SERBIA'S TRANSITION TO MARKET ECONOMY: WHY HAS THE MODEL NOT DELIVERED?

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Abstract
The paper discusses the transition to a market economy in Serbia, a country that until the early 2000s was one of the principal laggards in the transition region. The paper tries to explain why Serbia, which had a relatively good starting position in 1989, has encountered substantial delays in carrying forward the main objectives of the transition to a market economy. Despite political stabilization and many positive economic achievements, the post-2001 transition strategy has not delivered the expected results. The strategy was based on the hyper-liberal model which placed emphasis on liberalization, stabilization and privatization, in line with the recommendations of the "Washington consensus", neglecting many other important areas of reform. With the new post-2000 turn towards the market mechanism, the essential role of the state and of state institutions was underestimated, which contributed to various long-run failures.
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1. Introduction

The transition to a market economy in Serbia has been more complex than in most countries in Eastern Europe and in many ways unique. The multiple political events that have inflicted Serbia in the 1990s have had very negative implications for its economy, greatly delaying the process of transition, economic recovery and integration with the European Union (EU). After a difficult decade characterized by political and economic instability, Serbia embarked on transition for the second time in late 2000. The September 2000 elections finally brought the end of the Milosevic regime, gradual democratization of the political system and the determination to implement more radical economic and institutional reforms. More than a decade later, however, the overall results of the new course in transition have been much less impressive than expected. Although there were a number of achievements in many areas of economic reform, there were also important policy failures.

The Serbian transition has been further complicated by continuous changes in it's constitutional order. Over the past twenty years, there have been five important changes in Serbia's status or country of belonging. After having been one of the six republics of SFR Yugoslavia for over four decades, Serbia in 1992 (together with Montenegro) created the new Federal Republic of Yugoslavia, that in 2003 was transformed into the State Union of Serbia and Montenegro. Following the referendum in Montenegro in May 2006 when the majority of its citizens declared to be in favour of independence, Serbia and Montenegro became two independent states in June 2006. Finally, after the unilateral proclamation of political independence of Kosovo in February 2008, Serbia practically lost its southern province.

The paper discusses the main achievements and failures of Serbia's transition, trying to explain why the overall results have not been more impressive. The highly unfavourable overall conditions that Serbia inherited from the 1990s will first be briefly recalled, since they add to our understanding why the policy agenda in late 2000 was extremely complex (section 2). The principal achievements of the post-2001 economic and institutional reforms are then presented (section 3), followed by an analysis of the main policy failures (section 4). Some of the main reasons why the model has not delivered better results are also discussed (section 5), before drawing a few concluding remarks.

2. The heritage of the 1990s

Serbia started its transition to a market economy over twenty years ago, in the late 1980s, while it was still part of the SFR Yugoslavia. As all the other republics of SFR Yugoslavia, Serbia inherited fairly good starting conditions in 1989 (Kekic, 1996), thanks to continuous economic reforms in the past which aimed to introduce elements of a market economy. Serbia also benefited from the more radical measures launched by the last federal government in 1988-90 aimed at economic liberalization, macroeconomic stabilization and privatization of socially-owned enterprises (see Estrin and Uvalic, 2008). However, the transition process was interrupted by the break-up of the country in June 1991.

After the split of the federation, the new Federal Republic (FR) of Yugoslavia, constituted in April 1992 by Serbia and Montenegro went through a decade of continuous political instability (see Uvalic, 2010). Due to the country's involvement in military conflicts in the early 1990s in Croatia and Bosnia and Herzegovina, severe UN and European Union (EU) sanctions were in place during 1992-96, which prohibited trade, foreign direct investment (FDI) and other types of links with the outside world. The adverse political conditions which prevailed also in the second half of the 1990s continued to negatively influence economic developments, resulting in unsatisfactory economic performance. Though the most severe sanctions were lifted in 1996, what remained thereafter was the "outer wall' of sanctions, which effectively prevented the re-entry of FR Yugoslavia into the UN and the most important international financial organizations. In the meantime there was progressive worsening of the political situation in Kosovo, which led to the reintroduction of international sanctions against FR Yugoslavia in 1998 and to the four-months NATO intervention in 1999.

These political events of the 1990s have had very serious consequences for the Serbian/Yugoslav economy. The political choices during the early phase of transition have fundamentally influenced subsequent economic developments in Serbia, hampering the faster implementation of transition (Svejnar and Uvalic, 2012). War-related expansionary monetary and fiscal policies led the country into one of the highest and longest hyperinflations ever recorded in economic history – of 116.5 trillion percent in 1993 – while the very deep recession in 1990-93 caused a cumulative drop of GDP of almost 80 percentage points. The government's political priorities and unwillingness to radically change the economic system delayed the implementation of most economic reforms required by the transition to market economy. In the meantime, the adverse political and economic situation also contributed to FR Yugoslavia's delayed integration with the EU.

