

Reform of State Owned and Public Enterprises¹

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After ten years of transition, there are still some 1,300 enterprises under state control in Serbia (state owned and social enterprises, which are still in the process of privatization, large public enterprises and local public enterprises). High proportion of these enterprises in GDP, employment and social wealth negatively affect economic efficiency, encourage financial indiscipline, corruption, etc. From the fiscal standpoint, the state-controlled enterprises receive substantial direct government subsidies and thus contribute to the increasing public spending and fiscal deficit. In addition, these companies receive various forms of indirect subsidies, such as government guarantees for loans, toleration of tax evasion, “linking years of service”, which have resulted in an increase in the current and future public spendings and reduction of revenues. A serious program of reforms for these companies would lead to the fiscal savings, but would also increase the overall efficiency of the domestic economy. Priorities should be as follows: for companies that are still under the jurisdiction of the Privatization Agency - to end the process of privatization in the next two years, primarily for troubled companies that are in restructuring status; for large public and state owned enterprises – to improve efficiency and accountability in governance, which would lead to a reduction of direct and indirect subsidies and privatization of some of the large state enterprises operating in the competitive conditions; for the local public companies – to improve operations, which would reduce the need for substantial direct subsidies these companies receive from local governments.

1. Introduction

After more than a decade since the beginning of the transition process, in the Serbian economy, there is still a very high percentage of companies in the state and public ownership. It is estimated that currently about 1300 companies, which are under a state control, operate in Serbia, either by virtue of majority state ownership or on the basis of the effective management control (in the companies in the restructuring process), with about 280 000 employees, i.e. over 15% of total formal employment in Serbia. These companies can be divided into three broad groups:

- 1) Companies under the control of the Privatization Agency. This group included about 600 companies with around 100 000 employees.
- 2) Large public and state owned enterprises. This group can be further divided into two subgroups:
 - a) Public companies that perform services of general interest and operate in the regulated market under conditions of monopolistic competition (e.g. EPS (Electric Power Industry of Serbia), P.E. Roads of Serbia, Srbijagas, P.E. of PTT Communications Srbija). In this group there are about ten companies with around 80 000 employees.
 - b) Large state owned enterprises operating in competitive industries (e.g. Telekom Srbija, Galenika, Jat Airways, Sartid, Ski Resorts of Serbia), etc. This group consists of about 40 companies with around 33 000 employees.
- 3) Local public companies. This group consists of about 650 companies with around 70 000 employees. Local utility companies are most important in this group.

Although, during the last decade, a substantial progress has been made in the restructuring of state owned enterprises and privatization of public enterprises, the situation in this area is unsatisfactory. There are still a large number of non-privatized social enterprises, while the restructuring of public and other state owned enterprises is unfinished. Leaving aside the economic and legal differences between state owned (public and others) and social enterprises, their common feature is that, directly or indirectly, they are controlled by the state. Participation of enterprises under state control in Serbia's GDP is very high, which adversely affects economic efficiency, encourage financial indiscipline.

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¹ We thank Dusko Vasiljevic who assisted in the preparation of this text. The largest part of the data used in this text was obtained from unpublished World Bank study, which refers to improving the management of enterprises under state control.

pline, corruption, etc. In 2010 the total loss of all civil, social and public companies amounted to about one billion euros (about 3.5% of GDP).

From the fiscal standpoint, it is relevant that the state controlled enterprises receive significant direct government subsidies, thus contributing to the increase in the public spending and fiscal deficit. In addition, these companies receive various forms of indirect subsidies such as government guarantees for loans, toleration of tax evasion, “linking years of service”, which have resulted in an increase in current and future public spendings and reduction of revenues. Total government expenditures for support of these companies - including direct subsidies from the Serbian state budget and the budgets of local governments, transfers for linking years of service and expenditures for servicing the guaranteed debt - in 2010 amounted to about 2.7% of GDP and in 2011 about 2.3% of GDP. Therefore, the restructuring and privatization of enterprises under state control is essential, not only for improving of the efficiency of the economy but also for successful fiscal consolidation. Additionally, from a fiscal (point of view) standpoint, it is relevant that privatization of enterprises under state control offers the ability of direct or indirect reduce of the public debt, but also for the growth of tax revenue in the future.

In the next section we present the current status and major issues for each of the major groups of state owned and public enterprises. Then, in the fourth (section) chapter, we estimate the total support that these companies receive from the state. In the last section we present proposals for measures that could improve the situation in this area.

