

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

HIGHLIGHTS

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

Pavle Petrović²

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.

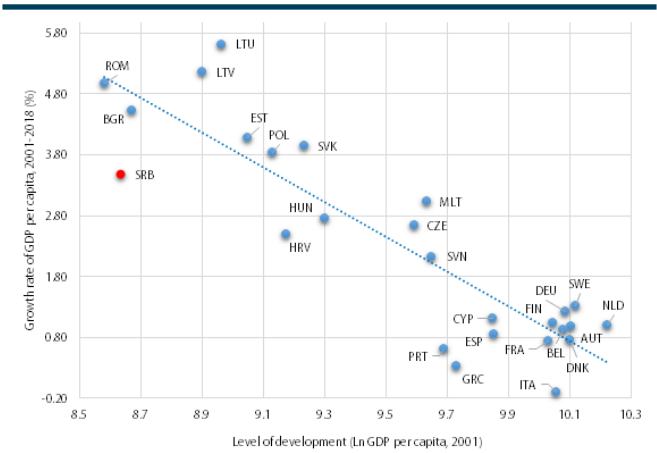
Whether Serbia has converged since 2001 is shown in Graphs 1 and 2. This refers to (absolute) beta convergence, which asserts that less developed countries have the opportunity (potential) to grow faster than more developed ones by leveraging their experience, existing knowledge, technologies, etc³. 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



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 capital investments 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).

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

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

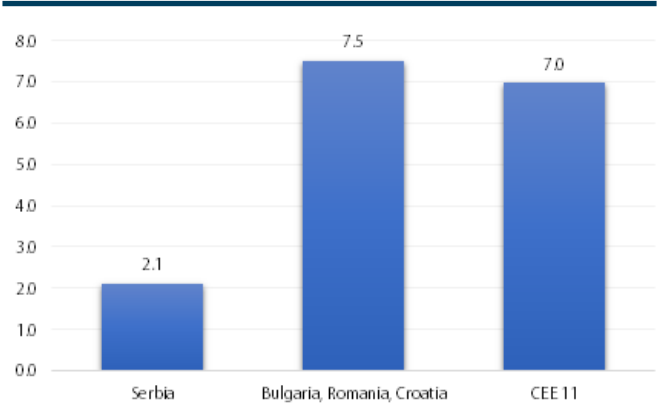
The first limitation to future growth based on quantitative expansion is the shrinking availability of labour in Serbia. The country is facing a depletion of its labour reserves due to previous growth, ongoing emigration, and unfavourable demographic trends. As a result, the unemployment rate has already 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).

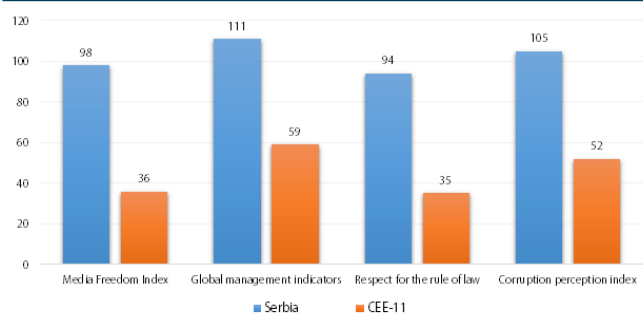
Graph 5. Serbia and CEE. Number of registered new enterprises per thousand working-age inhabitants (15–64 years), average 2018–2022



Source: Petrović, Brčerević, Minić (2025)

This represents yet another perspective that sharply illustrates the qualitatively opposed models of economic growth

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



Source: Petrović, Brčerević, Minić (2025) based on data from: Reporters Without Borders, World Bank, World Justice Project, Transparency International

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.