The 1990s also produced many complex social problems, with a dramatic social differentiation within society. Massive pauperization of large segments of the population went parallel with the fast enrichment of a thin layer of individuals, in part representing the new political and economic elite. In the early 1990s, the freezing of citizens' foreign exchange savings on their bank accounts and financial pyramid schemes orchestrated by the government through fraudulent private banks had robbed most citizens of their life savings. By late 1999, poverty increased rapidly, the average net Yugoslav salary declined to 95 DM, while the official unemployment rate was close to 30 percent. There was widespread corruption and criminality, the judiciary system had become highly inefficient strongly weakening the rule of law, and the population had lost all confidence in the government and its institutions.

By mid-2000, Serbia was among the transition countries that were lagging behind most in the implementation of market-oriented economic reforms. The first decade of transition in Serbia had brought most of the costs that have characterized other countries in Central and Eastern Europe (CEE) – a very deep recession, high inflation, poverty, social stratification, corruption – but had delivered very few, if any, of the expected benefits. The "gradualist" strategy of transition, implemented selectively and in a highly distorted way, in reality was extremely costly for the largest part of the population.

At the presidential elections held in autumn 2000, the Democratic Opposition of Serbia's candidate Vojislav Kostunica won against Slobodan Milosevic, which permitted a new course in political and economic reforms. At that time, however, the general conditions in the country were highly unsatisfactory (see more in Uvalic, 2010). In addition to the impoverished economy, there were a number of immediate political issues that the country had to address.

One of the most difficult was the undefined status of Kosovo. Although according to the UN Security Council Resolution 1244 Kosovo had officially remained part of Serbia/FR Yugoslavia, after the end of the 1999 conflict this province was effectively governed by the UN Mission in Kosovo (UNMIK). By 1 June 2012, however, more than four years since Kosovo's independence, the majority (53%) of UN members have still not recognized Kosovo, including five EU member states (Cyprus, Greece, Romania, Slovakia, and Spain).

The second problem regarded the re-entry of FR Yugoslavia into international organizations. After a decade of international sanctions and isolation, FR Yugoslavia had to regulate its status in the main international organizations, including its membership in the UN, the IMF and the World Bank. This required not only specific procedures and negotiations, but also finding a solution for its foreign debt obligations that had accumulated during the 1990s. Part of the international donors' assistance that was secured for FR Yugoslavia at the Donors Conference in June 2001 served explicitly for repaying the country's foreign debt owed to the principal international financial organizations.

Another group of delicate problems derived from the complex relationship between Serbia and Montenegro. After 1997 Montenegro tried to distance itself from the negative effects of Milosevic's policies by adopting its own laws in practically all relevant fields, including an independent monetary policy with the introduction of the German mark as legal tender. However, after the autumn 2000 elections, it was the Socialist People's Party (SNP) that continued to represent Montenegro in the federal Yugoslav government, a party that for years had been a loyal collaborator of Milosevic. The SNP disagreed on most issues with Djukanovic's government in Podgorica, which represented a serious burden for efficient decision-making in the federal government.

Last but not least, in late 2000 the country was subject to strict political conditionality related to war crimes, but within the government there was no consensus on the imprisonment and delivery of Slobodan Milosevic to the International Criminal Tribunal for the former Yugoslavia (ICTY) in the Hague. Milosevic was put in jail only at the end of March 2001 and was delivered to the Hague Tribunal much later, on 27 June 2001, the evening before the donors conference for FR Yugoslavia. The promised international assistance the country was badly in need of would not have been secured had Milosevic not been transported to the Hague prison the day before.

In late 2000 these political problems greatly hampered or at least delayed the implementation of key economic reforms, which at that time were considered less urgent. In addition, the specific political situation also strongly influenced the economic agenda. Given the country's extreme dependence on foreign financial assistance, the internationally imposed political conditionality determined, at least in part, the main directions of the transition strategy, since many economic reforms were undertaken following the advice of experts of international financial institutions (Uvalic, 2010).

The priority objectives on the economic transition agenda set in late 2000 were similar to those of the Central and Eastern European (CEE) countries a decade earlier. At that time, it was erroneously believed that the economic reforms applied in most CEE countries at the beginning of the transition would be equally successful in a country like Serbia. What was not taken into account was that Serbia was not starting its transition from scratch, but with a heavy burden inherited from the 1990s. The numerous economic, social and political problems that had accumulated during the years of sanctions, isolation, war profiteering, declining living standards, increasing corruption and criminality, absence of rule of law, had by the late 1990s determined highly unfavourable general conditions in Serbia. In other words, the overall situation in Serbia in late 2000 was far worse than in most CEE countries in the early 1990s when the transition was starting. The new strategy implemented from 2001 onwards in Serbia neglected these specific problems inherited from the past.