2. Overview

2.1. Enterprises under the jurisdiction of the Privatization Agency

Since the beginning of transition in Serbia, the Privatization Agency privatized nearly 2500 companies, and collected approximately 2.6 billion euros. Although, especially in the beginning, significant results were achieved, the pace of privatization has slowed down considerably in recent years. From 2002 to 2008 in average 320 companies were privatized a year, and from 2009 to 2011, only 47 companies in average. This slowdown is primarily a consequence of two factors: first, the remaining social enterprises are relatively problematic, and second, there was a decrease in the interest from investors because of the economic crisis. Beside the slowdown in privatization, in the last few years, a process of transforming the failed privatized companies into state owned companies is also present.

Under the jurisdiction of the Privatization Agency, there are currently about 600 companies of different sizes, with about 100 000 workers. Agency's portfolio is heterogeneous: Includes twenty very large enterprises (with more than 1000 employees), about 60 enterprises with between 250 and 1000 employees, and about 90 enterprises with no employees (most of these companies is in the liquidation process), and more than 130 companies with 1-10 employees. These companies have very different history: some of them are in the process of restructuring during the past ten years, and most have gone through several unsuccessful attempts of privatization, while others returned to the jurisdiction of the Agency upon the termination of the privatization contract, and third are relatively small public enterprises that also went through a series of unsuccessful attempts of privatization. The Agency's portfolio consists of a number of companies to which the final status solution was made more difficult by the legal problems (e.g. companies associated with former Yugoslav republics or with Kosovo), or by unclear division of responsibilities among various levels of government (eg, companies such as local media).

Enterprises under the jurisdiction of the Agency make significant losses (total losses amount to about 1.5% of GDP per year) and accumulate considerable payments lag. In 2010, more than 500 companies in the Agency's portfolio made losses. In the past three years, an average loss of the entire portfolio was over 400 million euros a year. The vast majority of these enterprises survive only thanks to the government support through direct and indirect subsidies.

Enterprises in the Agency's portfolio survive primarily due to the “indirect subsidies” from the state, but also, the support through direct subsidies is significant. “Indirect subsidies” include tolerance for unpaid taxes and contributions (e.g. only in 2011 debt these enterprises made for unpaid taxes and contributions increased by about 15 billion dinars), as well as non-payment of obligations to other public and state owned enterprises. As a result, companies from the portfolio of the Agency accumulated substantial debts for unpaid obligations to the state and public enterprises. Unusual and very significant subsidy for these companies is so-called linking years of service (see box).

A particular problem is the status of “restructuring”, which is used to permanently protect some of the most troubled companies from bankruptcy. In order to avoid a politically problematic process of solving the fate of these companies,

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and the fate of employes working in them, about 170 companies from the portfolio of the Agency is in the status of “restructuring” for unlimited time. Most large enterprises under the jurisdiction of the Agency would not be able to survive in a market in their current state, and would need extensive restructuring or resolution through bankruptcy or liquidation. However, resolving the status of these companies requires political determination, because it is associated with loss of jobs, but also with resistance from management and from some politicians.

Box 1. Linking years of service

Linking years of service represents untypical indirect subsidy whose beneficiaries are mostly workers in the enterprises under the jurisdiction of the Privatization Agency. In 2010 and 2011, the amount of this subsidy was about 360 million euros in total. In the year when this subsidy is paid, this operation does not affect the increase in public expenditures and fiscal deficit, because part of the transfer to the pension fund, intended for payment of pensions, is simply declared as the transfer from the state budget for linking years of service of those workers whom companies have not paid pension contributions in the past. Seem as though linking years of service is simply an accounting operation, which costs nothing. However, this subsidy increases the implicit obligations of the state regarding future pensions. The number of years of service is directly proportional to the initial amount of pensions, and with the payment of years of service tax, the state obligations to workers- future retirees- are increased. Hence, the phrase “linking years of service” is a euphemism for increasing the implicit debt to future retirees.

In addition to the fact that these transfers are financially significant, problematic, as well, is the fact that, thanks to this transfers, the employees of enterprises under the jurisdiction of the Agency, receive privileged treatment in relation to employees in private companies that have financial difficulties (if employers of workers in private enterprises do not pay contributions to the Pension and Disability Insurance Fund, the employees can not qualify for the retirement, nor can they count on co linking years of service from the state).

