



**9TH INTERNATIONAL ASECU CONFERENCE ON
“SYSTEMIC ECONOMIC CRISIS: CURRENT ISSUES AND PERSPECTIVES”**

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**OBSTACLES FOR EFFICIENT ECONOMIC POLICY IN THE
POST -CRISIS PERIOD: RENT SEEKING ACTIVITIES AND
CORRUPTION IN SERBIA**

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Abstract

The paper focuses on the question to what extent economic policy in Serbia is able to respond to new demands - to promote economic growth and solve the key problem of unemployment in the circumstances of insufficient institutional development, among other things characterized by widespread rent seeking activities and corruption, which were in the past determinates of decisions and behavior of policymakers. The global economic crisis (2007-09), as a specific economic event that is not the standard cyclical downturn in economic activity has led to significant changes in the objectives and instruments of economic policy. After decades of domination of rules in the conduct of economic policy and the primary objective of price stability, by relying on monetary policy, the need to overcome the economic crisis imposed necessities of discretion in the conduct of economic policy, especially fiscal policy. In this context, the economic policy returned from the monetaristic and new-classical postulates to the Keynesian recommendations. These changes in the economic policy are present in developed economies, but, also, in those that are still in the process of economic transition. Among them is the Serbian economy, which faced significant negative consequences of the global economic crisis, but also the consequences of the wrong model of growth that was applied, as well as of the unsuitable institutional development. Wider application of discretion in the conduct of economic policy inevitably imposed the question of competence and motives of policymakers who are also politicians, and therefore politically motivated (opportunistic and partisan). Politically motivated policymakers, as a limiting factor, are particularly important in the countries with underdeveloped institutions, economic as well as political. This is the case in Serbia, where we can find dysfunctional institutions.

An open question, however, is why some countries, as Serbia for example, choose such institutions. The answer to it must proceed from political factors, taking into account that the politicians in power are at the same time policymakers (in the form of government), but also decisive in shaping the legal, economic and political system of the country. Rent seeking preferences of politicians, as policymakers, determine their opportunistic motives – to come, or to stay in power in order to take the rents. In this context, the rent seeking activities are undertaken by individuals and interest groups to change the public policy in order to redistribute income and wealth. To the extent that it is possible to abuse the political process by individuals or groups, for appropriating wealth of others, the motivation for rent seeking activities will be more significant. The social and economic



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conditions characterized by corruption and monopoly privilege, in which the politicians in power provide significant opportunities for various forms of rent appropriation, are also important. Taking into account that these characteristics are present in the economic and political system in Serbia, preventing rent seeking activities and the elimination of corruption emerges as a necessary precondition for the overall economic growth and for the success of active economic policy.

Key words: global economic crisis, rent seeking, corruption

JEL: E02, E61, P48

1. The Effects of the Global Economic Crisis on Serbian Economy

Global economic crisis that started with the financial crisis and economic recession in the United States, officially in December 2007, had a significant impact on Serbian economy as well. The slowdown of global economy, the financial sector problems and the problems in financial sector functioning, which have significantly aggravated global lending activities and reduced liquidity, were bound to also have adverse effects on emerging economies and economies in transition, including Serbian economy. These effects were related to the problem of reduced global aggregate demand, which resulted in a slowdown in economic activity and lower exports, as well as in reduced capital inflows in the form of investment and increased borrowing costs due to reduced global liquidity.

There are two key channels through which global economic crisis influences Serbian economy (Prascevic, 2012 a):

- Reduced capital inflows, including a reduction in foreign direct investment, which leads to the problem of covering current account deficit, maintaining stable exchange rate policy, curbed GDP growth and recessionary trends, as well as rising inflation;
- Reduced export demand due to global reduction in demand, because recession is present in most economies, including key export markets for Serbian economy (although the share of exports in Serbian GDP is only 30%).



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Table 1: Key macroeconomic indicators in Serbia (2002-12)

