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1 country in the 'powder keg of Europe' is seeing tons of momentum

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Following the 1991 breakup of Yugoslavia, the Balkans seemed apt to reclaim their turn-of-the-century title of "the powder keg of Europe." The region experienced a series of crippling armed conflicts and international sanctions as newly independent states struggled to find a foothold in the peninsula. Though structural challenges have kept some mired in difficulties, others today show considerable promise.

Over the last couple of decades, economic reforms, democratization, and strengthened legal frameworks have put several Balkan states on the path to EU accession. Having become fully independent only in 2006, Serbia, in particular, stands out as one of the nations most eager to unfasten the shackles of its troubled past and deepen its integration into the global economy.

Two tumultuous decades have, until very recently, left the country devoid of meaningful growth. Serbia's rankings in the annual Global Misery Index (an economic indicator calculated by adding interest rates, inflation, and unemployment, and subtracting per capita GDP growth) have been unenviable, with the country consistently ranking among the top ten most 'miserable' worldwide. The 2013 survey placed it third among the 89 evaluated nations, according to a Cato Institute report. With low inflation in recent years, Serbia's shortcomings on the Misery Index are disproportionately caused by its high unemployment rate, which peaked at a worrying 24% in 2012.

Many within Serbia make the mistake of taking such macabre statistics at face value, though the country's most recent performance and medium-term outlook paint a much different picture. As part of stipulations attached to a 2014 IMF loan, Belgrade has undertaken ambitious structural reforms, due largely to Prime Minister Aleksandar Vučić's desire to accelerate the process of reaching European standards.

The latest economic indicators have demonstrated heartening progress. Serbia's unemployment rate had fallen to 17.3% by 2015, still high by any standard, but nearly seven percentage points lower than the 2012 rate. The country's 44.8 score on the 2013 Misery Index fell by more than 25% to 32.3 in 2015, corresponding to an improvement in its ranking from third to tenth most miserable worldwide. "Now, Serbia's score is still over 20, which means you still need deep structural reforms," said the Cato Institute's Steve Hanke, the creator of the index, "but they're certainly not moving in the wrong direction."

After a 1.8% contraction in 2014, Serbia's GDP is expected to grow 1.8% this year, with 3.5% growth forecast for 2018. After years of budget deficits hovering around 6%, Belgrade surprised IMF and EU monitors by posting a deficit below 3% in 2015, with similar projections for 2016. Just this March, global credit rating service Moody's changed Serbia's sovereign rating outlook from stable to positive, citing better-than-expected progress in fiscal consolidation and enhancements in institutional quality as reasons for the upgrade. The welcome revision further augments the country's prospects for growth in the coming years. Serbia's steady improvement, even in the face of Greek volatility and the recent influx of refugees, is a testament to the country's demonstrable commitment to far-reaching structural reform.

Integral to this reform has been a revamped effort to tackle the bloated and woefully inefficient state-owned enterprises (SOEs) that dominate Serbian industries. With its private sector accounting for a mere 66% of employment in 2014 (compared to Albania and Turkey's 83% and 87% respectively), Serbia had long been hampered by low levels of innovation and investment. The same year, Belgrade began issuing tenders for its underperforming firms, successfully auctioning off numerous mismanaged SOEs and implementing stricter oversight frameworks for others. Restructuring has met with opposition from industry leaders with vested interests, though the impact on Serbia's business environment is already apparent.

The country jumped 9 places on the World Bank's Ease of Doing Business ranking from 2014 to 2015, with the annual report citing an improved regulatory environment and diminished barriers to market entry. Belgrade has also begun actively pursuing foreign direct investment for its beleaguered industries and insufficient infrastructure, spurring a 30% increase in FDI from 2014 to 2015. Vučić's state visits to China and Albania (the first ever by a Serbian leader) and meeting with Turkish PM Ahmet Davutoğlu last year reflected this trade-oriented foreign policy agenda.

By December, Serbia had secured a high-level bilateral council to facilitate Turkish investment, a Chinese buyer for struggling state steelmaker Železara Smederevo and financier for a Belgrade-Budapest railway, and a joint construction deal for a road linking southern Serbia to Albania's Adriatic Sea port. The agreements are expected to provide a substantial employment boost to an economy wanting for jobs, as the country continues its steady descent on the Global Misery Index.

Though Serbia's recent improvements are commendable, much remains to be done in its path to sustainable growth and EU accession. Despite intensified labor inspection and oversight, a considerable portion of the population continues to work in the informal sector, complicating economic planning and diverting potential tax revenue.

Fiscal consolidation and economic modernization endeavors also face fierce opposition from those accustomed to reaping the spoils of Yugoslav-era clientelism, forcing Belgrade to adopt a reticent approach to reform. Such politically costly policies are vital bitter medicine that, while unpopular, will set the stage for steady medium- to long-term growth. "The resistance to modernizing, deregulating, it's tangled up with the typical kind of Balkan politics," says Hanke. "There's a certain element of rearguard action, holding onto elements of the old model."

IMF and EU monitors have urged the state to begin implementing reforms more zealously, stressing that forecasts for Serbia to transcend its current sluggish growth will not be met if the government does not increase the scope of its efforts. But structural challenges notwithstanding, Serbia appears committed to its new development project. With Russia facing mounting international isolation, Belgrade has set its sights on European integration, and the guidelines for EU accession now serve as an increasingly compelling impetus for change.

Provided the country does not lose its appetite for reform, the recent reductions in its misery indices are likely to be met with a sizeable plunge in the coming years. After 25 years marked by war, authoritarian rule, sanctions, natural disasters, and recession, Serbia certainly has a difficult road ahead, but if recent developments are any indication, the country seems up to the challenge. “They surely have huge, endemic, structural problems in the economy,” says Hanke, “but the momentum in Serbia now, I think it’s a good sign.