Enterprises from the portfolio of the Privatization Agency also accumulate considerable payment lags towards private suppliers, and are often generators of illiquidity in the entire chain of companies. On the basis of incomplete data, it is estimated that the total amount of debts to private suppliers in late 2011 amounted to almost half a billion euros.

These enterprises control significant resources and thus prevent their reallocation to more productive use. Asset's book value of these enterprises is over 5 billion euros. Although the trustworthiness of this information is in question, the fact is that certain enterprises control very valuable assets, in particularly land and buildings. Resolving the fate of these companies would allow mentioned resources to be much more productively used.

Although they received considerable support from the state and employ a large number of workers, the contribution from enterprises from the portfolio of the Privatization Agency to the Serbia's overall economy - is very modest. These companies employ about 5% of total formal employment in Serbia. However, the gross added value of these companies is less than 1.5% of GDP in Serbia. Labour productivity is very low, and is estimated to be about 4000 euros per worker, less than a third of average labour productivity in the Serbia's enterprise sector.

2.2. State Level Public Enterprises (SLPEs) and other state owned enterprises

In line with the privatization of social enterprises, a number of measures, aimed at restructuring public enterprises, were initiated. Among these measures, most important are: the price adjustment in regard to costs, reduce redundancy, separating out non-core activities, the division of a vertically integrated monopoly (a division of EPS to EPS and EMS - Public Enterprise for electric energy transmission and transmission system control). Most public enterprises have realized significant investment in equipment and infrastructure (important exceptions are the JAT and the Serbian Railways), which contributed to improving the quality and reliability of their services. In some activities in which public enterprises operate, effective liberalization was implemented (telecommunications, air transport, most of the postal services, production and distribution of oil, gas distribution, etc.), while in other areas (production of electricity) liberalization is only formal.

The privatization of public enterprises is at the very beginning (NIS is the most important case). It is estimated that in the pre-crisis period, opportunity to privatize public enterprises that can operate under competitive conditions, at relatively favourable prices, was missed. Moreover, as a consequence of the economic crisis and inadequate management, the state took ownership over some industrial enterprises (Železara Smederevo steel plant, Galenika) or indirectly through Srbijagas. Taking over these enterprises was mainly forced in order to prevent their bankruptcy, which would probably be completed in liquidation. Although not so relevant from the macroeconomic point of view, it is estimated that the establishment of new public enterprises in commercial activities (Ski Resorts of Serbia) is economically unjustified.

The portfolio of state level public enterprises and other enterprises in which the state holds a majority share, now consists of about 50 companies, some of them are among the biggest companies in Serbia and play a significant role in the overall economy. This portfolio, which consists of approximately 50 enterprises, can be divided into two broad subgroups: 1) enterprises that operate in sectors with commercial competitors (e.g. pharmaceuticals, tourism, transport, etc.) and 2) a large public companies that operate in regulated sectors, often in conditions of monopoly, or companies that provide services to public infrastructure (e.g. power distribution, railway infrastructure).

The largest public companies are particularly important for the competitiveness of the entire Serbian economy, because they provide key inputs for all other companies in the country. The challenge for government is to maintain correct balance of numerous, and often conflicting, goals in managing these companies. As the owner, the government should ensure that these companies operate efficiently, and to conduct investment policy which will ensure their long term sustainability. As a regulator, government should ensure that the tariffs are compatible with efficient long-term operation, but also to protect consumers from possible abuses of monopoly position.

Big public companies achieve poor operating results, do not have sufficient incentives to increase efficiency and are faced with pressures to keep prices of services on a socially acceptable level. As a result, the level of investment is low and threatens the long-term operation sustainability of some of these companies. Measuring the operational performance requires the development of appropriate indicators. For example, a recent report by the World Bank, found that the productivity of the Serbian Railways is only 29% of EU average (in comparison to 58% of the EU average in Croatia and 69% in Poland), while only 54% of freight cars and 28% of passenger cars have been operational in 2008. A good example of companies in which the effect of achieving social objectives (in terms of tariffs, and in terms of employment) leads to an insufficient level of investment is EPS. According to the report of the World Bank, the company has major problems due to insufficient investment, while Serbia is faced with a possible crisis in the supply of electricity. More than a half (53%) of EPS manufacturing facilities is older than 30 years, less than a quarter of transmission lines and substations are in good condition, distribution losses (due to depleted distribution network, faulty meters and theft) now reach 15.8% gross electricity consumption (versus 5.6% in the Czech Republic and 5.2% in Slovakia).

