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IN SEARCH FOR THE WAYS OUT OF NOWHERE: THE CRITICAL STATE OF THE SERBIAN ECONOMY AND THE ALTERNATIVES BEFORE US*

U potrazi za putevima izlaska iz nigdine:
kritičko stanje privrede u Srbiji i raspoložive alternative

Abstract

The dire state of the Serbian economy is a diagnostic finding which no one questions. Conspicuous signs of faltering in the process of growth, unprecedented unemployment volume and rate, persistent and disturbingly large deficits in the balance of current transactions, equally large and unsustainable fiscal deficits, and the highest rate of inflation in the region ranking also among the highest in all of Europe - clearly indicate that the economy is facing grave difficulties without reliable means or coherent strategies of overcoming them. A number of determinants of such a dramatic constellation is identified and discussed in the paper. Significant extraordinary inflows stemming from privatization, increase in foreign indebtedness, external donations and even remittances from abroad have almost exclusively been channeled into current consumption, raising it to irreversibly high levels and thus eliminating savings and undercutting the economy's growth potential. Foreign direct investment has largely crowded out domestic undertakings. The strategy of privatization was directed towards retaining the unsustainable economic tissue inherited from the socialist past. That amounted to preventing the needed radical reallocation of resources by imposing on the buyers in the process of privatization the obligation to preserve more jobs than it was economically warranted. Huge and heavily bureaucratized government, with accompanying unbearable fiscal burden, drastically reduced the profitability of businesses and forced many of them to exit. The financially exhausted economy faces grave difficulties in meeting its financial obligations, the arrears are mounting, and the system as a whole seems to be heading towards a breakdown. Like in the Greek tragedy, there are alternatives but none of them leads to a satisfactory resolution of the crisis. Drastic steps will have to be taken, but political determination and strength appear to be so far lacking to venture them.

Key words: *growth deceleration, unemployment, inflation, fiscal deficit and public debt, foreign indebtedness, political opportunism in economic policies, privatization strategies, erosion of the financial discipline, arrears, currency appreciation.*

Sažetak

Šokantno stanje privrede u Srbiji predmet je i suština dijagnostičkog nalaza koji niko ne dovodi u pitanje. Upadljivi znaci malaksavanja razvojnog procesa, neviđen obim i stopa nezaposlenosti, trajni deficiti u bilansu tekućih transakcija, jednako veliki i neodrživi fiskalni deficiti i najviša stopa inflacije u regionu koja istovremeno spada i među najviše u celoj Evropi - sve to jasno pokazuje da se privreda suočava sa golemim teškoćama, bez pouzdanih sredstava ili koherentnih strategija za njihovo prevazilaženje. U radu je identifikovan i pretresen jedan broj determinanti ovog dramatičnog sklopa okolnosti. Značajni vanredni prilivi koji potiču od privatizacije, porasta spoljne zaduženosti, spoljnih donacija i čak doznaka iz inostranstva bili su skoro u celosti skretani u tekuću potrošnju, dižući je na nepovratno visoke nivoe i tako eliminišući domaću štednju uz podsecanje razvojnog potencijala privrede. Strane direktne investicije su u osnovi istisle domaća ulaganja. Strategija privatizacije bila je usmerena ka zadržavanju neodrživog privrednog tkiva nasleđenog iz socijalističke prošlosti. To se svelo na onemogućavanje radikalne realokacije resursa tako što su kupcima u procesu privatizacije nametane obaveze da sačuvaju više radnih mesta nego što je bilo ekonomski opravdano. Ogromna i silno birokratizovana država, sa pratećim neizdrživim fiskalnim teretom, drastično je oborila rentabilnost poslovanja i prisilila mnoge privredne subjekte na gašenje. Finansijski iscrpena privreda suočava se sa golemim teškoćama u podmirivanju svojih finansijskih obaveza, brzo narastaju neizmirene obaveze i sistem kao celina kao da se kreće ka opštem slomu. Kao u grčkoj tragediji, postoje alternative ali nijedna od njih ne vodi ka zadovoljavajućem razrešavanju krize. Moraće da se posegne za drastičnim koracima, ali zasada izgleda da nema političke rešenosti i snage za njihovo rizično preduzimanje.

