

## What is the problem?

In the last decade the state has often addressed numerous socio-economic issues separately and treated them as single phenomena, while small effort has been taken to identify systemic errors and deficiencies that lie at the basis of those issues. In the first part, this document presents **CEP's view on the system cause of the problems that arise in Serbia in many sectors**. We believe that solution to this problem at the very beginning of the term of the new Government could appreciably advance functioning of the system and as a result of that advancement Serbia could improve its economic indicators and be more successful in the future EU accession negotiations. In the second part document reflects on **several sectoral/specific issues that require immediate state action and that could be mitigated to the greater extent by changing system approach in public policy making**.

### Absence of the (public) policy<sup>1</sup>

At the basis of the (public) policy should lay the vision of the state development that government presents before the public at the very beginning of the term.<sup>2</sup> The Government discusses indicators that need to be fulfilled in order to achieve that vision, and then begins with (public) policy making process.<sup>3</sup> **(Public) policy in every single field should be determined on the basis of choosing the best policy options offered** (in the sense of effectiveness and efficiency, effects on the economy, environment etc). Options of the (public) policy in every sector should be offered to the ministers and the Government **on the basis of deep analyses and problem studies and possible solutions** (evidence-based policy making). In the successful systems, summaries of those analyses, as well as the arguments for the most desirable option are being elaborated in the frame of (public) policy proposal, tailored by competent state officers, very often **in cooperation with academic institutes, think-tanks** and similar, whose role is to make some sort of „stock market of ideas” using results of deep analyses and studies, for which public administration is usually lacking time and resources.

In the process of (public) policy making **key position should hold coordination between different sectors**, because there is no policy area that is not connected or not influenced by many other areas. Ministries in Serbia, however, act like feuds, that in most cases make decisions independently without essentially consulting with other ministries and bodies (exceptions are formal consultation mechanisms like giving opinion procedure that makes consultation possible only after certain policy direction has been chosen). In developed systems, interdepartmental coordination starts from the early stages of (public)

<sup>1</sup> Serbian language (as well as majority languages of the continental Europe) does not recognize different words for politics/ policy in the sense of party politics (in English: politics) and policy in the sense of development direction for certain field or many fields governed by the state (in English: policy). However, Serbian administrative practice has neglected this difference not only at terminological level but also at substantive level. For the purpose of delineating those two notions, in this document we use the word „public” in the parenthesis before the word „policy” when using second meaning (policy).

<sup>2</sup> For instance, „Serbia as the country of the high economic growth, where work places are being created and do not vanish, and quality of life of the citizens is constantly increasing.”

<sup>3</sup> This vision, as well as the indicators that follow the progress, are commonly being defined through „roof” strategic documents - e.g. Europe 2020 in the European Union. In Serbia there is no such document!

**policy making process, at the multiple levels, from operational to political. This coordination is based on the culture of consensus, unknown to the Serbian administrative practice (moreover, majority of the state officers do not differentiate consensus from unison).**

According to some analyses, only at the central level in Serbia there is dozen of different valid strategies, mutually unadjusted, often contradictory, and as a consequence it can be seen essential absolute absence of strategy at the Government level. **If aims from different departments are mutually unadjusted, or even confronted, there is no integral (public) policy of the Government.**

**Owing to the absence of the consensus-based, on the grounds of deep analyses constructed and interdepartmentally adjusted (public) policy, ministers govern their departments spontaneously.** Thus, instead of keeping the state policy on the single already given course (that is abandoned only temporarily, during the time of crisis, to the extent seen as necessary, and then taking it back), they persistently „extinguish the fire” and change policy from problem to problem. This kind of „managing” (public) policy has **as a consequence high regulatory risk, legal uncertainty, damage to economy, investments, and finally to the living standard of the citizens.** In that situation neither domestic nor foreign investors can base their investment decisions on single, in advance announced course of the (public) policy, with legitimate expectations that it will be implemented on the basis of analyses and selection of the most desirable options. In democratic states, as well as in the EU, protection of legitimate expectations is one of the core principles in administration proceedings and it has been affirmed through court practice.

