CHAPTER 26.

ECONOMIC INTEGRATION AND ANALYSIS OF EXTERNAL DEBT POSITION OF SERBIA[1]

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Abstract:

Serbia had, when started its process of European integration in 2000, relatively high level of external debt amounting to 132% of GDP. All liabilities were practically inherited Government external debt since private sector during the period before 2000 even did not have the opportunity to take credits abroad. After the regime was changed, significant part of the liabilities was written off. In that position, country was thirsty for new capital resources and private sector indebtedness rise was not surprising. Moreover, it was one of the preconditions for future economic development. Even Central Government was in position to take credits under relatively favourable conditions in order to finance infrastructure projects and support structural economic reforms. Unfortunately, after ten years of transition structural reforms did not performed and external debt continued to increase dynamically reaching at the end of 2010 disturbing 84.9% of GDP and 236.2% of total annual export. After the slight stagnation during the crisis, external debt continued its rise dominantly as a consequence of rising Government debt. Current situation should attract the attention of the economic policy makers. Further external debt increase may jeopardize macroeconomic stability as well as the process of economic integration since it is expected that European Union will carefully observe macroeconomic situation in potential member states, especially after the PIGS countries phenomenon.

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[1] This chapter is a part of research projects: 47009 (*European integrations and social and economic changes in Serbian economy on the way to the EU*) and 179015 (*Challenges and prospects of structural changes in Serbia: Strategic directions for economic development and harmonization with EU requirements*), financed by the Ministry of Education, Science and Technological Development of the Republic of Serbia.

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Key words: *External debt, External position, Serbia, Economic integrations, macroeconomic stability*

INTRODUCTION

After the political changes in 2000, Serbian external position changed dramatically. Country openness increased from 60% in 2002 up to 90% at the end of 2011, and during the 2012 reached more than 100%. From the economical point of view, there are at least two important implications of country's opening to the rest of the world. First, Serbia was in a position to attract investments from other countries in order to boost economic growth and develop its economy. That was very important source of new capital and chance for creating new jobs and reducing of unemployment, typical for the first transition years, as well as one of the ways for export increase. Second, that was an opportunity for both Government and private sector to take credits in order to finance its activities. Openness may be problematic also, since undeveloped domestic economic entities have to compete with foreign subjects. The consequence may be current account deficit worsening that could jeopardize macroeconomic stability by creating many imbalances. Government mainly took credits in order to cover its fiscal deficits, rarely for the purpose of structural reforms. On the other hand, private sector lacked capital resources for investments. Rising payment balance deficit was only a consequence of that situation. Thanking to the openness, people lived better than they would if the economy stay closed and trade deficit actually represents a difference between Serbian citizens spending and earnings[4].

Our uncompetitive economy exposed to international competition was actually created debt rather than attracting foreign direct investments to cover balance of payments deficit. One of the most deteriorating effects of that deficit was external debt enlargement. Its dynamics refers to questionable sustainability in a long term, and a process of adaptation may be painful if not perceived on time. In that context, it is necessary to make slight difference between public and private sector. Despite the fact that Government is a last resort for private sector debt repayments, it is very indicative that after 2007 Government sector is the main reason for external debt increase while the private sector behave rationally and its debt stagnated in that period. Currently, very good sign is the fact that almost 95% of debt is long term and its maturity is about 7 years[5]. However, it should be noted very dynamic increase in debt repayments in the last period. Annual

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[4] Hrustić H., Uticaj zaduživanja Srbije na stanje njene privrede, MP 1, 2011 (str. 160–181)
[5] Deutsche Bank research, June 2012,
http://www.dbresearch.de/PROD/DBR_INTERNET_EN-PROD/PROD0000000000291203/Serbia.PDF

repayment in 2011 was more than 13% of GDP comparing to 7% in 2006. Only in 2011, Serbia paid more than 4bln EUR to service its external debt obligations.

