THE FIC ASSESSMENT OF COVID-19 IMPACTS

EXTERNAL SHOCK

The COVID-19 virus pandemic has caused a recession all over the world, including the Serbian economy. It was a big and unexpected external shock for all economies this year. Although it currently appears that the negative impact on the Serbian economy will be milder than expected, the effects of the crisis in the medium term are still uncertain. Our economy is fully involved in the European market where real GDP will shrink by about 7% this year, the most significant drop since World War II to date. The expected recovery of only 4.5% next year will not return real GDP in the EU to the level that existed before the crisis. Getting out of the recession for the EU, in that sense, does not mean returning to the path of long-term growth. That will have adversely affect to the Serbian economy, which exports 55% of all its goods to the EU market.

Many international institutions have forecast GDP trends for both Serbia and other countries. The EBRD predicted a decline in GDP by -3.5%, the IMF by -3%, the World Bank between -2.5% and -5.3%, and the European Commission -4.1%. However, all of these forecasts are subject to quarterly revision due to high uncertainty. Based on GDP trends in the first three quarters of this year, the decline in GDP in Serbia will be smaller, ranging between -1.2% and -1.5%. Compared to the expected growth of over 4% before the outbreak of the pandemic, the annual loss of potential GDP will be at least -6%, which more or less coincides with the fall in GDP in the second quarter of this year of -6.4%.

Not all sectors are equally affected by the pandemic. According to FIC members, 69% of the sectors monitored by the White Book were immediately affected by it, while the remaining 31% of the sectors were missing without immediate negative impact, but with possible indirect or subsequent negative consequences.

EXPECTATIONS

Economic expectations are important because they affect real economic activity. We checked this in a survey among FIC members. One third of FIC members participated in the survey in June 2020 on what they expect from their activities by the end of this year and next year. The general impression is that the decline in their activity will be mild this year, with a much faster recovery next year.

The crises will affect investments more than exports and employment, and also, profits will vary more than operating income. Within this framework, the financial sector will be less affected than the real sector. This survey was conducted before the second wave of the COVID-19 pandemic and the publication of data on the drastic fall in GDP in the second quarter in the EU and Serbia. The results of the survey are shown in Table 1 and illustrated in Figure 1.

The results of this survey fit the current GDP trend. However, it is uncertain how many expectations about the activity in 2021 will be realized, because we still do not know how long the pandemic will last, what health measures will have to be taken and what adverse effects they will cause. We also note that the structure of the economy in which the surveyed members of the FIC operate differs from the general structure of the Serbian economy. In the survey, one third of the members provide services, and two thirds are engaged in the real sectors in activity. In the Serbian economy, on the contrary, services form two

Table 1: Outcomes of FIC member' survey on activity during the COVID-19 pandemic[1]

Sectors	Year	Revenue	Profit	Employment	Export	Investment	Average
Financial sector	2020	-0.50	-0.88	-0.13	0.00	-0.25	-0.35
Real sector	2020	-0.15	-0.25	-0.20	-0.30	-0.45	-0.24
Weighted average	2020	-0.28	-0.54	-0.19	-0.18	-0.47	-0.33
Financial sector	2021	1.50	1.50	0.00	0.00	0.63	0.73
Real sector	2021	0.95	0.85	0.10	0.55	0.65	0.62
Weighted average	2021	1.20	1.21	0.07	0.38	0.63	0.70

1 The points for quantifying the answers are: 3 points for very good growth, 2 for good growth, 1 for some growth, 0 no change, some drop brings -1 point, a small drop -2 points and a significant drop -3 points. There were 17 large companies (weight 6 for size), 9 medium companies (weight 3) and 2 small companies (weight 1) participated in the survey (20 companies from the real sector, and 8 from the financial sector).