Seven of the twelve largest public and state owned enterprises have noted the loss of 343 million euros in 2010. In order to mitigate the effects of bad business, public and state owned enterprises receive substantial help from the state. Direct subsidies are limited to two companies, Serbian Railways and PEU Resavica (public company for underground extraction of coal). However, in recent years the issuance of state guarantees for their debt represents highly striking aspect of support for public companies is. In addition, state support includes debt service for some companies, as well as tolerating delays in the payment of certain obligations towards the state owned and other public enterprises.

The reasons for the weak economic and financial performance of public enterprises are numerous: low prices, surplus employees, neglected and overexploited equipment and infrastructure, and poor management of these enterprises. Here we specially focus on analyzing the most important indicators of poor management of public enterprises, for it is an important factor of inefficiency, which has yet not been examined in detail.

Most of the measures for improving the management of public companies do not require large resources, such is the case with the modernization and construction of infrastructure, nor high social costs, as is the case with the release of surplus employees or increasing prices. However, improving the management of public enterprises would lead to a loss of personal and political rent, and reduce irregular employment (political party, family, etc.). In order to successfully improve the management of public enterprises, it is necessary to take measures to prevent these illegal interests. Some of the most important indicators of inefficient management of public companies are²:

² Most recommendations for improving the operational management of public enterprises are taken from unpublished World Bank study.

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- Transparency in publishing the results of operations is limited, especially when it comes to operational indicators, plans and results. Reporting on operational indicators of business is almost entirely limited to the annual business plans, which are not publicly available. Although business plans contain plenty of detailed information, they are primarily related to short-term financial plans (i.e. plans for next year), and very little attention is paid to the evaluation of results achieved. Noticeable is the lack of focused and coherent framework for evaluating the results, which could for example consist of a small number of carefully selected indicators of financial and operational performance (which should also be internationally comparable) that would be actively used to monitor the enterprise business by the owner (state) and were publicly available.
- Although the Ministry of Finance supervises the business plans and financial statements of public companies, this surveillance is largely focused on respect of the financial guidelines, and not the quality of strategic planning and ongoing management.
- Although the public and state owned enterprises differ in their legal status (e.g. some are organized as public companies that fall under the Law on Public Enterprises and Activities of general interest, and some are corporatized and fall under the Law on Enterprises) and market structure, all these companies are suffering from weaknesses in the corporate and financial management.
- The process of appointing of the management of public and state owned enterprises is very politicized. Nominally, the government appoints the board members and directors of these companies, but in practice, this largely depends on the mutual agreement of political parties.
- Politicisation is associated with the decision making process, in which, policy objectives are the priorities (e.g. maximization of employment and relatively high wage levels, as well as maintaining low tariffs as a “social” category).
- It is estimated that for some of the large state owned enterprises in the commercial sector there are good prospects for privatization. Companies like Telekom, Galenika, Ski Resorts of Serbia et al., could be good candidates for privatization. For companies where the State decides to retain a majority stake in the medium term, priority should be to increase the efficiency with adequate regulatory policy.

In addition to the inefficient management and cost inefficiency (redundancy, relatively high wages, inefficient procurement, etc...), an important cause of loss of some state level public enterprises are the low prices of their services. This is especially important in the case of EPS and Srbijagas, whose products are sold at prices lower than cost. Low prices of electricity and gas, besides affecting the losses of these companies, increase the probability that in the future these companies will not be able to repay loans for which the state has issued a guarantee.

State level public enterprises and local public enterprises are faced with problems in the collection of services from other companies and citizens. Especially great obligations to public companies, whose collection is unlikely, have companies in restructuring that are under the control of the Privatization Agency.

Legal or informal barriers for investment in sectors in which public companies operate, as well as the unfavourable economic environment, prevent or hinder the entry of private capital in activities public companies deal with. In the case of electricity generation, low price discourages commercial investors to enter into the construction of private thermal and hydro power plants.

2.3. Local public enterprises

Local public enterprises are a heterogeneous group that differ in size and market conditions in which they operate. Some of them operate in industries that are natural monopolies, while others work in industries where competition is possible. Currently there are about 645 local companies whose founders are municipalities or cities, and they employ about 70,000 employees. Most of them (348) are the local utility companies, some of which offer their services as natural monopolies, including the companies for water supply and sewerage. There are also plenty of local companies that provide commercial services, e.g. parking services, market maintenance companies, companies maintaining cemeteries. Finally, there is a group of companies that provide non-commercial services, such as companies for parks, street cleaning, licensing, etc... However, the most important groups are the local utility companies, which employ about 80% of the total number of employees employed in local enterprises.