| Key macroeconomic indicators | | | | | | | | | | | | | | |
|---|--------|--------|--------|--------|---------|---------|---------|---------|---------|---------|---------|---------|---------|------------------------|
| | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | Q1 2012 | Q2 2012 | Q3 2012 | Q4 2012 |
| Real GDP growth (in %) ¹⁾ | 4.3 | 2.5 | 9.3 | 5.4 | 3.6 | 5.4 | 3.8 | -3.5 | 1.0 | 1.6 | -2.3 | -0.6 | -2.5 | -1.5 |
| Consumer prices (in %, relative to the same month a year earlier) ²⁾ | 14.8 | 7.8 | 13.7 | 17.7 | 6.6 | 11.0 | 8.6 | 6.6 | 10.3 | 7.0 | 3.2 | 5.5 | 10.3 | 12.2 |
| NBS foreign exchange reserves (in EUR million) | 2,186 | 2,836 | 3,104 | 4,921 | 9,020 | 9,634 | 8,162 | 10,602 | 10,002 | 12,058 | 11,073 | 10,161 | 9,833 | 10,914 |
| Exports (in EUR million) | 3,125 | 3,847 | 4,475 | 5,330 | 6,949 | 8,686 | 10,157 | 8,478 | 10,070 | 11,486 | 2,519 | 3,031 | 3,083 | 3,293,6 |
| - growth rate in % compared to a year earlier | 16.0 | 23.1 | 16.3 | 19.1 | 30.4 | 25.0 | 16.9 | -16.5 | 18.8 | 14.1 | -2.6 | 5.2 | 3.2 | 8,7 |
| Imports (in EUR million) ³⁾⁸⁾ | -6,387 | -7,206 | -9,543 | -9,613 | -11,971 | -16,016 | -18,843 | -13,404 | -14,643 | -16,627 | -4,042 | -4,323 | -4,235 | -4,620,7 ⁹⁾ |
| - growth rate in % compared to a year earlier | 27.2 | 12.8 | 32.4 | 0.7 | 24.5 | 33.8 | 17.7 | -28.9 | 9.2 | 13.6 | 5.5 | 6.3 | 1.3 | 1,6 |
| Current account balance ⁴⁾⁸⁾ (in EUR million) | -671 | -1,347 | -2,620 | -1,778 | -2,356 | -5,053 | -7,054 | -1,910 | -1,887 | -2,856 | -1,177 | -738 | -546 | -685,8 |
| as % of GDP | -4.2 | -7.8 | -13.8 | -8.8 | -10.1 | -17.7 | -21.6 | -6.6 | -6.7 | -9.2 | -16.9 | -10.2 | -7.3 | -8,3 |
| Unemployment according to the Survey (in %) ⁵⁾ | 13.3 | 14.6 | 18.5 | 20.8 | 20.9 | 18.1 | 13.6 | 16.1 | 19.2 | 23.0 | / | 25.5 | / | 22.4 |
| Wages (average for the period, in EUR) | 152.1 | 176.9 | 194.6 | 210.4 | 259.5 | 347.6 | 402.42 | 337.9 | 330.1 | 372.5 | 357.6 | 363.2 | 351.8 | 385.3 |
| RS budget deficit/surplus (in % of GDP) ⁶⁾ | -4.3 | -2.6 | -0.3 | 0.3 | -1.9 | -1.7 | -1.7 | -3.4 | -3.7 | -4.2 | -7.0 | -7.1 | -3.9 | -5.0 |
| Consolidated fiscal result (in % of GDP) | -1.8 | -2.4 | 0.8 | 0.9 | -1.9 | -2.0 | -2.6 | -4.5 | -4.7 | -5.0 | -7.3 | -6.9 | -4.1 | -7.3 |
| RS public debt, (external + internal, in % of GDP) ⁶⁾⁷⁾ | 72.9 | 66.9 | 55.3 | 52.2 | 37.7 | 31.5 | 29.2 | 34.7 | 44.5 | 48.7 | 52.0 | 56.0 | 55.1 | 59.2 |
| RSD/EUR exchange rate (average, in the period) | 60.66 | 65.13 | 72.70 | 83.00 | 84.10 | 79.96 | 81.44 | 93.95 | 103.04 | 101.95 | 108.11 | 113.73 | 116.95 | 113.45 |
| RSD/EUR exchange rate (end of period) | 61.52 | 68.31 | 78.89 | 85.50 | 79.00 | 79.24 | 88.60 | 95.89 | 105.50 | 104.64 | 111.36 | 115.82 | 115.03 | 113.72 |

Source: National Bank of Serbia (<http://www.nbs.rs>)



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The strongest impact of the crisis on Serbian economy was recorded in 2009, when a decline in GDP (Table 1) was recorded for the first time since the political changes in 2000. Significant slowdown in economic activity was recorded in the second half of 2008 due to the decline in aggregate demand in both components - domestic and export demand, which can be attributed to the effects of the global economic crisis. Although the decline in export demand was higher, due to the larger share of domestic demand in aggregate demand, by about 80%, this decline had a more significant impact on economic slowdown than the decline in exports. At the same time, we can see that in 2009, the decline in aggregate demand was greater than the slowdown in economic activity. These trends originating from the slowdown in real wages growth due to public sector wage freeze and reduced employment in the private sector, the depreciation of the Serbian dinar, reduced foreign capital inflow which financed domestic demand, reduced income from privatization and reduced lending activity.