Ključne reči: *usporavanje rasta, nezaposlenost, inflacija, fiskalni deficit i javni dug, spoljna zaduženost, politički oportunizam u ekonomskoj politici, strategija privatizacije, potkopavanje finansijske discipline, kašnjenja u plaćanju, aprecijacija valute.*

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Introductory remarks

There isn't much to be discussed regarding the diagnostic statement of the state of the Serbian economy. The conspicuously revealed unfavorable traits of the macroeconomic situation of this country fit consistently into an overall picture which leaves no room for serious doubts and even less for hopes of easy and timely way out. It is safe to state that a strong and unequivocal professional consensus has been formed in connection with key impediments and functional distortions faced and borne by the economy of Serbia. The authoritative *White Book*, the yearly report of the *Foreign Investors Council* [5, p. 12] sets it out succinctly and in exemplarily precise terms. Quite frequently Serbia had the highest inflation in Europe and in all years following 2000. The rate of inflation was among the highest in Europe and literally the highest in the region. The unemployment rate also ranks among the highest and thus far has widely surpassed the critical threshold of 20%. The *White Book* also points to truly critical fiscal situation, emphasizing the markedly shrinking fiscal revenues, the implied budgetary deficit and the unpleasantly high public debt. The Dinar is appreciated, hurting the most vital exports sector of the economy and, moreover, its unpredictable twists and turns in repeated, but inconsistent attempts to depreciate unavoidably discourage exports and thus slow further the efforts to include the economy into the international division of labor. Contrary to expectations, the combination of an expansionary fiscal policy and a restrictive monetary policy doesn't seem to have produced the desired and long sought results.

Other sources point to somewhat different, but closely related to the just enumerated weaknesses of the economy. Arsić [1, p. 5] brings up the fact that investment in Serbia depends heavily – as it has in all of the past decade been – on the foreign direct investment (FDI), making the entire economic development dependent on a process which is practically beyond control of the policy making authorities, and thus largely determined by exogenous factors and random fluctuations. Renewed appreciation of the Dinar undercuts again the feeble tendencies of revival of exports, leading to serious and practically insurmountable foreign exchange shortages. The main fiscal bases seem to be

continuously shrinking, leading again to impermissible deficits and bringing foreign debt to the dangerous upper limit prescribed by the law. The credit rating is poor and likely to deteriorate further, which is unwelcome news in view of the declining value of the credits advanced to the economy; this not only reduces the capacity of the economy to utilize available investment opportunities but also hampers the current operations of the economy and its normal functioning on a daily basis.

Due to visibly declining fiscal revenues the budgetary deficit is growing by the hour, the dangerous upper limit of public indebtedness, prescribed by the law, is practically reached, and the failure to intervene more energetically on the expenditure side of the budget aggravates the fiscal crisis and narrows down the set of options available to the policy makers. These developments generate grave tensions in the entire public finance and make it more and more difficult to close the gaps in the vital components of the orderly social survival. That seems to be the principal reason for ever more frequent mentioning of the debtor's crisis, with some professionals viewing it as an unavoidable predicament, compare [1, p. 6]. A very detailed and meeting high professional standards analysis by the Fiscal Council of the Republic of Serbia [6, pp: 5-10] uncovers the far-reaching hazards in the entire area of public finance, in particular the declining tendency of the rate of growth of the GDP implying (1) insufficient expansion of the fiscal bases, and even the contraction of some of them, (2) unrealistic assessment of the aggregate of fiscal revenues for 2011 leading to possible breaks in orderly financing of essential social needs, (3) the wide variety of fiscal positions at local and other sub-republican levels, with some of them heading towards serious jeopardy, and (4) equally hazardous financial situation of social funds, including in particular the Retirement and Disability Insurance Fund and the Health Insurance Fund. Having to consistently rely on the massive budgetary injections, these funds are very likely to run up against serious difficulties once the budget as a whole finds itself in a not easily surmountable financial impasse. There are serious reasons, dealing with the resource constraints and the growing difficulties of further expansion of public indebtedness, because of which the projected growth of the GDP at the rate of 1.5%

is not likely to materialize, but there is also a technical, arithmetic reason which makes this goal hard to implement: the economy entered the current year (2012) at a very slow pace of development, meaning that there remains a worrying lot to be made up during the rest of the year in order to reach the projected 1.5% of yearly growth. The latter seems to be an achievement with exceedingly low likelihood to be materialized [2, pp: 57-9]. Even the EBRD [4, pp: 152-3], despite the unavoidable adherence to the polished diplomatic language, draws attention to the towering structural failures and functional difficulties of the Serbian economy: inflation is high above “that of / Serbia’s/ regional peers” and the pensions commitments are far from “a more sustainable footing”. Government’s loan subsidies program is also singled out as a questionable policy intervention and the efforts of the National Bank of Serbia (from now on NBS) to promote the credit activities in domestic currency are mentioned, clearly so far without possibilities to pass a definite judgment on the expected results of this policy.