Problems in the functioning of local public enterprises are similar to those that are a hindrance in the work of state level public enterprises:

- their efficiency, which is low on average, varies considerably from one to another local government;
- appointment process of the management is often politicized. As in the case of public enterprises at the national level, in local public enterprises economic efficiency is generally not a priority, but are social and political goals (as previously stated, this involves maximizing the number of employees and relatively high wages, and maintain low tariffs as a “social” category)
- low cost of some utilities (heating in many communities, public transport in Belgrade, etc..) directly influence the occurrence of loss of utility companies and the growth of budget subsidies;
- local enterprises in aggregate have high losses and receive substantial subsidies.

3. Direct and indirect subsidies to state-owned and social enterprises

A significant number of state owned and social enterprises ran business inefficiently, and in a sum, they realize heavy losses. Many of them have survived thanks to the abundant support of the state through direct and indirect subsidies. The total monetary cost for the support to these enterprises—which include direct subsidies from the Republic of Serbia budget and the budget of the local governments, transfers for linking the years of service and the expenses for servicing the guaranteed debt—amounted to about 2.7% of GDP in 2010, and about 2.3% of GDP in 2011. Besides the fact that these costs are quite high, they are often non-transparent and not based on the *cost-benefit* analysis of the effects. Apart from these direct subsidies, companies received a very strong support in the form of indirect subsidies: tolerating the accumulation of the debt for the unpaid taxes and contributions, the unpaid obligations towards the public enterprises, as well as extending the government guarantees for debt. Overall, accumulated debt for the unpaid taxes and contributions, the debt towards the public enterprises and issued government guarantees reached over 12% of GDP at the end of 2011 (Table 1).

Table 1a. Subsidies to enterprises controlled by the state (% GDP)

„Monetary“ expenditures (average of 2010 and 2011)				
	Direct subsidies	Expenditures for servicing guaranteed debt	Transfers for linking years of service	Total
Portfolio of the Privatization Agency	0.3*	0.0	0.5	0.7
Public and large SOEs	0.5	0.3	0.1	0.8
Local public enterprises	0.8	0.0	..	0.8
Total	1.6	0.3	0.6	2.5
„Soft“ budgetary support (status at the end of December 2011)				
	Status of issued government guarantees	Accumulated debt to state (taxes, contributions, Fund for development, etc...)	Accumulated debt to public enterprises	Total
Portfolio of the Privatization Agency	0.2	3.6	1.5	5.3
Public and large SOEs	5.7	0.9	0.3	7.0
Local public enterprises	0.0
Total	5.9	4.6	1.7	12.2

Table 1b. Subsidies to enterprises controlled by the state (millions of euros)

„Monetary“ expenditures (average of 2010 and 2011)				
	Direct subsidies	Expenditures for servicing guaranteed debt	Transfers for linking years of service	Total
Portfolio of the Privatization Agency	94*	0	172	266
Public and large SOEs	160	76	12	248
Local public enterprises	223	0	..	223
Total	477	76	184	737
„Soft“ budgetary support (status at the end of December 2011)				
	Status of issued government guarantees	Accumulated debt to state (taxes, contributions, Fund for development, etc...)	Accumulated debt to public enterprises	Total
Portfolio of the Privatization Agency	74	1,100	441	1,616
Public and large SOEs	1,742	288	84	2,113
Local public enterprises	0
Total	1,816	1,388	525	3,729

Sources: Ministry of Finance, the Privatization Agency, Fund for the development, evaluation by authors

* Includes subsidies from the Republican budget, which the company obtained through the Development Fund, the funds "loans for special purposes" that are placed from the ministrie through the Fund for Development, and subventions from the replacement of the funds of the Development Fund.

Notes: Data on direct subsidies, transfers for linking years of service and state government guarantees are the original data of the Ministry of Finance and Development Fund. Data on accumulated debt to the state and the public enterprises are estimates based on incomplete data obtained from the Ministry of Finance and Privatisation Agency.