In the process of EU integration, macroeconomic stability is one of the necessary preconditions. Serbia actively cooperates with the international financial institutions. Their support will be necessary in order to maintain macroeconomic stability. As a matter of fact, main Central Government creditors are Paris Club of creditors, International Bank for Reconstruction and Development (IBRD) and European Investment Bank (EIB). They approve credits mainly for structural reforms or important infrastructure projects. In that way they act as kind of financial control. International financial institutions are important creditors in private sector too. EBR, IBRD and IFC together gave more than 1,3bln EUR to the private sector. Their presence is one of the guarantees of stable business environment important for future investors. Especially important is IMF arrangement that for example, limited Government budget deficit at 4% of GDP in 2010. Unfortunately, Government sometimes does not act as a responsible partner in a long term. By the latest Serbian Ministry of Finance data, Serbian budget deficit is more than 52bln RSD in the first quarter of 2012, which is more than half of the amount agreed by the last year budget[6]. The second aspect of relations with EU when considering external debt position is external trade. EU is the largest Serbian trade partner. Balance of payments problem only reflects Serbian weak export potentials. Since all economies that passed process of integrations continued to liberalize economy it is hard to expect that Serbia will go other way. In our case, domestic demand strengthening influenced import to rise rapidly. It should be quite important in the future period to make the export products more competitive and that will probably determine perspective of the Serbian economy.

RELEVANT LITERATURE REVIEW

By the IMF methodology, gross external debt, at any given time, is the outstanding amount of those actual current, and not contingent, liabilities that require payment of principal and/or interest by the debtor at some point and that are owed to non-residents by residents of an economy[7]. Serbia has completely adjusted its external debt method according to the IMF standards as of September 2010. IMF methodology concerning external debt mainly focus on highly indebted low income countries having in mind that European economies, especially those EU members, are relatively stable concerning that issue.

[6] www.mifin.gov.rs
[7] http://www.imf.org/external/pubs/ft/eds/eng/guide/file2.pdf

However, there are a lot of papers covering that issue in low income countries and World Bank methodologies enable us to derive useful conclusions for Serbia.

Our motivation to explore external debt situation in Serbia in the context of EU integration has strong theoretical background. Namely, many arguments defending sustainability of Serbian external or public debt refer to the IMF methodology and benchmark given as an orientation for countries how much debt they can afford. As we will see later, Serbia is, by these criteria, below the critical values of 220% debt to export ratio and 80% debt to GDP ratio. Also, when considering public debt burden, Serbia is below the critical value of 60% public debt to GDP ratio, prescribed by the Maastricht criteria. However, these critical values serve only as an orientation for the countries and nobody would guarantee that problems may arise before country achieves critical point. Moreover, some data lead to different conclusions. According to the Reinhart and Rogoff study, more than half of cessation of debt repayments in the middle income countries actually happened below external debt to GDP ratio of 60%[8]. Their argumentation also stressed willingness of country to repay its liabilities. Serbia is certainly not in a position to create conditions for its creditors. Our debt repayment will happen in one or another way, especially having in mind future economic integration and costs of eventual repayment cessation may be very painful. The opportunities Serbia had by its access to the international capital markets also have a different aspect. International capital markets may act in a disciplining way. Government need to take care about its reputation. As Eaton and Gersovitz stressed, Government will not easily decide to stop repayments if that will jeopardize its reputation and that is probably typical for Serbia[9]. Importance of joining EU as a source of direct investments and our main trading partner will be seriously threatened.

Further investigations also demonstrate misleading treatment external debt has in domestic public discussions. "Safe" thresholds or highly debt-intolerant emerging markets appear to be surprisingly low, perhaps as low as 15 to 20 percent of GNP in many cases, and these thresholds depend heavily on the country's record of default and inflation[10]. However, the developed economies such as Italy, whose gross external debt in end-2009 was 120% of GDP and public debt 115%, need to be differed from Greece, Spain or potential member states such as Serbia. Italy’s net international investment position was just about -19% of GDP. So, much of

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[8] Reinhart, M., Rogoff, K., 2009, This Time Is Different: Eight Centuries of Financial Folly, Princeton University press

[9] Eaton J., Gersovitz, M, 1981. „Debt with potential repudiation. Theory and estimation“, Review of Economic Studies 48 (2)

[10] Reinhart, M., Rogoff, K., Savastano M., 2003. Debt intolerance, Brookings Papers on Economic Activity, Vol. 2003, No. 1

Italy's interest burden is paid to Italians, and some of it is paid back to the Government in form of taxes. Cabral especially stresses the importance of differentiating external and public debt. Debt held by own citizens has less pernicious consequences – the interest paid is returned to the domestic economy. The situation with external debt is completely different, especially when it is used for non-productive purposes. Non-residents receive the interest on such debt, making the nation increasingly poor with every interest payment[11].