The trends in all macroeconomic variables in 2009 point to adverse economic trends. And although it is certain that the effect of the global economic crisis was the decisive factor for this, it is important to note that errors in economic policy making in the period before 2008 also contributed to such poor indicators. This specifically refers to the two internal factors:

1. the selected model of economic growth based on aggregate demand, specially on domestic demand (Cerovic, 2009, p. 23.),
2. political instability and economic policy making in the circumstances of coalition governments.

These two factors are interrelated and interdependent. Initially, the choice of a growth model that generated insufficiently dynamic development and internal and external imbalances was determined by the political factors that dominated the period after the democratic changes in 2000, which can simply be defined as political instability. Although it has different definitions in professional literature and includes different elements, in Serbia, in the period of 2000-2008, it can be recognized by frequent elections at various levels (Table 2) and significant political differences between political parties, with particularly devastating differences between the coalition partners in the government itself (Jaksic and Prascevic, 2011, p. 553). In addition to frequent elections, there were also great tensions within the government that were often related to political issues (the pace of political reforms necessary for EU accession), and to economic issues as well. The most prominent ones were: the disagreements within the government (2003-07) that were present from May 2006 regarding freezing negotiations on the Stabilization and Association Agreement with the EU for political reasons, which were resolved in November 2006 by calling regular elections for January 2007 (the pre-electoral campaign lasted from May 2006, and it is precisely the period in which a distinct change in the form of expansionary fiscal policy occurred), the disagreements in the coalition government (2007-08), which occurred as soon as late 2007, which ended in elections in 2008 (the whole of 2007 was characterized by significant fiscal expansion), the disagreements within the coalition



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government (2008-12), which were primarily related to economic issues in February 2011, which did not result in the collapse of the government, as well as long term consequences in the form of alienation of formerly crucial coalition partners.

Table 2: Electoral years

| Year | Elections |
|-------------|---------------------------------|
| 2000. | Parliamentary |
| 2002. | Presidential (2 x unsuccessful) |
| 2003. | Presidential (unsuccessful) |
| 2003. | Parliamentary |
| 2004. | Presidential (successful) |
| 2007. | Parliamentary |
| 2008. | Presidential |
| 2008. | Parliamentary |
| 2012. | Parliamentary and Presidential |

2. Economic Trends and Economic Policy in the Pre-electoral Period (2011-12)

Although parliamentary elections in Serbia were regular and were held upon regular expiration of the mandate of the government (in May 2012), which is why the government managed to stay in power a full mandate, there were great political tensions and speculations regarding an early “downfall” of the government, which resulted in negative economic consequences for Serbian economy.

The onset of these tensions occurred in February 2011, coinciding precisely with the talks with the IMF on the seventh revision of the arrangement, which were focused on establishing and maintaining strict fiscal discipline. At the same time, there was a major government restructuring, and the negotiations with the representatives of trade unions in the public sector, regarding the improvement of their economic situation, were also heating up, where the government representatives insisted that this should be in accordance with the agreed budget and overall economic policy.

The pressures for wage increase early in 2011 came as a result of their freeze during 2010, extremely high rates of inflation recorded in 2010, and the depreciation of the dinar (almost throughout 2010), which significantly reduced the purchasing power and the living standards of the public sector employees. On the other hand, already in late in 2010, the government itself was sending some signals that gave rise to expectations that the unfreezing of salaries and pensions was bound to occur, as the country had come out of the economic recession. In 2010, average real wages rose by 1.2%, which resulted from the growth in private sector, while those in the public sector registered a decline in real terms due to the freeze in 2010 and rising inflation (QM 27, 2012, p. 20). The largest fall in gross wages in public sector (from the budget) was registered in education, culture, health care and social work, whereas the fall in public enterprises was smaller. However, in contrast to private sector, which continued with increasing unemployment rate and decreasing employment rate, this was not the situation in public sector because its restructuring had



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been postponed. Thus, even with lower wages, a job in the public sector was considered a privilege in Serbia.

According to macroeconomic indicators, 2011 was crucial for the negative trends which later culminated in 2012. A great deal of responsibility for this is credited to economic policymakers, i.e. monetary and fiscal policies. Although they have declaratively stated their commitment to a new growth model based on export demand, and thus on significant production and investment into sectors that produce tradable goods, it lacked realization. Instead, during 2011, there was a significant decline in net exports, which partially resulted from real appreciation of the Serbian dinar in 2011 (due to the high influx of foreign capital which, however, was a one-off), but also from reduced production and export of steel due to the deterioration of business at U.S. Steel Serbia. In 2011, the current account deficit increased significantly (to 9.2% of GDP – primarily due to reduced inflow of current transfers). In 2012, due to the absence of significant capital inflows from abroad, this trend would continue in further deficit increase and problems in maintaining the value of the Serbian dinar, which would inevitably record depreciation.