It is apposite to add that there are much more vocal and undoubtedly more alarming voices warning about the perils facing the Serbian economy. Kovačević [7, pp: 3-27] calls attention to the drastic foreign trade imbalances, including in particular the long series of deficits in the balance of current transactions, the steady and excessive appreciation of the Dinar, abrupt and ill-advised liberalization of the foreign trade flows, particularly liberalization of imports, and the failure to protect the economy in other ways, as major determinants of the spectacular collapse of economic activity. *Scorched land* is the metaphor by means of which he expresses his appraisal of the consequences of an unprecedented upsurge of imports, a source of the insuperable competitive pressure which in his view even much stronger economies could not endure. Very indicative of his gloomy assessment of the current situation of the economy and, perhaps even more foreboding its growth prospects, is his newest paper presented at the latest conference of the Serbian Scientific Society of Economists [8]. The title of the paper – *Serbia Heading towards Economic and Financial Collapse* – conveys the thrust of his analysis of the forbidding economic future of this country.

There are analyses which have centered on the opportunities and constraints of Serbian economic growth in an uninterrupted and consistent way over a protracted series of years. Carefully identified through them are important features of the growth of this economy which make it unsustainable in a somewhat longer time perspective. Such are leading papers presented at the consecutive yearly meetings of the Serbian Scientific Society of Economists by S. Stamenković and his associates, a particularly representative contribution is [10, pp: 15-27]. The especially commendable property of these papers is their centering on the long run tendencies of economic development and identifying growth determinants of limited duration thus harboring the seeds of future overall declines and making the growth unsustainable along trajectories initiated in the recent past. More specifically, they investigated the underinvestment in the economy of Serbia, documenting precisely that investment had been at the level of less than half of the depreciation charges over an entire decade. They further found out that investment picked up following the big social and political turnaround in October 2000, but turned out to have been financed exclusively by external inflows, with domestic savings staying fixed at the level approximating zero. A still further finding was that deep structural discrepancies marked Serbian economic growth, with sector of tradeables dwindling to extremely low shares, with nontradeables sector determining the growth thrust. They demonstrated such structure to be unsustainable even in the foreseeable future, not to speak about the long run in the proper sense of the word.

The growth potential determining features of the Serbian economy

Stating that Serbian economic development has been rather unsuccessful in its entirety would certainly be a safe, easy to prove proposition. It has left much to be desired not only in the course of the last decade of the past century, but also during the recent decade, coinciding with the rule of the “democratic” governments. Several facts can be advanced to corroborate this claim. To begin with, the economy has not yet reached the level of the GDP of 1989, the last “normal” year, the one on the eve of the transition

towards full-fledged market economy and multi-party parliamentary democracy. Transition really produced a deep decline of the economy as a whole, considerably deeper than in the majority of other transition countries (hereinafter TC) and deeper than in the countries in the relevant region of the Central and South-East Europe. Then economic sanctions hit the country and covered about half of the last decade of the twentieth century, culminating with the unauthorized, illegal bombing in 1999. The qualifiers *illegal* and *unauthorized* are important in this context only as indications that the country was to some extent taken by surprise, not having been able to undertake necessary precautionary measures. There is a finding in the theory of economic catastrophes that the sudden and abrupt falls of activity tend to be followed by rather quick, almost as “abrupt” as the falls themselves, recoveries. That did *not* happen in Serbia. Quite to the contrary the economy lingered at deplorably low levels for years. The potential for rapid recovery has not been utilized by the Serbian economy, which could be taken as its first weakness and the first piece of evidence of the poor performance of its development policy.