**This state of affairs will negatively affect Serbia’s accession negotiations in the EU (as well as the membership once Serbia becomes Member State).** Namely, in order to successfully negotiate terms of accession in the EU and to properly identify chapters with small in number and difficult to achieve transitional periods for full implementation of *acquis communautaire*, state has to „speak with one voice” in Brussels. It means that **interests in more than 30 negotiating chapters have to be perfectly adjusted and that adjustment has to result in single prevailing state interest** and all direct and indirect negotiations participants should insist on it. As a potential Member State eventually, Serbia shall realize potential gains from membership only if it is capable of formulating its interests and coordinating in a very good way all departmental actors in numerous working groups, committees and other meetings at the different levels in the Council of the EU. **State that properly defines, coordinates and advocates its own (public) policy has far better chance of being net winner from the EU budget, in this complex system of government with multiple levels,** and also far better chance to build in part of own interest in every decision made by the EU institution. As one of the most striking example of successfully administered (public) policy can serve British example of gaining so-called rebate on contribution to EEC budget, which United Kingdom negotiated in 1984.

Today, Serbia needs to make significant advance in economic performances. Serbia has to profile itself as a well-regulated state, state of legal certainty, which knows how to define and keep with course of its development, at least during the term of one Government. Also, it is necessary to accomplish essential improvement in the EU integration process, which means more than mere opening of accession

negotiations - it means successful negotiating and advocating of consistent positions, which is respectful to the participants at the other side of the negotiating table. In order to achieve this, **Serbia needs to develop system of (public) policy making and to empower political officials as well as state officers to administer their roles in that system** – from analysis and preparation of (public) policy proposal, to essential interdepartmental coordination and construction of consensus, to smart, informed decision-making and advocacy of adopted positions within and outside the country.

Finally, in the (public) policy making process **appropriate place has to hold evaluation procedure**, not only ex-ante (evaluation beforehand), but also ex-post evaluation that makes possible examination of purposefulness of governed policy and making changes that will in the next cycle essentially improve achieved results.

In the following part of the document, several sectoral problems have been elaborated, that to great extent result from problem of non-functioning (public) policy process. Therefore, following pages give answer to the question:

### **What is the problem...**

#### **...of financial instability?**

**At the basis of fiscal problems in Serbia lie:**

- *problem of level and inefficiency of payment of public income,*
- *problem of level and inefficiency of use of public expenditures.*

**Decrease in fiscal incomes was affected by many factors, with complex origin:**

1. Avoiding payment of fiscal duties **resulted in significant increase of grey economy**. Non-payment of fiscal duties was caused, *inter alia*, by the increase of corruption in the overall system of payment of public incomes and by inadequate administering of the Tax Administration.
2. **Payment of contributions for PIO and health services have dropped**, above all because of the absence of efficient system and control of paying in contributions, as well as growth of grey economy in the sphere of employees registration and real level of wages.
3. **Economic activity decreased due to:**
  - 3.1 **effects of the EU crisis** (the only factor outside direct Government control) that overruns Serbian economy and leads to drop of demand in Serbia and on export markets,
  - 3.2 **increasing para-fiscal levies** arisen from:
    - misuse of „monopolistic position“ of certain public agencies (absence of control of price level of services and in this regard „over-pricing“),
    - unnecessary administering i.e. (un)justified existence of some agencies, commissions, as well as the para-state apparatus,

- levies of local and regional bodies;

3.3 To decline of economic activity also contributed **increasing (as well as unpredictable and non-transparent) administrative costs of doing business**, because of:

- unpredictable and frequent shifts of regulatory framework (already mentioned regulatory risk) and
- influence of growing independent regulatory bodies that do not take into consideration „broader picture” of the state of the economy but they rather deal with their jurisdiction narrowly and rigidly, often without communicating with „beneficiaries” of their services;

3.4 Decline of economic activity was also caused by **increasing insolvency** that has several generators:

Firstly, **banking sector alone has the role of generator of economic insolvency** by reducing total placement to the economy and directing free solvency towards state securities, as well as increasing share of the „rolling” short-term loans at the expense of long-term placements (the reason why those loans dominate on the market).

Secondly, **the state itself is also generator of insolvency**, it:

- takes over liabilities in the budget without coverage in adequate borrowing or selling of state capital (so-called „non-financed” deficit),
- borrows on the domestic market and turns solvency at the disposal from economy towards public finances;
- acts „pro-cyclic” in monetary policy through:
  - ✓ Relatively high primary „base” interest rate owing to exaggerated concentration on „targeted” inflation and negligence of economic growth as a goal of monetary policy,
  - ✓ compensation of growth of controlled prices through too restrictive monetary policy which affects cost-uncontrolled sector of the economy,
  - ✓ sterilization of significant part of the domestic savings through high level of obligatory bank reserves,
  - ✓ unadjusted monetary and fiscal policy due to very non-transparent monetary policy management by the NBS (there is no public debate nor real opinion exchange on defined policies of the NBS).