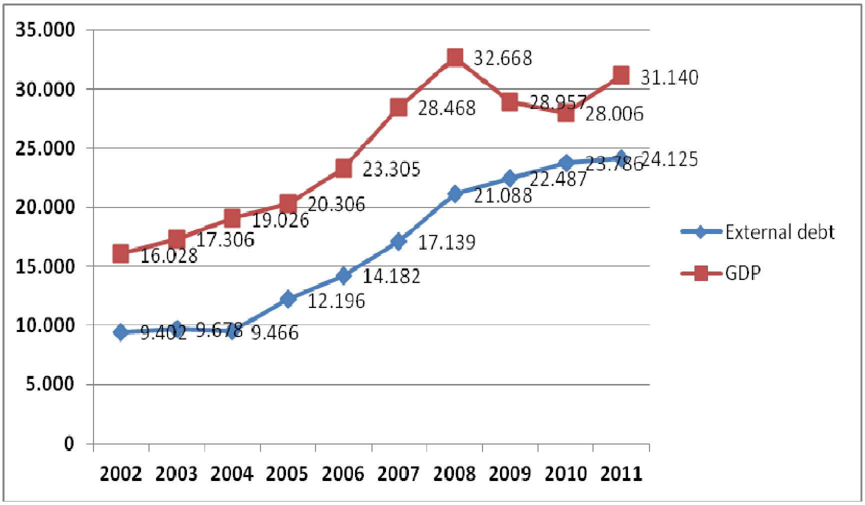
It should be stressed that not only potential default is a reason for examination of country's external debt position. There are many other consequences and one of them is also growth. Deteriorating effects of external debt may be seen in several econometric studies. Reinhart and Rogoff have shown that, when gross external debt reaches 60 percent of GDP, annual growth declines by about two percentage points. For levels of external debt in excess of 90 percent of GDP, growth rates are roughly cut in half[12]. Another study performed by IMF experts refers to slightly different results. For a country with average indebtedness, doubling the debt ratio reduces growth by a third to a half percentage points. Critical points after debt impact becomes negative are about 160-170% of exports and 35-40% of GDP[13].

SERBIA'S EXTERNAL DEBT INDICATORS

Serbian external debt was increasing in the last 10 years, basically having the higher average growth rate comparing to the GDP growth rates in the same period. At the end of 2011, external debt amounted to 24,1bln EUR. External debt was increasing by 9.88% annually in the period 2002-2011. On the other hand, GDP was increasing about 6.87% on the average in the same period, measured by current prices. If there was inflation included in the calculation, the average rates would be lower, but trend is still the same. Such a trend cannot lasts forever. There should be a critical point when debt will become unsustainable causing macroeconomic stability disturbance. More precisely, it is impossible for Serbia that in a long term sustains economic growth with continuously widening balance of payments deficit financed in that way.

[11] Cabral, R., (2010) "The PIGS' external debt problem", VoxEU.org
[12] Reinhart, M., Rogoff, K., 2010, Growth in a Time of Debt, working paper, American Economic Review Papers and Proceedings
[13] Patillo, C., Poirson, H., Ricci, L.A., 2011, Review of economic and institutions, Vol.2 – No. 3

Figure 1: GDP and External debt trend in Serbia (in mill EUR)



Source: National Bank of Serbia

The table presented below briefly shows the Serbian external debt structure by the debtors in the last five years. The period chosen is the most appropriate having in mind that in the early 2000s the debt level actually included inherited part that was written off afterwards. It is evident that after first signs of crisis in the 2008, public sector debt continued to raise debts. The main sources were assets IMF provided as well Eurobonds issue in September 2011. Contrary to the Government, enterprises decrease its indebtedness for about 1.3 bln EUR in period 2008-2011. Such behaviour resulted with total private sector debt stagnation as well as higher share of public debt.

Table 1: Serbian external debt by debtors (in mln EUR)