3.1. Enterprises in the jurisdiction of the Privatisation Agency

Enterprises under the jurisdiction of the Privatisation Agency receive significant support through the "indirect" subsidies, primarily a tolerance for evasion of obligations to the state and public enterprises. Most of the enterprises under the jurisdiction of the Agency realize losses: the losses from 2008 to 2010 amounted to about 350 to 400 mn € on average per year. In order to survive despite these losses, the enterprises under the jurisdiction of the Agency are tolerated the non-payment of the obligations for taxes and contributions, as well as obligations to the public companies. The enterprises under the Privatization Agency accumulated about 1.1bn euros of debt to the state, and somewhat over 400mn euros of debt to public enterprises. Debts to the state include the debts for the unpaid taxes and contributions, as well as the debts to the Development Fund.

In 2011 only, the debts for the unpaid taxes and contributions were increased in the gross amount by about 15bn dinars, i.e. about 150 mn euros. The majority (more than 80%) of the accumulated debts to state refer to the enterprises in the status of restructuring.

In addition, these enterprises receive generous direct subsidies in the amount of about 95 mn euros annually (this also includes "soft" loans which are mostly not repaid, thus, also treated as a subsidy). These funds are mainly invested by the Development Fund. They include subsidies from the budget of the Republic of Serbia (about 35mn euros a year) which enterprises receive through the Development Fund, "special purpose loans" which are generally not repaid and are the expense for the Budget (are also invested by the Development Fund, more than 50mn euros a year), as well as the subsidies from the recourcers of Development Fund.

3.2. Public enterprises of the Republic of Serbia and other state-owned enterprises

The main forms of support to public and large state-owned enterprises are direct subsidies (even though they refer to only two enterprises) and in the last few years, extending the government guarantees for loans. As noted earlier, Serbian Railways and PEU Resavica receive direct subsidies from the state: from 2009 to 2011 direct subsidies had a total amount of 378mn euros for Railway, and 57 mn euros for PEU Resavica.

In the last few years, there has been a rapid expansion of the extending government guarantees. Total guarantees issued to the public enterprises reached 1.7bn euros at the end of 2011. A particular problem is that in the last three years the purpose of extending the guarantees has substantially changed. Until the year 2009, guarantees were mostly issued for infrastructural projects, while recently, guarantees for economically unjustified purposes are being increasingly issued- maintenance of a current liquidity, refinance of existing obligations, procurement of goods and services.

In addition, the state support includes servicing debts for some enterprises. For this purpose, the state has set aside a somewhat more than 150mn euros in total, in 2010 and 2011. Finally, the government support is reflected in the tolerance of lags in the payment of certain obligations to the state and other public enterprises. At the end of 2011, the accumulated debt of public enterprises for the unpaid obligations to the state and other public enterprises is estimated at about 360 mn euros, i.e. more than 1.2% of GDP (most of the accumulated debt refers to the obligations of Serbian Railways (Zeleznica Srbije)).

3.3. Local public enterprises

In 2010, the local enterprises received about 225mn euros (about 0.8% of GDP) of direct subsidies from the local authorities³, and the similar amount is estimated for the year 2011. It is noticeable that subsidies are concentrated in the large cities. More than two-thirds of the total amount of the direct subsidies to the local governments refers to the subsidies to three largest cities. The largest single user of the local direct subsidies is GSP Beograd. In 2010, from the budget of the city of Belgrade was spent about 34mn euros for the subsidies to GSP Beograd, and in 2011, about 47mn euros. Of a particular problem is that a mere ten percent of this amount refers to the subsidy for the capital expenditures, while the rest of the subsidy is used to finance the current business.

4. The reform of state-controlled enterprises

4.1. The reform of the enterprises under the jurisdiction of the Privatization Agency

The main objective of the reforms in the enterprises in this sector is the completion of the privatization process during the following two years. After more than a decade since the beginning of the transition, there are no more valid reasons to postpone the privatization of the enterprises that remained under the jurisdiction of the Agency. To achieve this objective, it is possible to implement the following measures:

- To determine the deadline for the privatization of the enterprises, and if that isn't possible, to run their bankruptcy. To increase the chances for privatization, it is possible to write off the old debts of the enterprises with the introduction of the hard budgetary constraints afterwards. If the enterprises re-accumulated the debts, bankruptcy procedure would be initiated even before the privatization deadline.
- To revise the Decree on Restructuring⁴ so as to limit the time of the process of enterprise restructuring (e.g., no more than 18 months). During this period, enterprises would be privatized, and if that is not possible, their bankruptcy would be initiated.
- In the case of the enterprises under restructuring, measures to improve their management would be undertaken, similar to the measures proposed for the public enterprises, to increase the chances for their privatization.
- In order to preserve the social stability, it is necessary to provide the additional funds for the social protection of the employees who will lose their job in the process of the privatization. It is estimated that the necessary funds amount to several hundred million Euros (probably between 300 and 500mn), which is comparable to the amount transferred for the linking years of service and the direct subsidies that these enterprises receive during the period of two years. The costs could be reduced if there would be an immediate implementation of the decisive reforms which would improve economic environment and attract investments that would at least partially absorb the excess employees in the enterprises under the Agency's jurisdiction. These funds should be available for a limited period of time, so the workers reluctant to abandon the failed enterprises have a clear motive to opt for this step.