A second major issue, amounting again to the poor result of the development policy, is the fact that, starting with 2000 and up to these very days, development has been financed by external means. No development strategy and the accompanying set of policies could be deemed successful if practically the entire set of development related ventures has been financed by the external means. With zero domestic savings the economy cannot be expected to develop in a sustained way, as external sources out of which this development is being financed are precarious and uncertain. Some of them face high likelihood to dwindle to the insignificant levels, while others are sure to come to an end in the foreseeable future. Thus, privatization proceeds are obviously certain to disappear, resource inflows on account of foreign indebtedness are bound to be drastically reduced because the rapid increase, and even relatively high level, of foreign and other public (and private!) debt undermines the credibility of the debtor and discourages the creditors to advance further loans. With the lack of trust on the part of the creditors, the willingness of the investors to come in with the FDI tends to be reduced and

doomed close to disappearing. Foreign donations have practically vanished anyway, and indeed quickly, following three years of the “democratic liberation”.

Summarizing, the abundant inflows of supplementary resources from abroad have not been properly utilized to accelerate the development of the Serbian economy; the bulk of such resources has been channeled into current absorption to generate political support and to vie to the utmost for the inclination of the electoral body. One has to emphasize that such a destructive dealing with the means which could have been used for speeding up the economic development has been forced upon the political parties, including those in power, by equally destructive political competition: the votes have been entrusted to those who promised and eventually delivered quick, better to say *immediate* improvements without regard to incomparably higher costs and losses in a somewhat more distant future. Incumbent authorities could simply not, in the face of competition by other parties, afford the luxury of pursuing the constructive strategic goals, based on sound economic criteria. Had they done so, other parties, undoubtedly worse in all important respects, would prevail and the results would be even worse. Politically speaking, Serbia has been in the position to choose among several evils for at least two decades, probably even more. Destructive development strategy, implying wasteful squandering of resources potentially available for feeding into development process, was politically determined. As such, it represented an objective tendency beyond control of government or any other authority. As the system cannot be changed overnight, such tendencies are a given fact of life with which Serbia will have to live for a long time to come. Responsibilities of the governing teams cannot be entirely negated, but it is far from having been the decisive factor in these processes. The teams have changed, displacing each other rather frequently, but the tendencies have persisted uninterruptedly.

Summarizing by going through a different set of issues, if we define the *genuine rate of growth* as the one that is determined by investments, driven and financed by domestic savings, then such GRG has in the course of the last decade been approximately equal to zero. The officially recorded and so frequently hailed rate of growth is *not* an

indication of the success of the development policy but, quite to the contrary, a miserable performance which offers nothing to be praised or commended. The proper way to proceed in these matters would have been not to crowd out domestic savings by privatization proceeds and externally received resources, but to promote domestic savings and favor corresponding investments *as if these external resources had not been flowing in*. Those externally acquired means should have been reserved exclusively for *additional investments*, thus raising the rate of growth far above the GRG and legitimizing the underlying policy as (just!) reasonably successful as the rate of growth would simply reflect the normal or standard saving effort and investment activity. One cannot go over these issues without noting that one component of the development policy should be pointed out as its particularly regrettable feature: namely, major infrastructural projects have, as it seems, without any exception been financed by public foreign credits, while (in relative terms) huge resources from privatization and other means augmenting operations have been diverted to current consumption!

One fundamental weakness of Serbian development strategy stems from a deep and fatal misunderstanding regarding privatization policies and directions to be properly pursued by and through them. The basic, regrettably ignored fact was that the bulk of the economic tissue, inherited from our socialist past and foreordained to be privatized, was of such a poor quality and inappropriate design that it had no chance to be incorporated into a properly shaped market economy. The basic fact that economic tissue inherited from the socialist past cannot fit into the market economy is not peculiar to Serbia and has general validity. It was relatively early, and rather thoroughly, researched in most TC [13, pp: 5-26], and the rest of the study *passim* with carefully analyzed evidence from Czech Republic, Hungary and Poland) and the key finding was that most that had been inherited from the socialist past simply had to be scrapped. Most enlightening is the experience of E. Germany, where the entire body of the capacities located in that country proved unusable and had to be liquidated at considerable cost [12, pp: 39-51, particularly 45-51]. The key word in the Sinns' analysis is *Zusammenbruch* meaning the *breakdown* or *collapse*.

