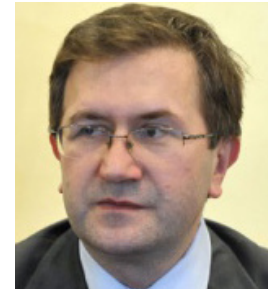

From the Editor



Over the last four years, Serbia has made significant progress towards establishing macroeconomic stability, but despite this growth, the Serbian economy is among the slowest in the region of Central and Eastern Europe. Key reasons for the slow growth don't lie in fiscal or monetary policies, but in bad economic environment i.e. in weak institutions. One of the important causes of the bad economic environment in Serbia is an inefficient state that burdens the economy with high costs and risks, whose services are of low quality and the price of these services, collected through taxes, is relatively high.

EU member states, on average, collect through taxes from citizens and the economy about 45% of GDP and then spend that on financing a number of functions. Serbia, after fiscal consolidation, spends around 42% of GDP, which is above the average of the EU member states from Central and Eastern Europe (CEE), which spend 40% of GDP. Modern states perform numerous and varied functions, some of which exist since the formation of first states, while the others were created during the second half of the 19th and 20th century. Functions such as judiciary, internal and external security, building of infrastructure, and maintaining macroeconomic stability are under the responsibility of states since their formation. Modern states spend less than 10% of GDP, or just over a fifth of their expenditures on these classical functions. For functions that they have began to carry out only since the second half of the 19th century, such as pension insurance, health care, education, the protection of the poor, ecology, fundamental scientific research and other, modern states spend almost 80% of total expenditures.

The state provides important services for citizens and economy, without which there would be no civilized society, nor longer lasting economic and social progress. It is therefore important for the overall functioning and progress of the society how efficiently the state performs its functions. The Efficient State provides legal certainty, social stability, good relations with the world, macroeconomic stability, good infrastructure, educated workforce, encourages innovation, whereby all these activities are financed by moderate taxes. Such a state reduces the costs and risks for the private sector and promotes private activities that are crucial to economic and social progress, such as diligence, honesty, education, savings and investment, innovation, and the like.

Efficiency of the state is measured in such a way that its results are compared to the resources it engages when achieving those results. The state is efficient in performing a function if it achieves a certain result with minimal costs. It is therefore important to question the effectiveness of the Serbian state, how does it affect economic and social progress and what can be done to improve this?

For now, there is no comprehensive analysis of the efficiency of the Serbian state in performing the most important functions. Nevertheless, based on the comparison of placement on ranking lists which assess results of the state in relation to resources used, we can make approximate estimates of efficiency of the Serbian state. On the World Bank ranking list which measures quality of governance Serbia is ranked among the 3-4 weakest countries in Europe. Only three countries from Europe are ranked worse than Serbia on the ranking list of the World Economic Forum according to the quality of institutions, while based on the quality of infrastructure, training of the workforce and the quality of health services Serbia is positioned better, but still below the CEE average. Given that the results of Serbia in the performance of most of the functions are weaker than the average of the CEE countries, and that the share of public spending in GDP is above the average of this group of countries, it can be concluded with a significant level of certainty that Serbia's efficiency is lower than the CEE average. This result was confirmed in one study (Mitrović et al. 2016) on the effectiveness of health services, where the results of health services (infant mortality, mortality of people younger than 64 years of age) were compared with resources used (number of doctors and nurses per 100,000 inhabitants, health care costs per capita). According to this study, Serbia is ranked 15th in the group of 21 countries of Europe and Central Asia, based on the efficiency in providing health services.

