HIGHLIGHTS

Highlight 1. Is Serbia's Current Economic Growth Sustainable?¹

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Serbia's economic growth has accelerated over the past five years, with its trend value now standing at around 4%, which is higher than the average for EU member states from Central and Eastern Europe (CEE). Whether this growth has already ensured Serbia's convergence with the CEE economies—and, more importantly, whether this growth trend will continue are the questions examined in this contribution.

Whether Serbia has converged since 2001 is shown in Graphs 1 and 2. This refers to (absolute) beta convergence, which asserts that less developed countries have the opportunity (potential) to grow faster than more developed ones by leveraging their experience, existing knowledge, technologies, etc³. Beta convergence therefore implies an inverse relationship between the initial level of development and subsequent economic growth, a pattern confirmed by the graphs for EU member states.

Looking at Serbia up to 2018 (Graph 1), we see that it grew significantly below the potential offered by its initially low level of development. This is evident from Serbia's position well below the line representing its potential growth: roughly, it could have grown at 5% annually, but instead grew at 3.5%. As a result, Serbia did not catch up with more developed CEE economies, despite having, as the convergence concept suggests, the potential to do so. In contrast, CEE countries successfully narrowed the gap with developed EU countries during the same period.

The previous conclusion regarding Serbia's economic convergence does not change qualitatively even when the past five years of accelerated growth are taken into account. Although the period 2019–2024 saw somewhat faster growth in Serbia compared to the average for CEE countries, the analysis for the entire 2001–2024 period (Graph 2) indicates that Serbia's long-term

growth remains slower than what could be expected given its lower initial level of development. Admittedly, the lag in the long-term growth rate has been reduced by approximately half—instead of a 1.5 percentage point gap by 2018, it now stands at 0.7 percentage points for the period 2001–2024 (Graph 2).



Graph 1. Relationship between growth rate and initial level of GDP per capita, 2001–2018

Source: Petrović, Brčerević, Minić (2025)







On the other hand, if Serbia manages to maintain its current GDP growth trend of 4% over the long term, it would begin to successfully catch up with the CEE countries. Therefore, it is important to analyze whether the current growth trend is sustainable, i.e. to examine which factors have contributed to the acceleration of Serbia's economic growth and whether they will continue to have an effect in the future.

Serbia's insufficient growth up to 2018 was primarily the result of inadequate investment and weak institutions⁴. The government's response to this challenge was a sharp

¹ This article is based on a more extensive study presented in: P. Petrović, D. Brčerević, S. Minić. (2025). Economic Development of Serbia: Between Institution Building and the Middle-Income Trap. Proceedings: Economic Development of Serbia and Its Determinants, Serbian Academy of Sciences and Arts (forthcoming). For further clarifications, findings, and data, please refer to the aforementioned work.

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³ For a review of the theoretical background and empirical findings on convergence, see Petrović, P., Gligorić Matić, M., Convergence of the Periphery towards the Developed EU and the Determining Factors: Empirical Research and Implications for Serbia. Faculty of Economics, University of Belgrade, (2021).

⁴ See Petrović, P., Brčerević, B., Gligorić, M. (2019). "Why is Serbia an Economic Growth Underachiever?" Ekonomika preduzeća, 67(1–2), 17–33.

increase in public investment and state-driven foreign direct investment. Of the total increase in gross fixed capital formation by 6.9 pp of GDP (Table 1), as much as 4.2 percentage points of GDP, or around 60%, was due to higher capital investment by the public sector. General government capital expenditures rose from 3.1% to 6.4% of GDP, while investments by public enterprises-primarily EPS and Telekom-grew by 0.9 pp of GDP. Investments by foreign enterprises operating in Serbia (FDI)⁵ increased by about 2 pp of GDP, accounting for roughly 30% of the overall rise in total investment. In contrast, investment by the domestic private sector remained stagnant, with a relative decline of 0.5 pp of GDP. The low level of investment by domestic private companies is further illustrated by the fact that it is only slightly higher than capital spending by households, which includes expenditures for the purchase or construction of housing units, as well as major repairs of existing ones (Table 1).

Table 1. Level and structure of gross fixed capitalinvestments by sector (as % of GDP)

	2014-2016	2021-2023	Difference
Public sector	5.6	9.8	4.2
General state	3.1	6.4	3.3
Public enterprises	2.5	3.4	0.9
Private sector	8.0	9.5	1.5
Domestic	4.9	4.4	-0.5
Foreign	3.1	5.1	2.0
The rest	2.9	4.2	1.3
Of which: households	2.7	3.9	1.1
TOTAL	16.6	23.4	6.9

Source: Petrović, Brčerević, Minić (2025)

This is, therefore, a case of state-driven economic growth acceleration, as the government itself accounts for over 40% of total investments, and together with foreign investments—which it directly promotes—nearly two-thirds. Meanwhile, the domestic private sector contributes less than 20% of total investments (see Graph 3).

The previous economic growth in Serbia, driven by the state, was based on a quantitative increase in investment and employment, rather than on significant productivity growth generated through the expansion of new technologies, knowledge, and business models. In Serbia, the contribution of capital to GDP growth is twice as high as the contribution of total factor productivity (TFP). In contrast, in the CEE countries, technical progress is the main engine of economic growth (see Graph 4).