³ Direct subsidies to public enterprises of the provincial government of Vojvodina, which in 2010 amounted to about 18 million euros, were also included.

⁴ Regulation on the procedure and method of privatization, restructuring of companies, the Government of the Republic of Serbia.

4.2. The reform of the State Level Public Enterprises

From the standpoint of the public finances, the main objective of the public enterprises reform is to decrease the direct and indirect subsidies to public enterprises. The direct subsidies to the state level public enterprises would probably not reduce significantly, but with the same level of subsidies, a higher efficiency in a service delivery would be ensured.⁵ However, the indirect subsidies (guarantees, linking years of service, not paying taxes, etc...) could be fairly reduced. In addition, the privatization of some public enterprises could provide the considerable funds for the direct (the existing debts return) or indirect decrease of the public debt (the financing of a reduced future fiscal deficit with the revenues from the privatization). From the standpoint of the public finances of the government subsidies users, the privatization of the public enterprises is preferable, even if it doesn't bring significant budgetary inflows- an example of such a privatization could be JP Resavica.

From an economic standpoint, the objective of the restructuring is to improve the efficiency of public enterprises, and that could be achieved by applying the following measures:

- By improving the corporate governance; the Government should complete the corporatization of the remaining large public enterprises.
- To achieve the expected benefits of corporatization, it is necessary to establish the implementation of the transparent and professional framework for the appointment of directors and members of the public enterprises management and supervisory boards.
- For the large public enterprises, it is necessary to strengthen the role of the state as a leader, including the way it manages the public enterprises and monitors their doing business. One possible approach is a clear delegation of authority and responsibility to a specialized department of the Ministry of Finance, which could help reduce the unfavourable political impacts and facilitate the capacity strengthening to be focused and more efficient.
- An important element in the reform of the public enterprises should be the development of the integrated performance management system, which would include the development of "key performance indicators". The achieved results would be publicly proclaimed. It is also necessary to introduce the firm budget constraint (i.e. to prevent the accumulation of the unpaid obligations and unjustified guarantee issuance).
- To distinguish more clearly the role of the public enterprises in the carrying out the services from the public interest and their commercial business. One possible model are contracts to provide services of public interest. Public enterprises would commit to a certain level and quality of service of public interest that are not commercially viable, and for this would receive a direct compensation from the state. This compensation should gradually replace all other forms of support (e.g., subsidies for a current operations and guarantees for borrowing).
- Apart from the reforming the system of subsidies and issuance of guarantees, a system of tariff determination should also be reformed, as well as the appointing authorities, so that they are based on the achieved operating results of the enterprises, measured by both financial and "key performance indicators".
- The current system of the state aid is fragmented; it is necessary to develop a unique and comprehensive database for all forms of the state support, which would include public and large state-owned enterprises, the enterprises under the jurisdiction of the Privatization Agency and local public enterprises.

Improving the management of the public and industrial enterprises (Galenika at al.), which are directly or indirectly owned by the state, could increase the chances for their privatisation. From the standpoint of the economic efficiency, privatization of the enterprises operating in competitive conditions, such as Telekom, Galenika, Smederevo Steelworks, enterprises owned by Srbijagas, Ski resorts of Serbia et al. Furthermore, it is reasonable to consider the privatization of some parts of EPS. Liberalization of the activities in which public enterprises operate would contribute to improving their performances in different ways: the prices of their products would be in compliance with the costs, reducing unproductive expenses would be necessary for the enterprises to survive in the market, various direct and indirect forms of state aid would become illegitimate because they would disrupt the competition. Moreover, effective liberalization of the electricity production and rail transport would reduce the need for the EPS and the Serbian Railways' borrowing, and thus limit the growth of indirect debt of Serbia.

⁵ The largest part of direct subsidies is now meant for railway, which could be expected in the future. However, restructuring of the railways should ensure that subsidies go to the maintenance and modernization of infrastructure, not salaries.