During 2011, inflation was brought under control (realized inflation at the level of 7%), although the growth trend from the previous 2010 continued until May (year-on-year inflation in May was as high as 17.9%), after which point it stagnated and then declined. In terms of the exchange rate, the appreciation in the first half of the year was followed by its nominal depreciation, which continued into 2012, was curbed only in the last quarter of 2012, and the average exchange rate was restored to the level from the second quarter of 2012.

We can say that economic policy of the pre-electoral period, i.e. in the final months of the previous government, was unsystematic and determined by short-term goals. Positive effects on economic growth have not occurred, even in the short term, but the effects of wrong dynamics in aggregate demand in terms of increase inflation and weakened local currency – the Serbian dinar have occurred. These effects are recognized in political macroeconomics models (within opportunistic political cycle models), but the exploitation of increased government spending is based on the right "timing", which did not occur in this case. Namely, Serbian economy was already in recession and the election had to be called and they were scheduled within final due date (in accordance with the Law), which means that the government did not have much choice with respect to "timing." In the meantime, some unforeseen circumstances occurred, which could not have been affected, or not fast enough.

Economic developments were bad to the extent that no substantial public spending could reverse them (though in April and part of May, there was an upsurge in industrial production), because there was no increase in net exports and investment. This indicates that the current "sick" model of growth and recovery in Serbia suffered a complete collapse, which means that the new economic policy makers will possibly abandon it.

The fact that the economic policy for overcoming the impact of the global economic crisis (2008-09) was in fact wrong is reflected in the fact that economic activity has not yet



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reached the level from the spring of 2008 (prior to the effects of the global crisis), but was lower by 3% in the second quarter of 2012, compared to the same period in 2008. The structure of GDP use in electoral period completely corresponds to the populist and politically motivated economic policy:

1. significant increase in government spending (on goods and services, increasing wages) – contributed to year-on-year GDP growth by 2%,
2. growth in private consumption - came from real growth in average wage and real growth of total spending on pensions - contributed to year-on-year GDP growth by 1%,
3. decline of investments - contributed to year-on-year GDP growth by 0.5%,
4. decline in net exports - contributed to year-on-year GDP growth by 3%.

Growth of government and public spending, however, also resulted in the deterioration of external and internal imbalance, via growth of imports, i.e., increased inflation. Nevertheless, since the main drivers for maintaining economic activity were limited (the inevitable tightening of fiscal policy in the last quarter of 2012 and during 2013), this will not be favorable for economic activities in the future. Therefore, the forecast of minimal growth of about 1% in 2013 are primarily based on the growth of exports (exports by FIAT automotive factory), as well as increasing agricultural production (QM 30, 2012, p. 8).

Uncontrolled growth of government spending in 2012 resulted in the problems of Serbia's public and external debt. The total public debt at the end of the second quarter was 56% of GDP, only to rise to as much as 59% of GDP at the end of the year (government borrowings by issuing euro-bonds), which significantly exceeded the required 45% of GDP. In addition to borrowing abroad, the government also borrowed in the country (by issuing Treasury bills). However, the amount of external debt indicates that in the end of 2012, it would exceed 80% of GDP, with high cost of for its repayment in the future. In order to eliminate the threat of foreign insolvency of the country and given that in 2012 there was a decline in foreign currency reserves, it is necessary to have those economic policy measures which would reduce the current account deficit, i.e. increase exports, limit domestic demand and lead to acceptance of the exchange rate policy based on sustainable exchange rate (abandoning overvalued dinar and maintenance of artificial exchange rate at the expense of spending foreign exchange reserves).

Employment and unemployment rate, two important dimensions in a pre-electoral period, continued their negative trend that began back in 2008, with the global economic crisis. The state was able to maintain employment in the public sector, but this could not significantly help the overall problem of unemployment, or maintain employment rate. On the other hand, in the pre-electoral period, minimum wage was raised, which increased earnings in the private sector. In contrast to economy, where earnings grew by 0.8% in the second quarter of 2012, in public sector earnings decreased. Thus, in the second quarter, just at the time of elections, real net earnings in public enterprises, education and healthcare, fell as compared to the first quarter. These trends in earnings in the period



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immediately before elections were certainly not in favor of the then economic policymakers, especially taking into account that those employed in public sector are primary voters of the ruling parties.

