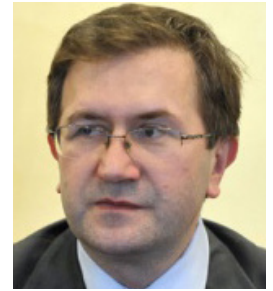


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## From the Editor



During 2015 and at the beginning of this year, moderately positive trends continued in Serbia's economy. After coming out of recession, a period of relatively slow growth began, which continued even in the beginning of 2016. Employment is slowly increasing, fiscal and foreign deficits are decreasing, and inflation is at a low and stable level. At the end of the previous and beginning of this year, dinar slightly depreciated, which will have a positive impact on the competitiveness and economic growth and will mitigate deflation. During the second part of the previous year, Foreign Direct Investments significantly increased, and after a long period, growth of credit activity began, while interest rates are on a historical minimum since they have been formed freely. Still, improvements in the economy are slow and not sufficient to solve the biggest economic and social problems in Serbia, such as high unemployment and low income. Investments are still low, and the growth of exports have slowed down, so no considerable acceleration of the economic growth is expected in the short term.

Reforms and economic policy in the last quarter of the previous and beginning of this year have been significantly determined by early parliamentary elections scheduled for the end of April. Holding of elections has directly affected the deceleration and delay of political unpopular reforms, such as the privatisation of former state companies, restructuring of public enterprises, and reducing the number public sector employees. The laws that were passed in this period, such as the law on public sector wages, are pretty watered down, while the changes and amendments to the law on tax procedures and tax administration present a typical example of a pre-election law (in Serbia), which awards the undisciplined tax payers.

It is estimated that during the first half of this year, due to the elections, there will be a slowdown in the inflow of Foreign Direct Investments, and the announcement of elections probably contributed to the turbulence on the foreign currency market, which occurred due to withdrawal of a part of portfolio investors. Therefore, the elections will have a negative effect on the implementation of reforms, and they will slow down some positive trends that have occurred during last year. The duration and intensity of negative effects of early elec-

tions on economy will depend on how fast a new government will be formed, its composition, as well as its economic programme. Naturally, what will be important for the functioning of the economy in the future will be how representatives of international financial organisations and business people will assess the announced economic policy. Considering the current state of Serbian economy and characteristics of the economic system, it is estimated that after the elections the Government should act in three basic directions. First direction includes measures whose goal is strengthening the macroeconomic stability, second includes the reform of enterprises, and the third establishment of institutions adequate for the modern market economy. Crucial to the strengthening of macroeconomic stability is the continuation and additional acceleration of fiscal consolidation. Acceleration of fiscal consolidation should in the following year stop the growth of public debt in relation to GDP, and as of 2018 it should start the reduction of Serbia's indebtedness in relation to GDP. In order to realise this, it is necessary to rebalance the budget after the election or at least to adopt an austerity plan, which would ensure the fiscal deficit in this year to be 3.5% of GDP at the most, instead of the planned 4% of GDP. Halting of the growth of public debt in relation to GDP requires the deficit to be less than 3% of GDP next year, while a considerable reduction of public debt and costs of interest in relation to GDP would take a fiscal deficit being brought down to a long-term sustainable level of 1% of GDP.

In order for the realised results in fiscal consolidation to be sustainable in the long term, it is necessary to reduce the fiscal deficit by applying permanent measures on the side of taxes and expenditures, and not based on temporary measures such as non-tax revenue and other extraordinary revenue. In order to sustain results of fiscal consolidation, it is important to establish additional legal limitations in order to avoid new uncontrolled growth of the fiscal deficit. Introducing limitations could present a barrier in relation to the frequent proposals to introduce expensive programmes of public spending or to reduce taxes, expand tax reliefs and tax exemptions. In that respect, it would be good to supplement the existing fiscal rules with new ones, which would

obligate the Government and other policy makers to accompany each proposal for introducing new spending with a proposal for increasing tax revenue, which would ensure funds for financing that spending. Similarly, every reduction of tax rates, expansion of tax exemptions or abolishing of levies of any kind would have to be accompanied by legislative proposals which reduce public spending. It would be good to introduce additional fiscal rules based on new EU rules or national rules in some countries (e.g. Slovakia or Poland), which introduce measures that automatically come into effect immediately after the public debt reaches a critical limit.

Second direction in which the new Government would need to act is finalising privatisation of former state-owned companies and core restructuring of public enterprises. Privatisation of state companies is important to the Serbian economy for several reasons, because it would create conditions for establishing financial discipline and create possibilities to productively use a relatively large part of social wealth. It is still estimated that the relevant ministry should express a higher degree of agility in finding strategic partners for some of the biggest companies, in order to avoid the last phase of privatisation that included over 500 companies being completely reduced to bankruptcy. During last year, the Government implemented a series of significant organisational changes in public enterprises, which are a precondition for applying essential measures that should lead to improvement of results in their business operations. Essential measures mean reducing the cost of public enterprises by reducing the surplus of employees, reviewing revenue, which is usually higher than market revenue, putting a stop to outflow of funds from public enterprises to the privileged private companies, etc. On the side of revenue, the most important measures are improvement of collecting payment for the services of public enterprises, increasing the volume and quality of their services (e.g. the railway), and in some cases, increasing the rate of services (electricity). Although some progress has been made in certain segments, such as improvement of the collection of payment for services, other measures have been delayed due to the strong resistance toward laying off redundant employees or stop delivering services to non-paying customers.

Third direction in which the new Government should act in the field of economy could be building of institutions that are appropriate for the modern market economy. Over the last few years, this area has had the least progress, so Serbia is ranked 120<sup>th</sup> in the world by the quality of its institutions, and among the countries of the

Central and Eastern Europe, Serbia is at the bottom. It would seem that unlike the fiscal consolidation and privation and reform of enterprises, the importance of good institutions for economic and social progress is not even recognised by the ruling elite in Serbia. Establishing good institutions requires numerous and various reforms, but they could be summarised in building an efficient public administration, and solid and consistent implementation of the laws. When it comes to establishing an efficient public administration, it is estimated that things only regressed over the last four years. The main manifestation of regression of the public administration is the mass employment of political party activists in the public sector. Partisan and other irregular hiring is nothing new in Serbia, but what represents a regression compared to the previous period is the mass employment of people with dubious degrees, which deteriorates the quality of public administration in the long term. Hiring of people with dubious degrees will reduce the already low capacity of administration to create and implement policies that enable an economic and social development. It sends a message to younger generations that partisan and other connections are more important than education, dedicated work and entrepreneurship. Therefore, it is necessary for the new Government to set as one of its main priorities building of a modern and efficient public administration, backbone of which will be educated, capable and honest bureaucrats. That requires a thorough change of legislation, and even more of practice in the field of employment, promotion and reward system in the public sector.

Out of the concrete reforms that would improve the functioning of institutions in Serbia, it is estimated that priority should be given to the reform of the justice system, cadastre and tax authority. These institutions have jurisdiction over the protection of property rights, establishment of financial discipline (contract enforcement), combating corruption and grey economy, etc. Of course, reforms of other sectors are important too, such as improving the quality of education, advancing the policy of competitiveness, development of financial markets, stimulating innovation, etc.

In addition to regular analyses of economic trends and policies, this issue of Quarterly Monitor also contains a Highlight (by Mirjana Gligoric and Irena Jankovic), which analyses possibilities of improving the economic potential of remittances in Serbia.