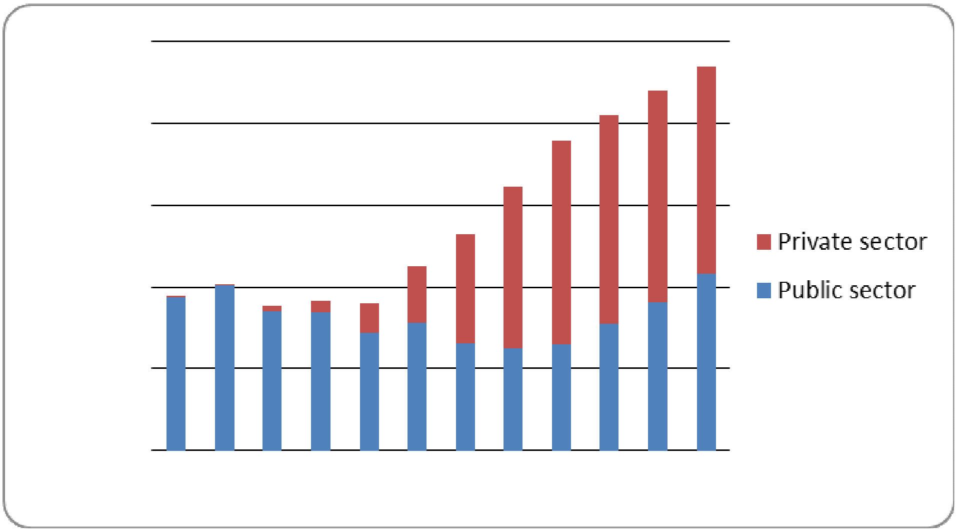
	2007	2008	2009	2010	2011
STOCK OF EXTERNAL DEBT (A+B)	17.138,7	21.088,4	22.487,3	23.786,4	24.125,4
LONG-TERM DEBT	**16.088,7**	**18.945,1**	**20.482,5**	**21.956,0**	**23.477,5**
Public sector	**6.251,1**	**6.503,0**	**7.762,3**	**9.076,4**	**10.773,3**
NBS debt under IMF Standby arrangement	0,0	0,0	1.110,0	1.528,9	1.617,6
Government obligation under IMF SDR allocation	0,0	0,0	422,2	449,5	459,3
Private sector	**9.837,6**	**12.442,1**	**12.720,3**	**12.879,6**	**12.704,2**
Banks	2.713,2	2.201,3	2.596,9	3.361,9	3.782,4
Enterprises	7.124,4	10.240,8	10.123,4	9.517,6	8.921,8

	2007	2008	2009	2010	2011
SHORT-TERM DEBT	**1.050,0**	**2.143,3**	**2.004,8**	**1.830,4**	**647,9**
Public sector	**33,9**	**17,7**	**1,5**	**0,0**	**0,0**
Private sector	**1.016,1**	**2.125,6**	**2.003,3**	**1.830,4**	**647,9**
Banks	892,3	1.322,9	1.713,1	1.730,7	581,7
Enterprises	123,7	802,7	290,2	99,7	66,2

Source: National Bank of Serbia

On the following graph, it is presented external debt development by the type of debtors, simply divided on public and private sector. After the initial years of transition, when considerable amount of former country inherited debt is written down, starting from 2006 it is rather obvious that Government sector plays very important role in the country's indebtedness. It is necessary to remind that it is a period when privatization revenues were still coming. After 2008, another paradox is evident. In the crisis period, private sector start to repay its obligations and total private sector debt was stagnating. On the other hand, Government needed money to finance its expansionary fiscal policy. Privatization inflows dried up as well as possibilities to take credits at the domestic market that would probably cause crowding out effect. After the support for macroeconomic stability from IMF in 2009 and 2010, Government finally decided to enter the international financial market by issuing Eurobonds worth about 800mln EUR. International financial market will probably present main source of deficit financing in the future period.

Figure 2: Public and private in external debt of Serbia (in mln EUR)



Source: National Bank of Serbia

On the following tables it is presented current short term and long term situation concerning sustainability of Serbian external position. First of all, it should be stressed that practically whole debt is long term by its maturity. The average maturity is 7 years and actually fell comparing to last years. This is encouraging data, although in the following years annual debt service will gradually increase. There are authors believing that discipline of debt result in more responsible Government behaviour if the debt is short term[14]. Debt repayment to GDP ratio in the last year was more than 13% and almost doubled comparing to the 2006. Fortunately, foreign exchange reserves are despite constant interventions on the foreign exchange market due to the exchange rate defending still high. Therefore, general liquidity position may be evaluated as satisfying.

Table 2: External liquidity indicators (in %)

External liquidity indicators (in %)	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012 Q1**
Forex reserves/imports of goods and services (in months)	6,1	9,0	7,2	5,2	9,4	8,1	8,6	7,8
Forex reserves/short-term debt	519,2	941,7	917,5	380,8	528,8	546,4	1.860,8	1.914,1
Forex reserves /GDP	24,2	38,7	33,8	25,0	36,6	35,7	38,7	35,5
Debt repayment/GDP	4,7	7,0	10,1	10,6	11,5	12,3	13,1	12,1
Debt repayment/exports of goods and services	17,7	23,5	33,2	34,0	39,1	33,8	35,5	33,7

Source: National Bank of Serbia

When considering solvency position, all parameters are according to the World Bank methodology, slightly below critical points. External debt share in GDP at the end first quarter of 2012 amounted up to 77.5% (80% is per World Bank considered as high indebtedness. As it was already mentioned, it is completely different when considering that ratio for low, middle or high income countries.