3. Old Goals and “New” Economic Policy?

The new government (with the participation of some parties that were also part of the previous government) was faced with solving the most difficult combination of economic problems: the decline in economic activity, high inflation, high unemployment, high state budget deficit, high current account deficit, high public debt. Since the effects of the economic crisis were not overcome, the new government faced almost identical economic goal as that in July 2008 - ensuring economic growth with macroeconomic stability. However, the conditions in which it should be achieved are quite difficult, and the choice between saving and consumption is now extremely complex.

However, although consolidation of public finances emerged as the first task, which is not uncommon both in terms of past experience regarding the pre-electoral fiscal developments in Serbia, and in terms of what models of political budget cycles teach us (Rogoff, 1990, Rogoff and Siebert, 1988). Such high deficit and debt increase are fully compliant with the assumption that in a situation where policy makers face the prospect of losing power, they opt for extremely expansionary economic policy. In addition to the budget deficit, as a pressing issue, there is also high inflation, and the depreciation of dinar. This third problem - the decreased value of the dinar (nominal and real), was the first to be eliminated, initially by nominal, and then substantial real appreciation of the exchange rate (due to high inflation rate, and a relatively stable nominal exchange rate). To solve the problem of inflation and depreciation, in addition to fiscal restrictions, it was also necessary to have restrictive monetary policy, which the National Bank of Serbia continued with the new governor as well. Among these measures, there certainly was a further increase in the reference interest rate, increase of the dinar share in the foreign exchange reserve requirement, and the transition to standard repo-operations.

In the field of public finances, the new government has taken measures to limit government spending. The state has also taken measures to limit wages in the public sector by introducing the upper limit (through the Law on Setting Wage Ceiling for Employees in Public Sector, passed in September 2012), whose more appreciable effects will become visible in the following period. In the field of public expenditure, there was less capital investment spending, which could have been expected because the outgoing government delayed payments for completed works, such payments usually being slow, and in the first months of its mandate, the new government acted in a similar fashion. Therefore, most of the country's huge budget deficit in 2012 came from financing excessive current consumption rather than from capital investment that would in the future be able to increase production in Serbian economy. It is, however, entirely consistent with the models of budget cycles, which show that in the pre-electoral period, the policy makers try to present themselves as competent. They do this by increasing current expenditures, which are visible to voters, at the expense of capital expenditure whose realization is completed in the



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future (after the elections). It is also important to note that, according to these models, in the pre-electoral period, they also delay increase in the tax rate, which voters perceive as an expression of incompetence of the government. That is exactly why raising value added tax as inevitable measure to increase public revenues, waited for the new government (Alesina, Roubini and Cohen, 1997, p. 234).

In the first months of the new government, it had to face the problem of a significant drop in public revenues (more precisely, in value added tax, customs duties and fees), so that the growth of the fiscal deficit in this period originated primarily from this drop, which was followed by a decline in spending, but not to the necessary extent. The key reason for this was the slowdown in economic activity, as well as reduced imports due the dinar appreciation. The calculations for public revenues made for 2012 was unrealistic, because of unrealistically anticipated tax bases. The new government therefore had to take considerable fiscal austerity measures (tight fiscal policy) and include all fiscal and para-fiscal revenues into legal flows. As one of the first measures, the government has abolished own source revenues for budget beneficiaries and included them in the budget revenues system, which increased non-tax budgetary revenues. After months of uncertainty about the election results, and after the new government has been formed and introduced new economic policy since autumn 2012, it is possible to monitor the growth of public revenues, especially from value added tax and excise duties. However, the budget deficit realized in October was higher than that achieved in October 2011 by as much as 12.5%.

In addition to fiscal austerity, the government also opted for increasing major taxes (value added tax from 18% to 20%, excise tax on tobacco products, personal income tax), which had positive effects, and since 2013, the corporate income tax is also increased (from 10% to 15%). These measures, along with economic growth of about 1.5%, should ensure the decrease of the budget deficit to below 4% of GDP (3.6% of GDP) in 2013, with the aim of lowering it to 1% of GDP by 2015. This would stop the increase of the public debt, which in 2012, threatened to spin out of control and draw Serbia to a public debt crisis. The trend of expenditure increase for due interest rates will continue in the future period as well (it has already surpassed state appropriations for the army and police), which confirms that Serbia has enormous debt. The backbone for the deficit reduction policy is increasing taxes and lowering increases of pensions and public sector wages, but also a reduction in spending on goods and services (government authorities), as well as in expenditures for subsidies. Aggravating circumstance in deficit reduction will certainly be constant real pressures to increase spending, as compared to that which has been planned. One of these pressures will most certainly be the case with expenditures for social protection, and agriculture as well.