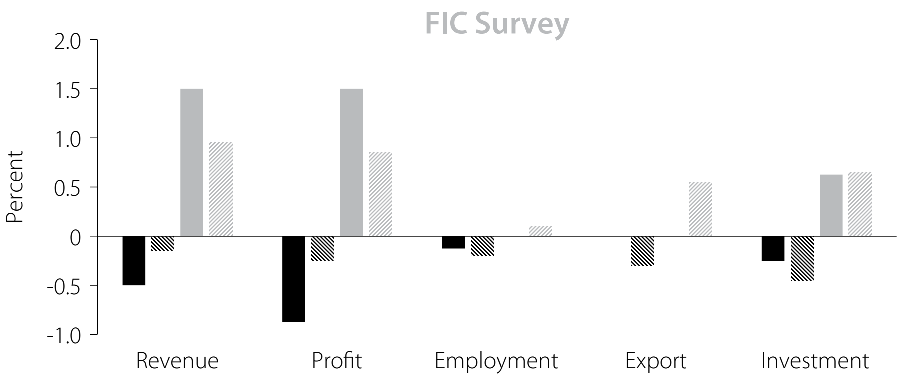

Figure 1:
Business expectations of FIC members in 2020-21

thirds of GDP, and production activities only one third. The data show that services were much more affected by the pandemic than production in the first three quarters of 2020.

RECOMMENDATIONS PRIORITY

In this edition of the White Book, we will not provide the FIC's Index of Institutional Progress in 2020. Although this index has gained the trust of the professional public, we decided to skip 2020 and continue publishing it in 2021. The reason for this decision is straightforward and justified. The COVID-19 pandemic in mid-March disrupted the usual activity of the Government and other state institutions on improving the economic environment and switched to fighting the virus disease and providing support to businesses, entrepreneurs and citizens to more easily withstand the impact of the recession. The FIC supports such state engagement and believes that external factors have caused the stalemate in institutional change. Therefore, it makes no sense to compare the two levels of institutional change, this and previous years, which are entirely incomparable.

However, further improvement of the business environment is a long-term necessity. Institutional changes must allow structural changes in the economy and better effects of fiscal and monetary measures to emerge from the recession. That is why our committees ranked the priority of the recommendations in this year's White Book.

Recommendations that should be adopted immediately received weight 3; weight 2 carries recommendations whose urgency is average and recommendations whose priority is not high carry weight 1. We called the average value of the estimated priority of implementing the recommendations the Priority Index (PI).

In Table 2, we ranked the sectors according to the priority of changing the institutional environment, i.e. according to the value of the Priority Index.

In addition to the priority of implementing the recommendations, we also added data on last year's scores and the average waiting time for the implementation of recommendations. The correlation between scores and priority of recommendations is 0.09, and the correlation between delayed implementation and priority of adopting new recommendations is -0.04. Correlation coefficients have the expected signs, but a very low value. Delays in the implementation of previous recommendations or unsatisfactory results in their implementation did not motivate FIC members to suggest what to do as soon as possible. The main motive was the assessment of which institutional changes would better help get out of the current recession. We believe that this is beneficial information for the Government.

In this sense, improvements are urgently needed in the areas of personal data protection, trade, central records of beneficial owners, mortgages and public procurement.

The second block of priorities includes staff leasing, energy sector, sanitary inspection, dual education, court proceedings, public-private partnership, restitution, VAT regulations, central records of temporarily restricted rights and related legislation to insurance.

Within the six aggregate sectors, real estate still requires rapid improvement. The insurance sector, on the other hand, has the lowest priorities.

It is interesting to note that the tax sector has priorities for change below the general average. In tax policy, the most significant problems are not in regulations and institutions, but

Table 2: Ranking of recommendations according to the priority of implementation in 2020/21