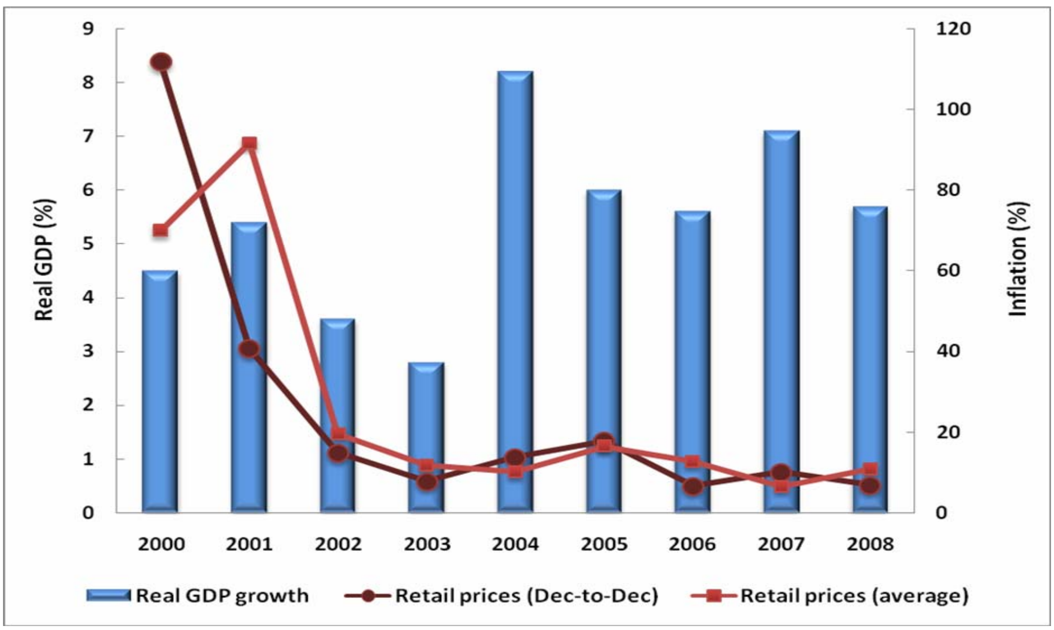
3. Post-2001 achievements

The end of the Milosevic regime in October 2000 led to the implementation of a number of important economic reforms. The establishment of a democratic government, together with reforms of political institutions, radical changes in a number of internal and foreign policy objectives, renewal of the country's relations with the outside world and inflows of donor's assistance, have permitted a profound transformation of Serbia's economic system. From early 2001 until the end of 2008, the new policies have brought a number of positive results.

One of the most important was gradual macroeconomic stabilization. Price liberalization initially led to very high inflation – in 2001, an average annual retail price inflation of over 90 per cent, or a year-to-year increase of 41 per cent. Thereafter, however, Serbia registered declining average inflation, from over 90 per cent in 2001 to around 10 per cent in 2008, sustained by prudent monetary and exchange rate policy. There was also some fiscal consolidation, although public expenditure remained over 40 per cent of Serbia's GDP throughout the decade.

The Serbian economy has also had relatively strong growth. The average real GDP growth rate during 2001-08 was 5.4 per cent, despite a notable slowdown in 2002-03, the year when the Serbian Prime Minister Zoran Djindjic was assassinated. Until the first negative effects of the global economic crisis in late 2008, growth was quite remarkable (see Graph 1).

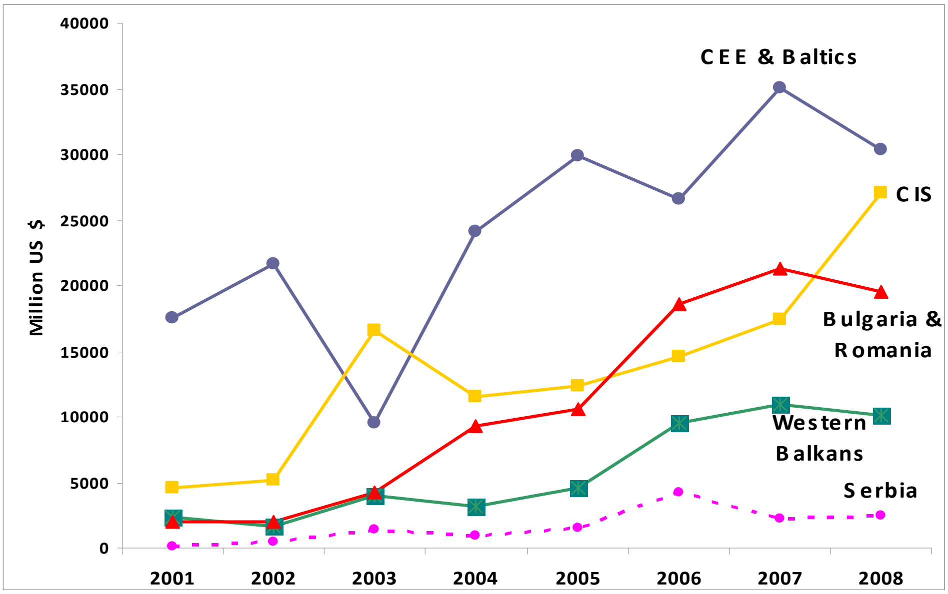
Graph 1. Real GDP growth and inflation in Serbia, 2001-08



Source: Uvalic (2010), p. 145.

Serbia has also attracted an increasing amount of FDI, until the end of 2008 a cumulative total of US$15 billion (see Graph 2). Considering that during the 1990s there was only one major FDI in the Serbian economy, on occasion of the partial privatization of *Srbija Telekom*, foreign resources were an important supplement to low domestic savings. Increasing capital inflows have also been secured through emigrants' remittances (around US$ 20 billion since 2001) and donors' financial assistance of various international organizations, the EU and other western countries. Foreign capital has played an important role in helping recent economic growth, but has also rendered the Serbian economy increasingly dependent on external capital inflows, thus highly vulnerable to external shocks as was the global economic crisis in late 2008.