In the future period, fiscal policy will be the backbone of economic policy, much as it was the case with the previous government. The new economic policy makers, at least officially, consider that future economic recovery and economic growth will not be based on unrealistic growth in domestic demand, primarily in government spending. One must not forget, however, that the previous government also adopted the "new growth model" in 2011, which was thought to be the end of the practice of growth based on domestic



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demand. Although officially adopted, this model has not taken root in practice, nor was it supported by relevant economic policy measures. Instead, in the field of fiscal policy, the previous government acted in accordance with the assumptions of the budget business cycle model in an attempt to deceive the voters, by artificially improving economic results just before the elections, in order to ensure their support. Negative effects on economic developments were left for after the election, which in this case means that they will be dealt with by the new government.

For these reasons precisely, it is too early to talk about the real intentions of the new government. As is well known in political macroeconomics, every government is trying to present itself as a so-called "adamant" government, especially in the first period, in which it is difficult to judge the character of the government based on actual economic policy. Based on the presented and adopted budget for 2013, it could be concluded that the policymakers have serious intentions to stop the current practice of abusing fiscal policy primarily for political reasons (opportunistic and partisan), but there are several important elements that cause suspicion, or pose significant limitations:

- the intended reduction in public expenditures for goods and services of state authorities has not been clearly defined,
- the intended reduction in expenditure for subsidies has not been completely defined,
- the unresolved issue of the company “Zelezara Smederevo” (former US Steel Serbia), which is why it is crucially important that it is privatized as soon as possible,
- the problem of indexation of pensions and salaries (scheduled for April 2013), which, due to the uncertain rate of inflation may be an additional blow to public expenditure, we should also consider the option of a "bonus pension",
- ignoring the fiscal problem caused by changes in the Law on Local Government Finance from 2011, that created vertical fiscal imbalances between state and local levels of government, which had a firm political stronghold that has not been removed in the meantime (the political party that once initiated such a solution in 2011, is now a key player in economic policymaking – it runs the Ministry of Finance and Economy), which suggests that the policy is not going to change,
- political instability with constant threats of a possible call for early elections, which would certainly deepen the fiscal problems and slow down economic activity, and the economic policymakers would surely turn to current public spending with the aim of achieving short-term gains in the form of voter support.

Despite the progress in certain cases, the economic policymakers have still not presented major institutional solutions that would reduce systemic corruption and prevent rent seeking activities, otherwise very present in Serbian economy. The exception is the new



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Law on Public Procurement adopted in December 2012, which should prevent corruption and achieve cost savings of 600 million euro.

On the other hand, some of the activities undertaken by the ruling coalition regarding significant changes in institutional arrangements, which would limit political interference and political motives in making economic decisions and economic policymaking, are not encouraging. One of these situations certainly was replacing the governor of the National Bank of Serbia and appointing a high political official, thus continuing the bad tradition in Serbia that, when the ruling coalition changes, the monetary authorities in the country also change, which increases macroeconomic instability and is associated with political instability. Similar can be said for the absence of implementing when it comes to the policy of excluding partisan interest from the management of public enterprises and institutions in Serbia, which was declared before the elections, but has been abandoned since. Taking into account the share of public enterprises in the overall economy of Serbia, and the fact that these companies have not been restructured, and one of the characteristics of these companies is that they have enormous redundancies, it is clear that their incomes, and operations still represent a key pillar for the realization of political goals for the parties whose representatives are managing these companies.

4. Rent Seeking Preferences and Corruption – Limitations of Economic Policy in Serbia

The economic policy of the new government is facing significant limitations - dynamising domestic demand has peaked and it can no longer be counted on, stimulating economic activity by means of economic policy measures is very limited and can be related to the possible use of exchange rate policy, primarily through its depreciation with the aim of improving Serbia's price competitiveness and exports. This leads to the conclusion that it is necessary to reform the system of economy and business operations in Serbia. In this context, some measures to facilitate business procedures, procedures for obtaining various permits (including construction permits), tax procedures and most importantly - the elimination of all forms of corrupt behavior in business operations, have been announced. It is also necessary to reduce all opportunities for rent-seeking activities that could be implemented at different levels of government, but primarily by business people.

Rent seeking preferences of the politicians in Serbia are directly related to their opportunistic behavior, which has been evident throughout the period since 2000. Namely, primary motivation for participating in the government is the possibility of various forms of appropriation of rents that being in power enables (Persson and Tabelini, 2000, p. 70). The social and economic conditions in Serbia, including underdeveloped institutions, the legal system inefficiency, underdeveloped democratic procedures, the presence of monopolistic structures in the market, weak anti-monopoly legislation, but also the specifics of how coalition governments function, abiding by the principle of the division of the departments among the coalition partners, managing public companies based on partisan division of enterprise between the coalition partners at the state level, partisan influence on the work of



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regulatory bodies and agencies, provide opportunities for rent seeking activities. Similar factors affecting state government level also affect local authorities (municipal governments and local public enterprises), as well as the ratio between the state and local levels of government.