Box 2. Financial indiscipline: problems and possible solutions

Problems with the collection of claims, that public enterprises have, are a part of a general problem of financial discipline, which has a long tradition in Serbia. A large number of participants on the market do not pay their obligations in the contractual and statutory deadlines. Moreover, enterprises that have a dominant position on the market impose the unsustainably long contractual deadlines to settle its obligations. From the standpoint of fiscal consolidation, non-payment of taxes is one of the important forms of the financial indiscipline. Based on the lists of the largest tax debtors, it is quite certain that the most of the claims on that basis will not be charged or will be charged a minimum percentage in relation to the value of the claim. It is a similar situation with the public companies, which have relatively high claims from the economic entities that are under state control.

Some of these enterprises, like the ones in the restructuring, are protected by the law from the forced payment and initiation of bankruptcy procedure. The debts of insolvent enterprises are transferred in a chain reaction through the economy so to create the chains of illiquidity. Accumulation of due, but unpaid claims is also contributed by the relatively expensive and time-consuming bankruptcy procedure. Inadequate legal solutions which would prevent systematic fraud by the entrepreneurs who create enterprises, accumulate obligations, and then liquidate enterprises also affect the growth of the unpaid claims. The current world economic crisis has further intensified the previously present systematic causes of the financial indiscipline.

The establishment of the financial discipline is an important condition for improving the safety of business operations and overall economic environment in Serbia. The main precondition for solving the problem of financial indiscipline is the existence of the efficient bankruptcy procedure which would quickly and at little cost exclude the insolvent enterprises from the market. The efficient bankruptcy procedure requires both appropriate legislation, and the training of all the participants in the mentioned process. One of the preconditions for the efficient and non-selective implementation of the bankruptcy procedure is a relatively quick resolution of the status of the enterprises in restructuring. Another measure that could contribute to the improvement of the financial discipline is the statutory limitation of deadlines for the settlement of obligations. It is possible that legislative solution is to be adopted already, which would immediately shorten the deadlines to 60 days, and in the next few years to 30 days. Shortening of the period for the obligation settlement would make redundant the extremely problematic proposals to extend the deadlines for the payment of VAT or introduce the VAT collection by the charged realization. It is necessary to establish the financial discipline with the reforms, rather than the tax system adapting to the financial indiscipline as given and unchangeable condition.

Public enterprises and other participants in the market have serious problems with the collection of claims. Enterprises in restructuring and local communities have the largest debts to public companies. Improving the payment of claims of public companies is possible as a part of systematic measures for the improvement of overall financial discipline in Serbia. Citizens' debt problems to public enterprises could be solved by combine use of measures of social policy (in the case of the poor) and forced payment from other citizens.⁶

While the improvement of management and the improving the cost efficiency contributed to the improving the financial performances of public enterprises, in some cases, it is necessary to increase the prices of their services. This primarily refers to the increase in the prices of electricity and gas that are now well below the market prices. Increasing the prices of the aforementioned services is important as well from the standpoint of fiscal consolidation. Although EPS and Srbijagas do not receive direct budgetary subsidies, the government issued relatively high guarantees for their debts. If the prices of their services permanently remained below the level, it could lead to the activation of the government guarantees for the debts of the aforementioned enterprises. The increase in the service prices of the mentioned enterprises should be gradual, not only for the protection of the standard of living, but also for the risks that the higher prices are used for the strengthening of the cost inefficiency.

⁶ In the case of electricity even stealing of electricity is not negligible, which is particularly widespread in wild unhygienic settlements.

4.3. Reform of the local public enterprises

With the local enterprises restructuring it is possible to achieve relatively large reduction of the direct subsidies, which local governments grant to utility enterprises. The business operations improvement of the local public enterprises includes four groups of activities:

- Completion, improvement and the implementation of the legislative framework for conducting public utility activities (new law on communal activities, the use of the public-private partnership and granting concessions, application of the Public Property Act, etc...);
- Improving the management of local public enterprises (corporatization and other measures, as well as at the level of the Republic);
- Increase of the prices at the level of long-term costs;
- Improvement in the cost efficiency of the local enterprises (reducing redundancy, more efficient public procurement, etc.; see the section on the fiscal decentralization);

In the case of local services that are not natural monopolies, the privatization of utility enterprises or their parts is possible, as well as the liberalization of some services (public transport). In the case of public-private partnership, the extreme caution is needed, due to a potentially great opportunity for corruption.

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