Graph 2. Foreign Direct Investment in transition countries and Serbia, 2001-08
(net inflows, in million US dollars)



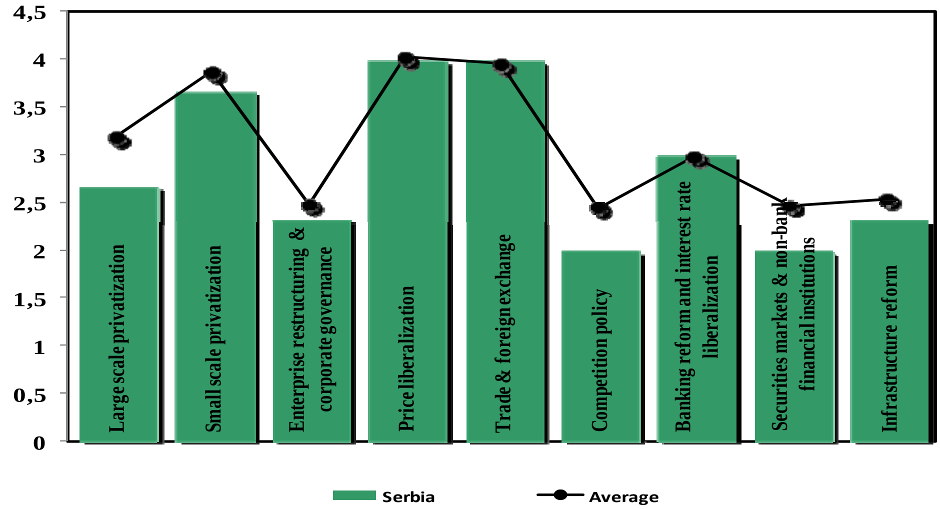
Source: Uvalic (2010), p. 158, based on data of the European Bank for Reconstruction and Development.

Post-2001 economic recovery has permitted a steady rise in living standards. Since 2001, Serbia's GDP per capita increased from €1,723 in 2001 to €4,500 in 2008, permitting some catching up with EU countries. GDP per capita (at purchasing power standards) increased from 21 per cent of the EU average in 2001, to 35 per cent in 2008. During this period average net wages in Serbia have increased more than four times, from €90 in 2001 to over €400 in 2008.

Serbia has also experienced an acceleration of institutional reforms, as illustrated by the transition indicators of the European Bank for Reconstruction and Development (EBRD) which measure progress in eight main areas of transition-related economic reforms in the Bank's 29 country clients in Eastern Europe, through scores that go from 1 (implying no reform) to 4+ (comparable to a developed market economy). From the assessment of the EBRD in 2009, we can see that Serbia has moved a long way towards the "ideal" model of a market economy. In some areas of reform Serbia has already reached, or is quite close, to the level of a developed market economy (see Graph 3).

The liberalization of prices and of the foreign trade system were implemented already in early 2001, while small-scale privatisation was carried further with the new law adopted in mid-2001. Major reforms of the financial sector were also undertaken with the closing down of four largest banks in 2001-02 and the privatization of most banks to multinational European banks after 2003, so that today 80 per cent of banking assets are foreign owned. The setbacks regard primarily four areas of reform: large-scale privatization, enterprise restructuring and corporate governance, competition policy, and securities markets and non-financial institutions, where Serbia in 2009 still had a below-average score of 2 or 2+.

Graph 3. EBRD transition indicators - Serbia and average scores for all EBRD client countries, 2009



Source: Uvalic (2010), p. 256, based on data of the EBRD.