A particularly important factor in encouraging rent seeking activities in Serbia is extremely pronounced corruption, which is considered the key issue in Serbia. The least progress in democratic reforms in Serbia has been made in the field of eradication of corruption, and can only be paralleled with the slow legal system reforms, two, generally interconnected segments of democratic reforms (Table 3). However, corruption is not only a constraint for the development of a democratic system and a social problem; it is essentially an economic problem which leads to significant redistribution effects.

Corruption in Serbia is not the result of erosion of moral principles either, but is the result of the abuse of power by state officials who seek their own benefit. This directly leads to redirection of resources to rent seeking activities, resulting in significantly reduced efficiency and slower economic growth. Generally, the concept of rent seeking involves actions of individuals or interest groups with the aim of changing public policy to redistribute income, directly or indirectly, in their favor. These activities are related to changes in the tax structure, the structure and components of government expenditure, and the overall state regulation in the economic system. Depending on the conditions and characteristics that are present in the economy, rents can occur in various forms, such as salaries and other forms of income for public officials, or the funds to finance political parties. (Prascevic, 2012 b, p. 328)

| | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|-------------------------------------|------|------|------|------|------|------|------|------|------|
| Electoral Process | 3.50 | 3.25 | 3.25 | 3.25 | 3.25 | 3.25 | 3.25 | 3.25 | 3.25 |
| Civil Society | 2.75 | 2.75 | 2.75 | 2.75 | 2.75 | 2.75 | 2.50 | 2.25 | 2.25 |
| Independent Media | 3.50 | 3.25 | 3.25 | 3.50 | 3.75 | 3.75 | 4.00 | 4.00 | 4.00 |
| National Democratic Governance | 4.00 | 4.00 | 4.00 | 3.75 | 4.00 | 4.00 | 3.75 | 3.75 | 3.75 |
| Local Democratic Governance | 4.00 | 3.75 | 3.75 | 3.75 | 3.75 | 3.75 | 3.50 | 3.50 | 3.50 |
| Judicial Framework and Independence | 4.25 | 4.25 | 4.25 | 4.25 | 4.50 | 4.50 | 4.50 | 4.50 | 4.50 |
| Corruption | 5.00 | 5.00 | 4.75 | 4.50 | 4.50 | 4.50 | 4.50 | 4.25 | 4.25 |
| Democracy Score | 3.83 | 3.75 | 3.71 | 3.68 | 3.79 | 3.79 | 3.71 | 3.64 | 3.64 |

Table 3: Progress indicators for democratic reforms in Serbia (Freedom House)



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Rent seeking activities in Serbia were aimed at generating some form of monopoly or special position for certain economic agents, but also for certain political parties that would enable them to obtain financial and political benefits they would not otherwise have had. For that, it was necessary to be in power, or for economic agents, to be close to those in power; quite often, they financially supported the political party in power, or facilitated their rise to power. These rent seeking activities might relate to the improvement of the position for some interest groups, or certain structures of the electorate, which in turn would supported the politicians in elections and facilitate their victory.

A special segment of the rent seeking activities in Serbia is related to interest groups. Interest groups are interesting to politicians in the pre-electoral campaign because their individual (special) interests can be met, by generating significant benefits for individual members of the interest groups and imposing small costs on other voters. If certain policy imposes small additional cost to voters, and in addition they have difficulties to recognize that policy, they will not be interested in punishing the politicians who satisfy interest groups. On the other hand, the politicians who want to achieve victory in the elections will be motivated to support the realization of the interests of the interest group members, using state funds (through fiscal and monetary policy), and in return they will gain the support and financial assistance of certain interest groups to win elections.

In this context, rent seeking activities imply the use of the political process by individuals or interest groups in order to acquire wealth at the expense of others. The easiness of the abuse of the political process in Serbia increased motivation for rent seeking activities. This could be eliminated by increasing effectiveness of the legal system, minimal state interference in the functioning of the economic system (the introduction of trade barriers, employment assistance, provision of subsidies, price freezes, discriminatory tax policies) and in particular - eradication of corruption.