Recommendations	Average score in 2019	Average waiting time in 2019 [years]	Priority index: PI 2020
Sectors			
Law on personal data protection	1.33	8.50	3.00
Trade	1.33	7.33	3.00
Real estate: Mortgages and real estate financial leasing	1.00	4.00	3.00
Public procurement	1.00	4.00	3.00
Central registry of beneficial owners	2.00	NA	3.00
Labour legislation: Staff leasing	2.00	9.33	2.70
Food&Agriculture: Sanitary and phytosanitary inspections	1.00	1.40	2.67
Energy sector	1.60	1.80	2.63
Dual education	1.33	2.00	2.60
Judicial proceedings	1.20	4.38	2.60
Public-private partnerships	1.40	3.00	2.50
Real estate: Restitution	1.33	3.00	2.50
Taxes: Value added tax	1.14	4.71	2.50
Law on Central Register of Temporary Restriction of Rights	1.00	3.50	2.50
Insurance: Related legislation	1.00	1.60	2.50
Non-performing loans	1.67	2.67	2.50
Food& Agriculture: Food Safety Law	1.33	2.83	2.43
Law on Notaries	2.67	1.67	2.40
Investment and business climate	1.80	4.60	2.40
Real estate: Cadastral procedures	1.43	3.57	2.40
Labour legislation: The Labour Law	1.00	3.14	2.33
Labour legislation: Employment of foreigners	1.33	6.00	2.33
Law on Payment Transactions	1.33	2.00	2.30
Law on Bankruptcy	1.57	3.43	2.25
Food& Agriculture: Declarations on food products	1.33	2.00	2.25
Environmental regulations	1.83	5.33	2.22
Foreign exchange operations	1.14	3.14	2.20
State aid	1.33	7.00	2.20
E-commerce and digitalization	1.60	1.60	2.20
Pharmaceuticals	1.65	3.45	2.20
Protection of users of financial services	2.00	5.00	2.17
Illicit trade prevention and inspection oversight	1.71	3.12	2.14
Protection of competition	1.29	4.57	2.10
Capital market trends	1.67	3.33	2.00
Real estate: Construction land and development	1.80	4.60	2.00
Prevention of money laundering	1.75	7.50	2.00
Food& Agriculture: Livestock production	1.50	1.00	2.00
Insurance: Motor third party liability	1.50	6.00	2.00
Customs	1.40	1.00	2.00
Human capital	1.20	3.60	2.00

Recommendations	Average score in 2019	Average waiting time in 2019 [years]	Priority index: PI 2020
Sectors			
Insurance: Law	1.00	3.50	2.00
Taxes: Tax procedure	1.00	4.33	2.00
Labour legislation: Employment of disabled persons	1.00	7.67	2.00
Leasing	1.14	4.43	2.00
Taxes: Corporate income tax	1.57	6.43	1.88
Taxes: Parafiscal charges	2.00	4.60	1.83
Oil and gas sector	2.20	4.40	1.83
Taxes: Property tax	1.20	2.40	1.80
Company law	1.17	4.17	1.80
Taxes: Personal income tax	1.33	3.50	1.75
Private security industry	1.67	5.00	1.70
Arbitration proceedings	1.33	4.33	1.67
Law on Whistleblowers	1.00	3.33	1.67
Intellectual property	1.67	3.67	1.60
Telecommunications	1.78	1.89	1.56
Transport	2.00	4.40	1.50
Consumer protection	2.00	5.33	1.50
Labour regulations: Secondment abroad	1.00	2.33	1.30
Insurance: Natural disasters and shared services	1.00	2.50	1.00
Tobacco industry	2.00	3.50	NA
AVERAGE	1.47	4.03	2.17
Divisions			
Real estate	1.44	3.79	2.48
Labour regulations	1.33	6.33	2.35
Human capital & dual education	1.25	2.80	2.30
Food & Agriculture	1.29	1.81	2.27
Taxes	1.36	4.49	2.01
Insurance	1.09	2.74	1.88

in fiscal policy. The FIC supports the Government's efforts to help businesses and individuals in overcoming the difficulties of the current recession, but at the same time points out that such assistance has its limits determined by the fiscal deficit and public debt. If those boundaries are crossed, the entire economy will be exposed to significant risk and macroeconomic instability in which no one will fare well.

ANTI-CRISIS POLICY

In 2020, Serbia pursued an economic policy similar to other countries in the fight against the recession caused by the COVID-19 pandemic. The measures were primarily fiscal and monetary. The FIC does not question the positive effects of these measures but notes that most of the available fiscal space has already been used. The outcome was favourable as materialised in the small decline in GDP, but it had significant fiscal costs. As the economy is in recession and public debt is rising sharply, room for future incentives is limited. Therefore, further institutional reforms are needed to return the economy to sustainable growth and secure jobs. Within this framework, the FIC contributes to formulation of a detailed package of institutional changes with this White Book. FIC also emphasizes the need to overcome the stalemate in the EU accession process urgently. That would have a positive effect on the willingness to invest by foreign investors, as well as on the improvement of the general business climate.