Beside banks and the state (in the narrow sense), public enterprises are also generators of insolvency, since they through inefficient managerial response to drop of incomes (there is no decrease of costs through rationalization of number of employees, and above all level of earnings) put additional burden on procurers (delay of payment).

Finally, private enterprises with significant position on the market also act as generators of insolvency (especially visible in trade sector) through drastically increased paying currency (180+), which through spill over effects leads to insolvency of the whole economy.

**Disproportionately high tax expenditures are to great extent „the other side of the medal“ of already presented problems on the side of incomes, and the main factors of their emergence are:**

1. **Tax expenditures did not follow decline and/or stagnation of economic activity;**
2. **Transfer level from the budget for PIO and health services has increasing and unsustainable trend** (in relation to point two on income side);
3. **Corruption in spending of public funds** escalated, and control of public procurement is extremely weak;
4. **Mismanagement of public deficit**, seen in following facts:
  - deficit level of public finances reached 7% with growing trend;
  - level of total public debt crossed legally acceptable height;
  - level of total foreign debt has growing and non-sustainable trend;
  - there is no strategy to keep the trust of the investors that Serbia is capable of servicing its obligations;
  - there is no public debate nor clear strategy whether it is better to borrow on domestic or foreign market - broad consequences of both options have not been taken into account;
  - there is no public debate nor clear strategy which instruments to use when borrowing:
    - ✓ loans from commercial banks or state bonds?
    - ✓ bilateral borrowing from other states?
  - there is no public debate nor clear strategy of role of the IMF i.e. there is no harmonized position whether IMF is desirable partner in controlling public income and expenditures policy;
5. **There is no public debate nor clear strategy on public policy in using (purpose) public deficit i.e. borrowing**, and it is rather made as a consequence of uncontrolled factors (drop of incomes and increase of expenditures);
6. There is conceptual **problem in formulating investment part of the budget**. Above all, it is seen in the lack of performance measurement (ROI - *return on investment*), failure to conduct analysis and to select projects with the best effects and in bad (or non-existent) defining of aims (expected effects) of investment projects;
7. There is conceptual **problem in formulating industrial policy**. There is no public debate nor clear strategy in subvention policy, in terms of their aim and expected effect – whether it is:

- export growth (e.g. factories of semi-finished and finished products);
- employment increase;
- generating growth of related industries („cluster approach”).

### **Problems in the field of finances cause serious consequences for economy:**

**Foreign currency denominated liabilities combined with weakning of RSD and incomes in RSD lead to....**

**...increased volume of problematic loans, which leads to...**

**...increase of unemployment because of expenditures cut and „downsizing” of the economy, which further leads to**

**...decrease of domestic demand, which leads to decrease of trading and public incomes also.**

Monetary policy and state investments so far, and also to lesser extent fiscal policy (especially in the period before the crisis started), have motivated economy to invest in **non-tradable sectors** (import, real estate, internal trade...), which in long-term makes **unsustainable level of trade deficit with the world**, and tendency of putting additional pressure on foreign currency market (weakening of RSD), financial market (increased level of problematic loans) and labour market (decrease of employment) is therefore enhanced.

**Borrowings are predominantly in foreign countries (in Euros) and capital is predominantly invested in projects that bring incomes in RSD.** Due to decline of RSD exchange rate and decrease of incomes in RSD, the question is how domestic economy will finance its liabilities in Euros.

### **... of low competitiveness?**

**Low competitiveness of Serbian economy is largely the result of numerous systemic problems and at the root of those lie badly defined and managed state (public) policy and shortages of legal system (which are also the result of badly managed policy in the area of legal reforms).**

#### **1. Regulatory risk management**

Frequent changes of the legal framework, with potential improvement, contribute to the insecure business and investment environment. We believe that better management of this regulatory risk would be accomplished, inter alia, through better planning via strategic and plan documents (and strict compliance), such as National Programme for Integration of the Republic of Serbia into the EU (NPI).

#### **2. Partnership towards greater competitiveness**

In order to ensure consideration and adoption of the best (public) policy options, authorities should undertake informed decision-making through partnership (not void dialogue) with the economy, experts and experts associations and non-governmental sector.

Former government established Coordination body - National Competitiveness Council of the Republic of Serbia - with aim to foster dialogue and activities for greater competitiveness of Serbian economy. This body, consisting of Government members as well as representatives of the business, has stopped its activities at one point during the term of the previous Government. However, it would be desirable for members of the previous Government to report their successors on implemented activities and achieved results of this body, which could (with possible improvement of structure and way of work) continue with work in the next four years.