[14] Reinhart, M., Rogoff, K., 2009, This Time Is Different: Eight Centuries of Financial Folly, Princeton University press

Countries that have huge wealth stocks accumulated and deserved confidence of international financial institutions and Governments may afford higher debt levels. On the other hand, Serbia belongs to the group of middle income countries that are more vulnerable to the external shocks. For Serbia, reaching external debt share above 80% would be very dangerous in the context of potential interest rates increase, export decrease, or any other volatility in the foreign markets. Confidence Serbia got with great difficulties would be questionable. Foreign Governments, financial institutions and markets in general carefully observe solvency indicators. Country may be solvent but illiquid in the same tame and vice versa. Solvent but illiquid country is considerably less risky than an insolvent one, and financial and monetary variables should reflect this[15]. For the future investigations, it would be interesting to perform more detailed analysis whether Serbian economy, in the sense of economic growth, has already suffered due to the high debt level. Other important solvency measure, ratio of external debt to the annual export is also below critical level of 220%, amounting to 211% at the end of first quarter in 2012.

Table 3: External solvency indicators (in %)

External Solvency Indicators (in %)	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012 Q1**
External debt/GDP	58,7	55,9	49,8	60,1	60,9	60,2	64,6	77,7	84,9	77,5	77,2
Short-term debt/GDP	3,8	3,1	2,3	4,7	4,1	3,7	6,6	6,9	6,5	2,1	1,9
External debt/exports of goods and services	300,9	251,6	211,5	228,9	204,1	197,3	207,6	265,3	236,2	210,3	211,1

Source: National Bank of Serbia

According to the presented data it should be noted that Serbian external position is far from stable. Serbia will be vulnerable in the future to all external shocks as well as unexpected Government behaviours related to the public spending increase. It is necessary to perform serious sustainability projections that would show how much debt more we can afford. In line with that are also recently published documents by Fiscal Advisory of the Republic of Serbia and Ministry of Finance. The Economic and Fiscal Programme of the Republic of Serbia for

15 Rossini, G., Zanghieri, P., 2009, Current account composition and sustainability of external debt, Applied Economics, 41, 677-683.

period 2012-2014 highlights that increase in spending beyond the planned framework would lead to a rise in consumption and dinar depreciation, as well as to the reduction in foreign currency reserves, along with the problems of external debt servicing[16]. Contrary to that statement, their estimation suggested that Serbia's external debt in the period 2012-2014 will be increased due to the growth in the external debt of the public sector, while on the other hand, tendency of debt release of the private sector will be continued.

COMPARISONS WITH OTHER COUNTRIES AND ECONOMIC INTEGRATION PERSPECTIVES IN THE CONTEXT OF EXTERNAL DEBT POSITION

The root of the external debt problems is balance of payments deficit that is consequence of inadequate structure of the Serbian economy. Low competitiveness caused weak export, while import as a consequence of country opening to the world, was constantly increasing in the last decade. Openness rise was a rule for all other countries in their integration processes. It would be hardly to believe that Serbian experience will be different.

However, there is no country in the region with such a huge external balance deficit as Serbian. Reasons for such a situation are various. First is without any doubt, late start of transition and therefore late start of restructuring of devastated economy inherited from the period of socialism and turbulent times during the 90s. Serbia in fact, does not have many competitive products for international markets. Also, country image is not on satisfying level and export level is certainly influenced by that. Finally, strong dinar policy is hardly without impact on competitiveness. There are calculations that dinar was actually 110% stronger in 2008 in the light of crisis, comparing to the 2000[17]. It became stronger in the years of low competitiveness and low industrial activity causing trade balance deterioration. Some authors revealed that there is no exchange rate proper for Serbian export increase. For example, Tasic and Zdravkovic in the paper titled *Long-run Exchange Rate Sensitivity of Serbian Exports and Imports* suggested that the estimated elasticity of exports with respect to real exchange rate is about 0.5, and the potential changes in the exchange rate policy would yield relatively small benefits for exporters[18]. In fact, it is evident that after the real depreciation