The low efficiency of the Serbian state in different fields is confirmed by numerous individual examples. In performing judicial functions, low efficiency is manifested through lengthy and expensive court proceedings. An additional problem is that the outcome of court proceedings is often determined by corruptive activities and political influences, which leads to legal uncertainty. In performing administrative affairs, citizens and businessmen are often faced with lengthy and expensive procedures, and their ending is often conditioned by bribery. The level of gray

economy in Serbia has been among the highest in Europe for a long period, indicating the inefficiency of the tax and customs administrations, as well as other state organs such as the judiciary and police. Serbia has been late with construction of key highways for many years now, and similar delays have also been present in the realization of public utility projects. State's inefficiency in infrastructure construction is manifested at all stages, starting with project selection, project documentation, contracting companies, quality control of works, etc. The consequence is that projects that are not objectively considered a priority or which are not economically justified, are being implemented, as well as that the costs of implementing a justified project are larger than it is economically necessary. One of the visible manifestations of ineffective and weak state over a long period of time is the absence of urbanistic order, which for the consequence has a growth in non-planned and wild construction. The state's ineffectiveness is also manifested in the fact that it imposes unnecessarily high costs for its citizens and economy in the form of time spent in carrying out the administrative work and money spent in order to exercise their legal rights.

Inefficient state has a negative impact on economic growth in many ways. Generally, it inefficiently uses funds collected through taxes, which could be more efficiently used in the private sector. The inefficient state provides citizens with judicial, administrative, educational and other services of poor quality, and these services are financed by high taxes. Given that many of the activities the state provides are by nature monopolistic (judicial, administrative, security), citizens and companies do not have the opportunity to avoid paying the low-quality services at high prices, except to turn to gray economy. The inefficient state is one of the important factors supporting a high level of gray economy in Serbia. Inefficiency of the state is, as a rule, associated with pronounced corruption, which causes citizens and the economy to deal with non-productive activities such as lobbying, bargaining, bribing, etc., rather than dealing with productive activities such as education, work, savings, investment and innovation.

Fundamental conditions for establishing an efficient state are not only good laws that are strictly implemented, but also building of a competent, dedicated and fair administration. These fundamental conditions for a more efficient state could be differently presented as a requirement for improvement of institutions. An efficient state implies its departisation, in order for it to be in function of social interest rather than the interest of political parties.

The second measure to improve the country's efficiency is to reduce public spending to around 40% of GDP, while keeping the fiscal deficit at a low level. If Serbia could succeed in reducing the level of public spending to 40% of GDP, while maintaining or even increasing the quality of public services, it would mean a direct increase of the

efficiency of the state. The state could further boost the economy if the reduction in consumption is followed by a reduction in labor taxes, due to the negative impact of these taxes on economic activity.

In addition to general reforms, increasing the country's efficiency requires reforms in specific areas. The example in investments illustrates which decision-making procedure should be used in order to diminish the unnecessary waste of taxpayers' funds. The decision on the realization of a particular project in democratic societies is based on a detailed analysis of economic and social justification, rather than the influence of privileged interest groups or the subjective assessment of politicians as to whether a particular project is justified. For each proposed investment, government representatives should present a detailed study on justification of its realization to the public. A justification study should, for example, prove that it is more economically beneficial for the state to finance the construction of a national stadium than to modernize one of the existing stadiums or build a new national stadium together with first league teams from Belgrade. Similarly, the state should demonstrate that the suggested routes of the Belgrade metro are optimal in relation to alternative solutions or that it is economically justified to build a ski resort at Avala Mountain, which is about 500 meters high. Professional debates should check whether the assumptions and projections that justify the realization of a project are realistic or pre-ordered in order to confirm the previously made political decision. Even if construction of a national stadium is justified, under the conditions of a limited budget, it is necessary to decide whether it is more important to build a national stadium or, for example, a wastewater treatment system or to build or renovate a number of kindergartens and student homes. The fundamental assessment of the justification for the realization of a particular project and choosing of the best way to realize it are only the first steps leading to the efficient realization of the project. After these steps, it is necessary to organize fair tenders for making of project documentation and choosing the project contractor, and then select an independent expert supervision and provide the most favorable financing method. Only if these conditions are cumulatively provided can it be expected that public projects would be carried out efficiently, and this means in the best interest of the society.

In this issue of the *Quarterly Monitor*, apart from regular research devoted to macroeconomic trends and economic policy, there is a Highlights section text by Milutin Živanović, which analyses the profitability of the Serbian economy in the last few years.