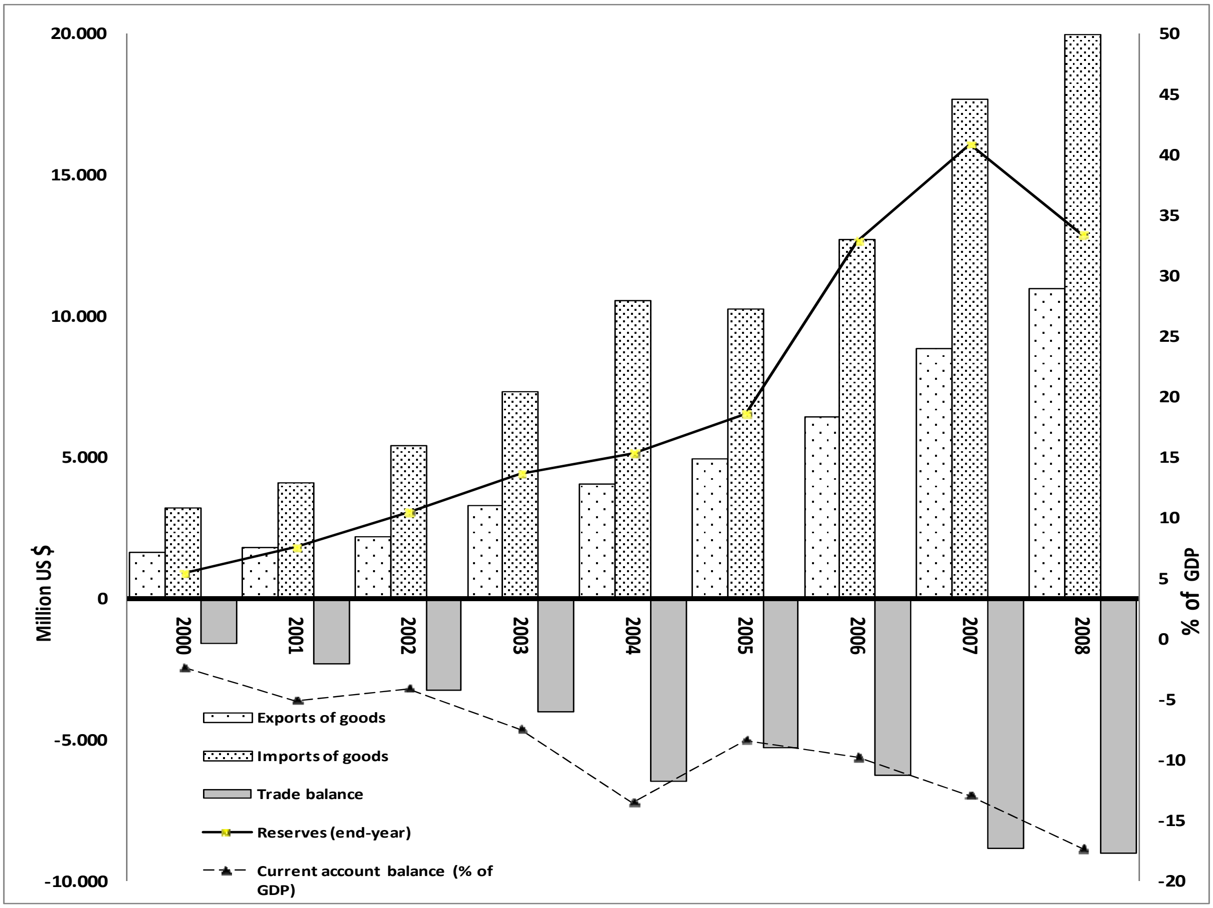
4. Major policy failures

The EBRD transition indicators measure progress in the most important areas of reform that are considered necessary for the development of a market economy. What they primarily take into account are the main systemic features of the pre-1989 economic system - regarding enterprises, markets and trade, and the financial sector - that required radical changes. What the EBRD transition indicators do not measure are the consequences of such systemic changes. In Serbia, transition-related economic reforms were accompanied by serious problems that are not reflected in the EBRD transition indicators - namely, extremely high unemployment rates, limited economic recovery of pre-transition levels of production, and the continuous widening of external imbalances.

(1) The phenomenon of *"jobless" growth* is one of the most pressing and long term problems of the Serbian economy. Despite relatively strong GDP growth during 2001-08, until 2006 employment has declined, while unemployment, whether measured by the official or the labour force survey rate, has continuously increased. Only in 2007 were there some improvements in labour market indicators, though the trend was discontinued with the outbreak of the global economic crisis in late 2008. Employment policy was basically treated as exogenous to the reform process and reduced to a supporting legislative labour market reform that was aimed at bringing more labour market flexibility in order to support the core processes of market liberalization and privatization (Arandarenko, 2009). The new system of labour taxation, in force in Serbia during 2001-07, introduced an inadequate, highly regressive, system of wage taxation, contributing to rigidities on the labour market and rendering the informal labour market much more flexible. One of the consequences is that the process of job creation in the new private sector has been very slow. After the outburst of the economic crisis in late 2008, the unemployment rate again increased, by mid-2012 to 24%.

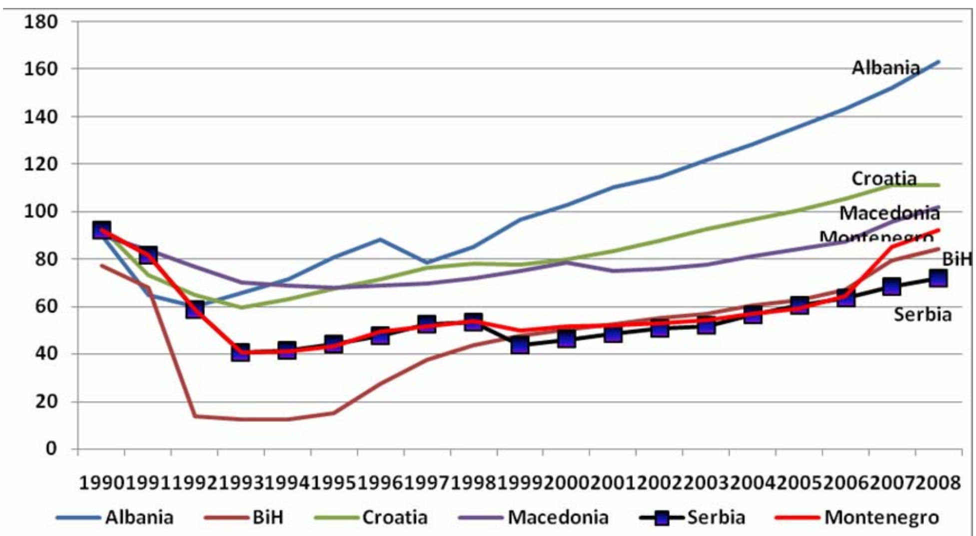
(2) Serbia has also been facing *increasing external imbalances*. Although foreign trade has recovered remarkably from 2001 onwards, the value of Serbia's imports has regularly been double that of its exports, determining a rising trade deficit (see Graph 4). The high foreign trade imbalance is the primary cause of the just as rapid increase in the current account deficit, which at the end of 2008 approached 18 per cent of Serbia's GDP. The global economic crisis, which hit the Serbian economy very strongly from late 2008 onwards, has brought some adjustments. The depreciation of the dinar by some 15% over the 2009-10 period has caused a decline in imports and increase in exports, but the trade and current account deficits nevertheless remain high.