Corruption is considered a significant source of costs to an economy, because it leads to redirection of resources towards rent seeking activities, reducing economic growth and leading to inefficiency in the allocation of resources. At the same time, corruption provides benefits for individuals. The level of corruption is determined by the structure of the political process (Shleifer and Vishny, 1993). It happens where the public and private sectors meet. For an economy, an especially pernicious corruption is that related to the so-called predatory regulation, in which the state creates regulations by which it actually encourages entrepreneurs to evade the regulations by bribing government officials.

The factors that determine the extent of corruption are many and not finally determined in the professional literature; however, the following are most prominent: the benefits that are gained by corruption, possible risks involved in corrupt activities, the negotiating power of the participants in the corruption and moral scruples. Eradicating corruption requires certain costs, so that the anti-corruption reforms must take into account both the benefits of eradication of corruption, and the costs arising from it.



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The motivation for corrupt activities comes from the fact that governments (states) purchase or sell goods or services, grant subsidies and incentives, grant concessions to private sector for providing infrastructure services, carry out privatization of state owned enterprises. Examples of corrupt behavior are numerous - in the event that the state is the purchaser or contractor, civil servants can be bribed by a company so that the company is included as an appropriate bidder or selected as the best bidder. Having been selected, a company may be encouraged to bribe a state official so that it can increase prices of their services for various reasons, or reduce the quality of their work. It is also often the case that companies in a non-market economic system, are motivated to bribe government officials in order to obtain state purchases of certain goods or resources (raw materials, loans or foreign currency) under more favorable conditions than if they bought these in free market.

Generally speaking, whenever the government spending for subsidies and incentives is limited so that it cannot satisfy all that they are qualified for receiving the support or relief from the state, officials will have to use discretion in the allocation of funds, which will encourage corrupt behavior. Building a market economy should, among other things, reduce motivation, and the chances of corrupt behavior of economic agents.

Corruption hinders economic development and discourages investment, at the same time weakening central government in the political segment, because corruption occurs at all levels, including the lowest levels of government (various government agencies and the bureaucracy) so that economic agents have to bribe them. This reduces the interest of entrepreneurs and investors, particularly foreign investors to invest in the country. Bureaucrats, in this case may at any time and at different levels of government stop an investment project. Also, corruption is associated with secrecy, which may lead to diversion of funds to those projects which guarantee maximum privacy, but not efficiency. It also encourages maintenance of monopoly, restricting the entry of new "players" and maintaining the existing political and economic elite that are already well established in corrupt practices.

One form of political rent seeking present in Serbia was related to the banking sector in the form of granting loans to companies which, generally could not have taken such loans under normal banking terms and conditions. These were politically motivated loan approvals if the owner or the management structures were directly linked to the political party in power, which allowed them to still get a loan despite the fact that the company did not meet the requirements. This requires the existence of state-owned banks which would disburse more loans to companies associated with politics. In return, a portion of the funds from these loans were returned to the political parties through various “slush funds” or donations. The rate of default debts is considerably higher in these companies. Politically powerful companies appropriate rents from state owned banks through their political influence on the employees in the bank (threats to employees or by offering awards and promotions). The state-owned banks were able to do this due to soft budget constraints, and it culminated in major corruptive scandal in Serbia.



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5. Conclusion

Serbia's economic policy during and after the influence of the global economic crisis is characterized by great dependence on political factors - opportunistic and partisan motives, type the coalition agreement, and it was all possible because both political and economic institutions were underdeveloped. Economic policy based on fiscal stimulation, as a legitimate response to economic crisis in Serbia had its specifics in the form of the continuation of extensive government expenditure, which began with long before the onset of the crisis, primarily for political reasons. While declaratively accepting the necessity of a new growth model based on exports rather than domestic demand, economic policymakers did not implement this in practice. Instead, they still opted for various fiscal incentives for current expenditure, as well as fiscal changes that violated the vertical structure of the ratio between local and state government. In addition to the direct use of budgetary expenditures for opportunistic purposes, Serbia was also characterized by the presence of rent seeking activities, i.e. the rise to power was used to change public policy and to use it to appropriate various forms of rent. Closely related to this was corrupt behavior, which remains the most significant problem not only of Serbian economy, but Serbian society as well (the segment in which there was the least progress). Since the effects of the crisis have not been fully eliminated in Serbia, and since the level of production has still not reached the level recorded in the spring of 2008, and taking into account the extremely high unemployment rate, the need for state intervention in the economy will exist in the future as well. However, the effects of this intervention will largely depend on the effects of the fight against corruption and the creation of such institutional arrangements which would prevent, or minimize rent seeking behavior. It would certainly be easier to achieve this if the state withdrew from the sphere of economy to a greater extent and exposed it to the laws of the market, which is highly unlikely in Serbia, if we observe key macroeconomic indicators.



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