[16] http://www.mfin.gov.rs/UserFiles/File/dokumenti/2012/EFP%20SR%202012.pdf
[17] Jovović, D., 2009, Devizni kurs dinara. Precenji dinar i alternativni režimi deviznog kursa, Kako povećati izvoz i konkurentnost privrede i izvoza Srbije, Naučno Društvo Ekonomista Srbije, 2010.
[18] Tasić, N., Zdravković, M., 2008, Long-run Exchange Rate Sensitivity of Serbian Exports and Imports, National Bank of Serbia working paper, series 16

in 2010 and 2011, balance of payments reacted in a very favourable way. It would be interesting to perform similar test after new data publishing.

On the following table it is represented balance of payments deficit share in GDP of the countries comparable to Serbia in the sense of economic integration process and size of economy.

Table 4: Balance of payments deficit (% in GDP)

Balance of payments deficit (% in GDP)	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**
Croatia	-5,26%	-6,63%	-7,19%	-8,83%	-5,18%	-1,09%
FYR Macedonia	-2,54%	-0,45%	-7,06%	-12,83%	-6,73%	-2,77%
Serbia	-8,76%	-10,11%	-17,75%	-21,59%	-7,22%	-7,43%
Bosnia and Herzegovina	-7,39%	-3,36%	-4,18%	-5,42%	-2,66%	-2,74%

Source: Eurostat

A next indicator comparative indicator interesting already mentioned before is Government external debt to GDP ratio. On the following table it can be noticed that Serbia, Montenegro and Croatia have this indicator among the highest in the region, about 42% in GDP. High share of Government external debt in GDP is very important sign for international creditors concerning macroeconomic stability. Values above 40% are considered as high for countries in that level of economic development.

Table 5: Government external debt to GDP in potential EU members (in %)

Government external debt/GDP	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**
Montenegro	38,30	32,60	27,50	29	38,30	42
Croatia	38,15	35,40	32,88	29,16	35,20	41,18
Former Yugoslav Republic of Macedonia	38,41	31,99	23,97	20,64	23,92	24,83
Bosnia and Herzegovina	25,30	21,10	18,20	17,20	21,81	25,70
Serbia	50,60	40,10	31,20	26,90	34,10	42,70

Source: Eurostat

There is no unambiguous conclusion about future government debt and external debt sustainability of Western Balkan countries. As it is well known Government indebtedness is also a matter of different economic policy one country aiming to implement. As a matter of fact, not many European countries had external debt problems in the last two decades. Russia faced financial crisis in 1998, and that was actually the last European default episode in recent history. Central and Eastern European countries were under special attention in the first transition years since their economic policy management was questionable and economic structure quite vulnerable. After the transition period most of them are now EU members having relatively stable external position. However, it should be noted that public debt problems of the PIGS countries, especially Greece in its roots dominantly had an external component. Moreover, relations between public and external debt were subject of many papers so far. That should be sufficient reason to carefully observe situation in Western Balkan countries, especially in Serbia considering its external position analysis performed in this paper. In the pre-crisis period, before debt repayment suspension, internal public debt increase is often equally fast as external[19]. Common debt movements are probably consequence of procyclical fiscal policy. Our idea was to explore parameters important for the external debt position in several countries that become EU members in 2004 and 2007. The parameters we decided to specially focus on are export trend, direct investments and net external debt since these factors may be possible signals of their external position strength and benchmark for Serbian economy. In every more detailed analysis of external position direct investments inflows should be included since they represent true sign how is balance of payments deficit covered. Some countries as Norway or Canada run current account deficits for many years but never face external debt problems. Others such as South Korea or Thailand faced serious economic problems caused by low level of imbalances. The main difference between mentioned countries represents FDI inflow as a source of deficit financing[20].

As we can see from the following graph, practically all observed countries achieved steady export growth and that is probably the main reason for their stability. Especially good examples are Hungary and Slovakia. Hungarian export had very dynamic rise amounting to 45 bln EUR in the 2003, just before country entered EU. Strong export was basis for country stability since irresponsible fiscal policy in period 2002-2010 jeopardized macroeconomic stability[21]. Country avoided serious loss of reputation despite the fact that gross government debt was enormously high comparing to the countries of similar economic size amounting to 80% of GDP at the end of last year. Slovakian experience may also be very useful. Thanks to the large foreign investments in automotive and electronic