### 3. Grey economy

Systemic disease that destroys the structure of the market. Although grey economy „employs” certain number of people, negative implications are way to numerous and serious and it is necessary for the new Government to reject mantra about the grey economy as a milder of social tensions at the very beginning of its term. Import increase (due to predominant sales of illegally imported products), distortion of consumer protection system and protection from unfair competition, losses on the income side of the state budget and tumbling the burden on those who legally work and pay taxes, corruption (of the custom, inspection and other services) as a consequence, delay of severe social problems (due to non-payment of contributions for social and pension insurance) are just some of the serious problems generated by tolerating grey economy. Essentially unfair „free-riding” that occurs this way can be avoided by applying analytical creation of respective public policy in this area. It means conduct of deep analysis (while using already existing) that would indicate to what extent would introduction of grey economy into the regular streams allow tax relief to already legal economy sector, with positive effects on general economic growth and employment.

### 4. Competitiveness and consumer protection policy

Weak competition protection was so far justified with bad and inefficient legal solutions. The question is what the excuse is after the adoption of the new Consumer Protection Law in 2009, since that Law provided Commission for Protection of Competition with all necessary powers, working conditions, as well as with adequate salaries for Council members and employees.

Effective and efficient consumer protection policy, beside evident positive effects, represents barrier to the unfair competition i.e. precludes market participants who lower their business costs by disobeying the rules to be awarded.

Besides, both of those policies represent priority areas of *acquis communautaire* pursuant to the Stabilisation and Association Agreement with the EU.

## ...with unreadiness for negotiations and management of the EU funds?

As a consequence of **severe brain drain from the public administration** during previous years (caused by non-stimulating management, negative selection, politicization, etc.) **Serbia at the moment does not have at disposal adequate human resources for leading successful accession negotiations in the EU.** Besides, during previous years the state did not adequately support scholarships for young/future state

officers for gaining qualifications in the field of European studies at the appropriate educational institutions in the EU and in the country as well (done by many neighbourhood countries for years), due to which **inflow of new officers with necessary knowledge in the field of European affairs was not ensured**. Large number of state officers with relevant qualifications (European studies, European law, public administration or public management) has not been utilized i.e. employed on the positions where they can largely contribute to moving forward Serbia's European agenda.

When it comes to access to significant financial resources of the EU funds, it raises the question of capability for effective and efficient utilization and management of those resources. With new financial perspective in the EU for the 2014-2020, implementation process of IPA projects in accordance with the EU financial rules would be transferred to domestic administration. **After the introduction of decentralized system of managing EU funds (DIS) it would be demanded greater role and responsibility of the state institutions in project planning and realization process.**

In this regard, **key question is what amount of resources from the EU funds would be actually utilized i.e. what amount would be returned to the EU budget due to unpreparedness of the state for using the EU funds.**

Driven by positive and negative experiences from other countries, it is clear that **administrative capacities are the decisive factor in using available EU resources**. This is especially important if it is known that with introducing DIS Serbia would have access to the investment projects in the areas of regional development, human resources development projects, as well as access to rural development component that includes direct financial aid to Serbian farmers.

In the context of the future EU membership negotiations and efficient utilization of the EU funds, **it is of key importance to stop big fluctuation of staff engaged on the EU integration tasks and to build new administrative capacities**. Otherwise, Serbia would face the same negative experiences of countries in transition, which had insufficient absorption capacity and slowly advanced towards EU membership due to shortage of quality human potential.

Having in mind complexity and time dynamics of project realization, one of the main preconditions for efficient management of the EU projects, beside adequate administrative capacities, is **introduction of principle of long-term strategic planning**.

Process of programming and implementing future EU projects can be negatively influenced by **non-existence of result-oriented budgetary system i.e. programme budgeting**, not only when it comes to creating mechanisms for co-financing multiannual EU programmes and projects, but also when it comes to consistency of these programmes with strategic aims and public policies of the Government.

Programme budgeting, in the broader sense, ensures greater transparency and participation of wider spectrum of stakeholders in budgetary policy making process and in actual budget creation. **By introducing programme budgeting and public expenditures performance measurement, tangible public administration accountability mechanism for more efficient management of the public**

**finances and budget spending is being introduced, with accomplishing aims and results laid down in advance.**

The Budget System Law envisages transition to programme budgeting until 2015. It is not hard to answer the question whether or not is Serbia ready for this kind of budget system reform. **Clearly defined budgetary policy, based on the mid-term and long-term aims and country development directions, with defined realistically achievable results and measurably set indicators of performance, represents precondition for efficient utilization of limited public resources in Serbia.**