Graph 4. Serbia's external sector indicators, 2001 - 08



Source: Uvalic (2010) p. 156, based on national statistics.

Graph 5. Real GDP in Serbia and other Balkan countries, 1990-2008 (1989=100)



Source: Uvalic (2010), p. 258, based on data of the EBRD.

(3) Another major long-term problem of the Serbian economy regards the process of *economic recovery*, which has not been fast enough. By 2008, Serbia's real GDP has reached only 72 per cent of its 1989 level, which is the most unfavourable position among all Balkan countries (see Graph 5). The slow process of economic recovery is due to both the severe recession of the early 1990s, more profound than in most other transition countries, and the GDP fall of 19 per cent in 1999 as a consequence of the NATO bombing. The relatively high GDP growth rates after 2001 have not been sufficient to compensate for the extreme loss of output in the 1990s. Moreover, there was a further setback in 2009 when Serbia, strongly affected by the global economic crisis, registered a negative GDP growth of 3.1 per cent, so by the end of 2010 Serbia was at only 70 per cent of its 1989 GDP level (EBRD, 2010).

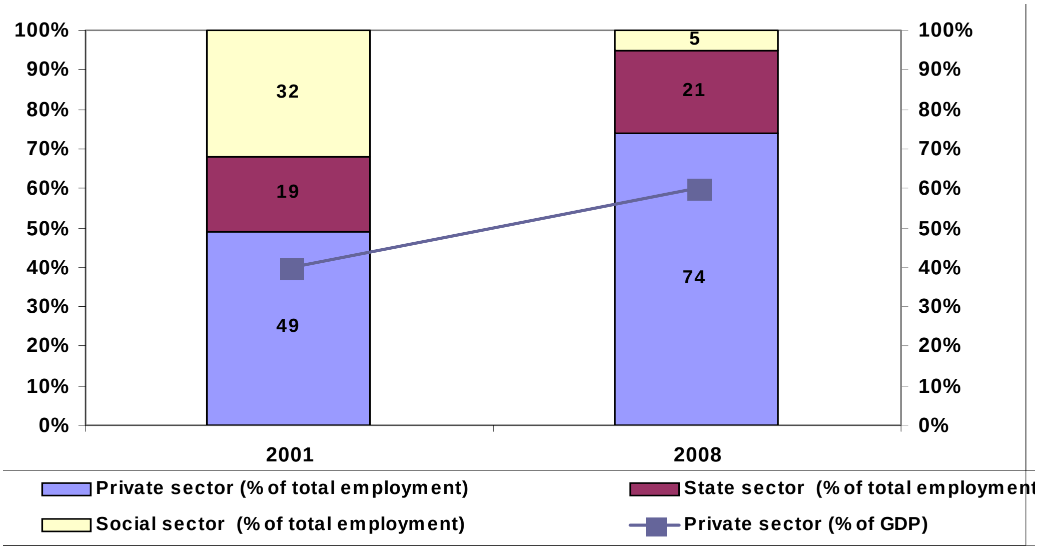
At the basis of the discussed failures – insufficient new employment, limited economic recovery, increasing external imbalances - are structural weaknesses in the real sector of the Serbian economy, which has not been sufficiently restructured and modernized. The new privatization law adopted in 2001, based on the method of sales to strategic investors of over 2,000 enterprises through tenders and auctions, encountered serious delays in its implementation (see Uvalic, 2010). While firms sold to foreign companies have mainly been restructured, in those sold to domestic owners, which represent the large majority of cases, little restructuring has taken place (see Cerovic, 2009). Privatization proceeds, for the most, have not been used for investment or restructuring. The new privatization strategy relied heavily on the quick arrival of FDI, but the expectations were far too optimistic. The radical political changes in late 2000 were not sufficient to immediately attract large amounts of FDI. Regarding the structure of FDI, two thirds have been in services - banking, telecommunications, real estate, trade - thus in non-tradables, not contributing much, if not indirectly, to an increase in Serbian exports. Many industrial firms have not been modernized or restructured, although the manufacturing industry represents 90 per cent of Serbian exports. The 2001 privatization strategy also excluded from privatization some 550 public/state-owned strategic firms that are among the most important Serbian firms.