Graph 3. Sector share in total investments in fixed assets (in %), 2021–2023



Graph 4. Contribution of Capital and TFP to GDP Growth: Serbia vs. CEE



The previous finding, that Serbia, unlike the CEE countries, bases its growth on "raw strength" is further confirmed by the fact that resource productivity, i.e. the ratio of GDP to domestic material consumption (euro/kg), is twice as low in Serbia as in the CEE: €0.8 vs. €1.4 per kg (2019–2021, source: Eurostat). This essentially means that Serbia consumes almost twice the amount of material resources—iron, concrete, oil, etc.—compared to the CEE countries to generate a unit of new value (GDP). In this way, we arrive at a confirmation, from another angle, of the same conclusion shown in Graph 4, which was derived using the analytically complex method of production functions.

It follows that Serbia and the CEE countries follow two qualitatively different growth models, with only the one in CEE, based on productivity growth and technological progress—ensuring long-term stable growth. Therefore, in Serbia, continuing with more of

⁵ In this analysis, investments by foreign companies refer to actual investments in fixed assets, in accordance with the national accounts statistics methodology. This definition is somewhat narrower than the FDI concept used in the balance of payments, which also includes other types of investments not related to fixed asset formation (e.g. acquiring a majority ownership stake or purchasing shares and bonds). For the sake of simplicity, the commonly used term FDI will be used in the remainder of the text to refer to investments by foreign-owned companies.

the same will inevitably lead to a slowdown in economic growth.

The first limitation to future growth based on quantitative expansion is the shrinking availability of labour in Serbia. The country is facing a depletion of its labour reserves due to previous growth, ongoing emigration, and unfavourable demographic trends. As a result, the unemployment rate has already declined significantly and is gradually approaching the (low) average rate in the CEE region, with some sectors already experiencing labour shortages. Furthermore, the labour shortage is generating growing pressures on the Serbian labour market, resulting in a long-term unsustainable trend of real wages rising significantly faster than productivity. This, in turn, leads to higher (unit) labour costs, reduced (price) competitiveness of the economy, and ultimately, slower economic growth.

A similar conclusion applies to the contribution of quantitative investment growth to Serbia's recent economic acceleration. The impact of public investments on growth is certain to decline in the medium term. Public investment is expected to decrease from the current very high level of 7% of GDP, and both project selection and implementation efficiency have been deteriorating for some time, all of which will reduce their impact on output growth. Foreign direct investment, another key driver of Serbia's growth, has been declining in relative terms (as a share of GDP), and this trend is likely to continue. A significant factor is that Serbia no longer offers cheap and abundant labour, which had previously attracted foreign investors to traditional, low-tech, low value-added sectors. Not only is the inflow of foreign investment in these sectors expected to decline, but there are already signs that existing investors are scaling back production or withdrawing entirely.⁶

It follows that the current state-driven model of economic growth is gradually being exhausted, and that turning to the domestic private sector is the only path to ensuring long-term stable and high growth in Serbia. Achieving this would require a structural shift, as the data (Table 1) show that the domestic private sector has not significantly contributed to the recent acceleration of Serbia's economic growth. Investments by domestic businesses have relatively stagnated and have mostly gone into traditional sectors that do not drive productivity growth and thus have limited impact on overall economic expansion. Another indication of the constraints facing the private sector—despite strong overall economic growth over the past five years—is the very low number of newly established companies each year: 3.3 times fewer than the average in Central and Eastern European (CEE) countries (Graph 5).





This represents yet another perspective that sharply illustrates the qualitatively opposed models of economic growth in Serbia and the CEE region. Namely, although Serbia has finally surpassed the CEE countries in terms of growth rate, these countries (as well as comparable neighboring economies), even with lower growth, "generate" 3.3 times more new entrepreneurs than Serbia. This clearly points to fundamentally different environments in which domestic businesses operate compared to those in the CEE, with Serbia's environment significantly holding them back.

This brings us to the issue of institutional quality—rule of law, property rights protection, fair market competition, level of corruption, etc.—as likely the decisive factor for the private sector's economic flourishing, especially the domestic one. In this regard, Serbia performs very poorly and has been consistently regressing (Table 2, Graph 6), which largely explains why the domestic private sector remains dormant.

Table 2. Deterioration of institutional qualityin Serbia, 2014–2024

	Rank 2014.	Rank 2024.	Drop in lists 2014-2024.
Media Freedom Index	54	98	44
Global management indicators	96	111	15
Respect for the rule of law	61	94	33
Corruption perception index	78	105	27

⁶ A detailed analysis of the effects of public investments and foreign direct investment on future economic growth is provided in Petrović, Brčerević, and Minić (2025).



Graph 6. Ranking by quality of institutions in 2024: Serbia vs. CEE

It is therefore clear what Serbia needs to do to transition from an unsustainable state-driven growth model that is being exhausted, to an economic growth model driven by private entrepreneurship, grounded in new knowledge, technologies, products, and business models—namely, a significant improvement in institutional quality. Major international studies (e.g., Acemoglu) confirm that strong institutions are crucial for a country's economic prosperity. Moreover, they stimulate technological progress, i.e., economic growth based on innovation and the application of new technologies, knowledge, and the like. In addition to this, high-quality and comprehensive education must be recognized as another fundamental factor of long-term economic growth.