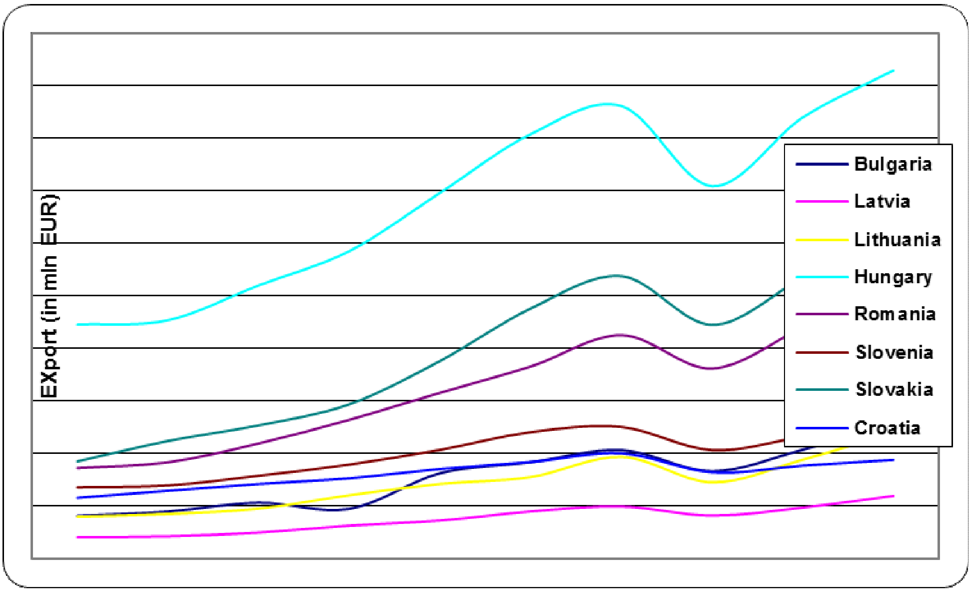
[19] Reinhart, M., Rogoff, K., 2009, This Time Is Different: Eight Centuries of Financial Folly, Princeton University press

[20] Perfect example gave Rossini and Zanghieri in the paper titled Current account composition and sustainability of external debt, Applied Economics, 41, 677-683.

[21] Deficits in that period were in every year higher than Maastrich criteria condition.

industries, export was rising in the period 2002-2010 with the average annual growth rate of more than 12%. In the period before entering the EU, Serbia may also look at the Bulgarian experience in the process of integration. Their export was rising almost 15% on average in the last five years before entering the EU. Serbia actually had serious export growth in the last 10 years. However, external balance of goods and services problems lies in very high rise of import in the same period.

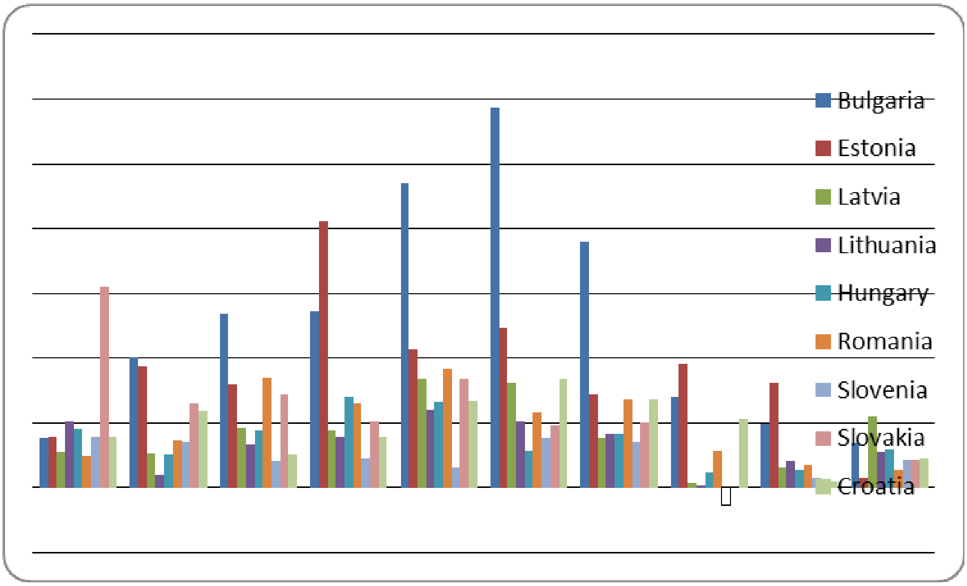
Figure 3: Export level in comparable EU members



Source: Eurostat

On the following figure it may be noticed that in years just before entering EU Bulgaria, Romania and Slovakia had very high level of investments inflow even GDP had a considerably strong rise in these years. That certainly helped in boosting economic activity, export rise and strengthening external position. Also, it is rather indicative data that all countries except Latvia and Slovenia experienced severe investments rise in the year of accession. Estonia had dramatic rise in the following years while Slovenia is by mot of parameters including net external debt as well as public in satisfying external position.