In addition to these weaknesses of Serbia's privatization strategy, there were also accompanying reforms that were unjustly postponed. Regarding firm entry and exit, Serbia has done a lot to improve the business environment, but entry barriers have been removed too gradually - there are still areas, like registering property or obtaining building permits, where conditions remain highly unsatisfactory - whereas an efficient bankruptcy law was adopted only a few years ago. As a result, there has actually been a *slowdown* in net firm entry: for every closed enterprise 8 new firms were created in 2006, but only 4 in 2008. The general situation regarding market competition also remains unsatisfactory, since in some sectors like retail trade anti-trust laws and institutions have not prevented further market concentration. Serbia has adopted new legislation introducing the OECD principles of corporate governance, but these principles are often not implemented.

Limited microeconomic restructuring in Serbia has had two important macroeconomic consequences. The first is that it has greatly contributed to the relatively slow growth of the private sector in Serbia, which increased its share from 40 to 60 per cent of GDP during 2001-2010. Among all 29 client countries of the EBRD, two countries have the same relatively low 60 per cent share of private sector GDP as Serbia, Bosnia and Herzegovina and Ukraine, while only other four countries have lower shares (Belorussia, Tajikistan, Turkmenistan and Uzbekistan). Somewhat paradoxically, Serbia's private sector expanded faster during the difficult 1990s than after 2001, increasing from around 10 per cent of GDP in 1991 to 40 per cent in late 2000. Employment in the private sector has growth much faster, where over 70 per cent of the labour force earns a living (see Graph 6).

The second consequence of limited enterprise restructuring is that structural changes in Serbia have favoured the fast expansion of primarily services. Services have had the strongest growth in recent years, by 2008 already contributing 64 per cent of gross value added. By contrast, industry has not only gone through a very strong process of deindustrialization in the early 1990s, but there was insufficient recovery and its further relative decline after 2001. By 2008, Serbia's industrial sector had reached only 52 per cent of its 1989 production (see Graph 7). Since the share of agriculture in GDP has also declined from 2001 onwards, Serbia has seen its tradable goods sector decline from 41 per cent of GDP in 2000 to 24.6 per cent in 2007 (Stamenkovic et al, 2009), strongly contributing to the rising trade deficit.

Graph 6. Growth of the private sector in Serbia: Employment and output, 2001-08



Source: Uvalic (2010), p. 199, based on EBRD and national statistics.

Graph 7. Industrial production in Serbia, 1990 – 2008 (1990 = 100)

Source: Uvalic (2010), p. 202, based on national statistics.

5. Why was the strategy not successful?

The discussed problems of the Serbian economy are closely related to the transition strategy adopted in 2001. The strategy was based on the hyper-liberal model of the capitalist economy, very much in line with the recommendations of the "Washington consensus" - liberalization, macroeconomic stabilization, and privatization (see Williamson, 1990). These were the priorities also recommended to other East European countries in the 1990s. The target model adopted almost everywhere in the transition region was that of an open and liberal market economy, of fast trade and financial liberalization, that was expected to reap the benefits of the market, private ownership and integration into the global economy. The timing of the postsocialist transition, however, coincided with the general domination of a particular and controversial model of the capital market economy, namely hyper-liberalism, typical of the Reagan-Thatcher era (Nuti, 2012). Under the strong influence of this ideology, the instigation of most foreign advisors and the conditionality imposed by the IMF and the World Bank, the most widespread model in the transition was a hyper-liberal model that was more fundamentalist than any modern capitalist model in existence, including American capitalism (Nuti, 2012).

The hyper-liberal model was particularly disruptive in a country like Serbia, that in late 2000 had to address many complex problems inherited from the 1990s. Also in Serbia, the emphasis was placed on liberalization, stabilization and privatization. Macroeconomic reforms were given priority, while many important microeconomic reforms - except for privatization - were neglected. At that time, the "Washington consensus" recipe - liberalize, stabilize and privatize – was also in Serbia considered to be the best way to ensure rapid growth, increasing inflows of FDI and fast integration into the world economy. In a liberalized and stable macroeconomic environment, it was assumed that enterprises, once privatized, would quickly and efficiently undertake economic restructuring and adopt efficient mechanisms of corporate governance. It was naively believed that a radical break from the past would bring fast progress towards the ideal model of a market economy. This did not materialize, since there were major setbacks and delays in the privatization programme, but even more due to the neglect of other important areas of microeconomic reforms (as described earlier).

Serbia in 2001 adopted the target model of other transition countries, but not taking sufficiently into account the rich experience accumulated during the 1990s. The lessons of the so-called "post-Washington consensus", based on some of the more successful transition economies, which could have indicated more preferable options, were neglected by Serbian policy-makers. The "post-Washington consensus", which emerged in the second half of the 1990s, stressed the importance of not only privatization, but also of easing conditions for the entry of new private firms; of not only the transfer of ownership, but also of effective mechanisms of corporate governance; of increasing competition, which is just as important as privatization; of not only markets, but also of active government policies (see Kolodko and Nuti, 1997). These are precisely some issues that were not taken into account in Serbia in 2001.

