrepreneurs than before expect increase in profit (44% in 2015, and 34% in 2012), and increase in employment also (24% in 2015 and 19% in 2012)[12].

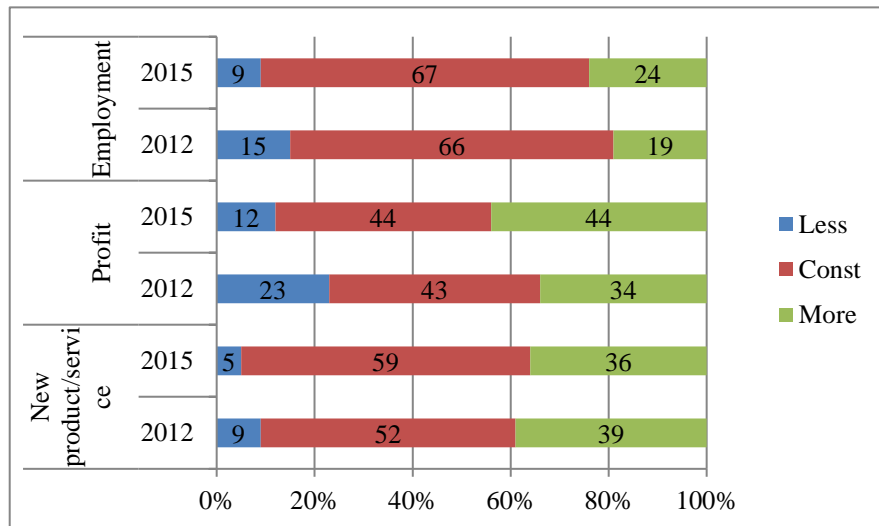


Chart 3.
 Serbia – Businessman's expectation

Source: [12]

4 Government SME supportive measures need time for full effects

Serbia has started process of transition after political changes in October 2000. Considering low statistical basis, because of deep economic and overall crisis during 1990s, market reforms and economic growth were very fast in the period 2001 – 2008 (GDP increase was 5,4% per year on average). During this period necessary institutional and legal framework for SME support were established, access to finance was easy and cheap, business environment was generally improving [6]. SME growth and development was fast considering number of entities and their increasing share in economic figures. It was fast enough partially to absorb increasing unemployment related to those workers who lost their job during restructuring of companies.

Regarding the government SME support policy and measures one can clearly separate two - sub period during transition process (2001-2016). The first phase was period until 2008 and the start of economic crisis, in which good record of SME growth and development was made, during which SME sector became important economic agent. In this period government support was of quantitative character, with a goal to establish as much as possible new entities (companies and shops as well) each year. The second phase was more difficult one, because of deteriorated overall economic environment related to the global crisis. During this period it became clear that Serbia has to change development approach (strategy) toward international market, with competitiveness strengthening and efficiency improvement. It means at the same time that goal became microeconomic, e.g. related to company (shops) level. So, government SME support policy ought to be rather qualitative, to strengthen innovations and technology, to improve productivity and internationalization of SMEs[13].

The main findings of SME Policy index, which is measuring achievement in several dimensions related to Small Business Act, is that general business environment is improving, especially in recent years, but some important questions ask for engagement, like access to finance and green economy [6].

Strong progress		Need improvement	
Dimension	Mark	Dimension	Mark
7. Technical regulation	4,01	9. SME greening	2,10
3. Regulatory framework	4,15	1. Learning and women entrepreneurship	2,70
5. Public procurement	3,96	2. Bankruptcy procedure	2,60

Table 3.
Progress made and challenges – SBA dimensions
Source: [6].

It was already mentioned that the finding is that the state is large and costly, while private sector is non – competitive [14]. Considering that after a few lost years when market reform were diminished, the market reform got momentum, it is necessary to continue with the reforming process especially in areas accessed as key bottle - necks, which stopping or slowing growth and development. As the economic growth has to be export led, the reforms would address constraints to investments in the tradable sectors and exports, access to finance for SME and start - ups, human capital for knowledge intensive industries and administrative and regulatory burden and uncertainty [17].

As fiscal deficit and public debt are the main macroeconomic problems it is necessary to continue with the fiscal consolidation. Public companies are at the very beginning of their restructuring, which have to speed up. Few dozens of still socially owned large companies also have to be restructured and sold (or closed) if one wants to cut government subsidies. In order to improve business environment further the legal framework have to be simplified and investments support system improved. For the research and innovation important, for supporting business innovation and addressing information externalities, is to adopt a new strategic and legal framework. A part of broaden reform should be improving the efficiency of managing educational system.

Conclusion

SMEE sector in Serbia became an important economic agent during the period of fast growth and development between 2001-2008, in which Government support was of quantitative character, with idea to establish as much as possible new economic subjects each year. However, one can see that a critical number of SMEEs was not reached, so development of the entrepreneurial sector was not self sustained.

Serbian economy was hampered by global crisis and zero rate of growth of GDP was evidenced in the period 2009-2014. SMEEs were severely affected as domestic and foreign demand weakened, government support also and market reforms lost momentum. Only a teeny segment of fast growing SME and gazelles continued to grow.

During the recent period market reforms fastened, in some important areas were made brake through. More important, domestic and foreign demand recovered and Government put the main macro problems, like public deficit and debt under control successfully. As a result inflation rate is, for the first time, comparable to EU level and FX rate is stable. Now, Serbian development strategy has to be changed toward export oriented one. It means that government support for SMEE ought to be of qualitative sort and micro oriented, with idea to strengthen competitiveness, innovations and internationalization of SMEE.

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