Figure 4: Direct investments flow (in % GDP)



Source: Eurostat

Table 6: Net external debt in % GDP in selected EU members

Net external debt in % GDP	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**
Bulgaria	9,5	8,5	2,5	11,3	15,5	32,7	48,9	49,6	43	32,9
Estonia	n.a.	13	17,6	18,4	27,5	35	37,6	34,5	23,4	6,5
Latvia	20,9	24,2	29,9	35,8	44,2	49,6	57,1	58,7	53,5	45,1
Lithuania	13,2	12,9	13,3	15,9	19,8	29,6	35,1	40,3	39,4	36
Hungary	22,8	29	33,1	37	43	50,9	57,5	63,3	60,7	52
Romania	10,4	13,9	8,2	8,3	11	20,9	27,7	34,6	37,9	37,4
Slovenia	n.a.	n.a.	-3,4	3,1	10,9	20,5	30,8	37,5	40,4	38

Source: Eurostat

Finally, net external debt measure is very important indicator of external health country for various reasons. In the table below it can be noticed that only Hungary and Latvia have little bit higher external debt position. However, Hungary by now had steady export rise, and that is very important factor of its sustainability.

As it is well known Government indebtedness is also matter of different economic policy and there are lots of papers proving that statement. Llorka and Redzepagic observed public debt in the paper titled “Debt sustainability in the EU New Member States: empirical evidence from a panel of eight Central and East European countries” and shown that despite of completely different fiscal policies of observed countries their budget deficits are sustainable in the long run. They performed their investigation on two groups of countries. First group included Slovenia and three Baltic countries, Estonia, Lithuania and Latvia, that performed strict fiscal policy. The other group included Visegrad group countries that have budget deficits exceeded the limit of 3% of GDP. Conclusion they got is quite encouraging for the Serbia, Croatia and similar countries: Every temporary fiscal deficit can be sustainable as long as it is matched by an adequate future budgetary surplus[22]. There is no unambiguous conclusion about future government debt and external debt sustainability of new EU members and Western Balkan countries. All criteria examined suggest that current situation is stable, significantly better comparing to Balkan countries. Every more in depth analysis of external debt should include sensitivity projections and variables such as public debt, interest rates volatility and potential external shocks.

CONCLUDING REMARKS

Serbian external debt had dynamic rise in the last decade. Large part of liabilities to the Paris and London Club was written off as a support to the structural reforms in the beginning of 2000s. However after that, debt continued to rise very dramatically on the waves of inflated domestic demand and both private and public sector credits. External debt rise was a consequence of balance of payments deficit increase that was not covered by the sufficient direct investments inflow. In 2008 balance of payments deficit reached 21.6% of GDP and that is the highest ratio in the region by far. This increase was a result of low competitiveness of the economy and unfavourable exchange rate in that period.

Many authors investigated external debt and balance of payments problems of countries similar to Serbia. It is well known conclusion that solution for this type of problems should only be productivity rise, export activities enhancement and attraction of direct investments. Government spending decrease would be helpful since large part of Serbian external debt is a result of Government debts increase. In the crisis period private sector repaid its debts while Government decided to finance to its budget deficit through new debts.

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New EU members had similar problems as Serbia. They succeeded in export awakening and Serbia should learn from their experience. In the process of EU integration it is normal for every economy to increase its level of openness. Country openness and process of economy liberalization have to be followed by the export strengthening. The examples of Slovakia and Hungary may be very useful for Serbia.

In the process of economic integration Serbia actively cooperate with international financial institutions. Their role is quite important due to the fact that they control future borrowings. In the times of financial crisis external debt increased as a consequence of Government procyclical economic policy. Such a practice cannot lasts forever since it will lead to serious macroeconomic imbalances. Also, it would jeopardize economic integrations and external position of Serbian economy. Government in that context have to react immediately by creating more favourable environment for investing, avoiding local currency appreciation, supporting export oriented companies and cutting budget deficit.

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