At a time when the invisible hand of the market continued to be glorified, the "post-Washington consensus" stressed the new role of the state and active government policies, not just *less* government but *a different role* of the government. In particular, the importance of industrial policy was pointed out, for example in promoting investment in certain priority sectors, improving access to credit for small and medium enterprises, encouraging innovation, or in introducing and protecting quality and technical standards for export-oriented firms. If a country has *no* industrial policy, its industrial policy will simply be the residual of other policies, for example liberalized foreign trade, high interests rates, and an appreciating real exchange rate (Kolodko and Nuti, 1997, p. 38). Such a "residual industrial policy" can be detrimental for industrial sectors requiring protection if tariffs are lowered excessively, or can prevent new investment and modernization of key industrial sectors, as indeed has been the case in Serbia. With the new post-2000 turn towards the market mechanism in Serbia, the essential role of the state and of state institutions was somewhat forgotten.

With the outbreak of the global financial and economic crisis from 2008 onwards, the main deficiencies of the hyper-liberal economic model pursued in Serbia (and elsewhere) came to the surface. The growth model applied in Serbia, as in many other East European countries, has been one of increasing integration into the global economy through fast trade opening, financial liberalization, expansion of cheap credit and increasing indebtedness. The global crisis has pointed to some of the structural weaknesses of the model applied in Eastern Europe based on credit-driven growth and the resulting high dependence on foreign capital inflows, as the transition region was among the most affected by the global crisis (see Nuti, 2009).

The main source of growth in Serbia after 2001 was domestic demand, stimulated by the rise in credit, wages, remittances and imports. Since strong GDP growth in Serbia was mainly based on growth of domestic demand, it could not have secured export-led growth. The global economic crisis hit Serbia at a moment when many economic problems were becoming unsustainable – consumption much higher than production financed by foreign savings and investment, an increasing trade and current account deficit, huge and increasing unemployment, limited enterprise restructuring, insufficient growth of the new private sector, mounting problems of many state-owned enterprises, inadequate structural changes that have favoured primarily the fast expansion of services. This model is no longer viable and will require a serious rethinking in the future.

What emerges from some recent discussions on the new growth model, particularly for countries in the Balkan region which are in a less favourable economic position than the CEE countries, is the importance of industrial policy in its various dimensions, encompassing not only horizontal measures to increase firms' competitiveness but also concrete government measures to support structural changes, industrial diversification, industrial upgrading. Many industrial sectors in Serbia have not been modernized and restructured after the extreme process of deindustrialization of the 1990s. Due to the recent strong decline in FDI – by some 40-60% from 2007 onwards – Serbia will have to rely much more on its own resources to finance investment and growth. It will therefore need a more focused and stronger industrial policy, not to subsidise national champions but to encourage investment, innovation and the transformation of key industries. The use of various measures to support concrete industrial sectors or export-oriented firms must become a crucial component of the new approach to development in Serbia.

For a more focused industrial policy to be implemented in Serbia, the quality of state institutions must be greatly improved. It is the state that needs to undertaken measures to strengthen the real sector of the economy. The restructuring of a large part of the real sector of the Serbian economy has not taken place because of a number of policy failures on the part of the government, not only because of market failures. Some important reforms were deliberately postponed since they were regarded secondary, while others were neglected because positive changes were expected simply as a by-product of liberalized market conditions (Uvalic, 2010, p. 264).

A new and more efficient government is an urgent priority in Serbia for other reasons as well - in order to improve the judiciary, ensure application of the rule of law, introduce effective systems of collecting taxes and of fighting against corruption, or provide better supervision of the financial sector. Without achieving these broader objectives and strenghtening the main functions of government institutions, the results of key economic reforms will innevitably remain partial.

6. Conclusions

Serbia has had a very difficult transition to a market economy, for various reasons over the past twenty years. The 1990s brought political and economic instability, a deep recession, hyperinflation, the disruption of foreign trade and UN sanctions, instead of international programmes to support transition and integration into the world economy. The new course adopted in late 2000 was expected to reap the benefits of trade and financial liberalization, of opening up and of acceleration of economic and political reforms, yet the transformation of the Serbian economy has been only partially successful. Due to the inherited difficult conditions in late 2000, convictions that the hyper-liberal model of transition would be the safest way to achieve quick systemic transformation, successful, and neglect of important functions of the state, the expectation were far from fulfilled.

If some of the chosen options of the post-2001 transition strategy have been strongly influenced by political conditionality, by objectives considered important by the main international financial institutions and foreign advisors, this does not mean that the Serbian government is not responsible for where it stands now. As in other cases, the ultimate responsibility for the policies actually adopted must be attributed to the sovereign governments that have adopted those policies, and often have been only too pleased to conform to the requests of international institutions and the advice of some western consultants (Nuti, 2012).

Given the highly uncertain present conditions as to when and how the Serbian economy will be able to recover more permanently from the current crisis, it is important to urgently change the growth model that has prevailed in recent years. Among the numerous challenges, the most important is to further increase competitiveness of the Serbian economy on world markets through more substantial enterprise restructuring and modernization and fast completion of all those reforms that were considered secondary in 2001, yet have proved to be very important. This can only be done through a more focused industrial policy, which ought to be the key ingredient of the new development model in Serbia. In order to accomplish these difficult tasks, a new and more active role of the state will be necessary, since the prevalent reliance on the market during the post-2001 period has clearly proved to be insufficient.

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