The underlying, truly deep logic of privatization implies that it is not the state which is capable of determining the right direction and form of committing resources. It bears repetition: had the state been able to husband resources in a commendable way, the privatization would not have been necessary! Conversely, if the state is deemed to be the right agent for determining the socially optimal use and allocation of resources, not only would not it have been necessary to launch privatization, but the state should have initiated major nationalization drives to put resources under control of the entity best equipped to husband them to the benefit of the society. But the privatization *had been* launched and a broad social consensus about the state not being an efficient and able investor, producer, entrepreneur, innovator...had been irreversibly reached. In particular, the consensus implied and even explicitly revealed that private sector entrepreneurs and commercial companies are undoubtedly superior in committing resources to the requisite uses, in allocating them over alternative options, and in husbanding them properly wherever they happen to be deployed. That quite clearly should have implied that, whatever basic economic and business issues happen to be raised, *the state cannot know better*, and that any decisions imposed by the government upon entrepreneurs and businessmen would simply be ill-founded and wrong-headed.

The impact of some policy misfirings and their academic endorsements

It should be apparent that from this it follows immediately that the privatization strategy and the programs through which it was operationalized *had a serious, irreparable flaw*. The flaw consisted in obligatory investment programs having been imposed and incorporated as contractual obligations on the part of the subjects who participated in these transactions in the capacity of the buyers. The government acted through its agencies and authorized bodies as a *subject who knows better*. Again, if that were true, why is privatization resorted to and how in the world could it (at all!) be justified. Another inadvisable component of these programs were so called *social programs* – the imposed obligation of the buyers in the process of

privatization to keep a certain number of employees, i.e. to preserve the jobs and to extend the operation of the company more or less along the lines prevailing in the past. As any major reorientation of the activity of the firm presupposes the retraining and the redeployment of the staff, preserving the jobs predetermines to a large extent the continuation along the old production programs and circumscribes severely the ability of the firm to readjust in accordance with the ever changing volume and structure of the market demand. Investment programs were thus counterproductive and counter indicated: the entity which knows less or even *doesn't know* imposes business decisions upon those who know. Moreover, there is a world of difference in motivation: those who have invested their own money in buying the firm are certainly incomparably more motivated than the state bureaucrats to find the most profitable ways of using and exploiting the corresponding resources. Those who have studied just a little more carefully one of the many introductory textbooks in Economics know quite well and understand clearly that the profitability at the level of business units coincides, under a broad set of assumptions, with social welfare, including *common good* and *public interest*. As for social programs, space should not be wasted discussing them: it is *not and has never been up to businesses to undertake the tasks of social policy*. The dividing line is here completely clear: social policy belongs to the government, and the management and profit pursuits are the province of the business. Even the government has, after a while, understood this elementary truth: the social programs were cancelled and ceased to be parts of the privatization transactions.

The familiar problems began to crop up in large numbers: having purchased the firms, new owners found out that they cannot be made profitable in the inherited lines of business. They also quickly found out that the overemployment, drastically excessive inherited labor force, was not consistent with the needs to conduct business in a profitable way, from the sound businesslike point of view, it was simply unbearable. The jobs started to be liquidated in large numbers. No one is that naive as to not be able to see enormous social, political, emotional, and all kinds of other problems, but very few are able to understand that

shedding excessive jobs is a price of the true consolidation of the firm, of its promising business future and of its future ability to generate new jobs, probably more and of a higher quality than in the moment of privatization. It is also a price to be paid for setting the firm(s), and by implication of the economy as a whole on a stable and sustainable path of dynamic development. It also came to be typical for the new owners to change the production programs of the firms in far-reaching ways, not infrequently transferring them into entirely different lines of economic activity. That produced massive outcries, particularly the left-wing intellectuals always willing and in the mood to assist the endangered and deprived *at the expense of somebody else's money*, usually the government's funds and thus ultimately by burdening the taxpayers. It was not understood, as it is so frequently the case with those who worry about the *fate of the man* that the inherited firms are by and large "properly coded", that the resources invested in them are poorly placed and that one can reasonably speak about a sort of *negative synergy*: the effects of the collection of the (poorly) combined resources are *less* than the sum of the effects of single resources deployed in individual options. It is only natural to break such negative synergy and find for the resources found in the firm far more profitable engagements. This is what the new owners largely did, but what caused tremendous upheavals in many circles. This is only natural because the social costs in terms of job and momentary income losses are indeed high, as well as the costs in terms of human sacrifices and frustrations. But the long run effects of these radical ventures are clearly beneficial and the underlying trade-off is undoubtedly favorable. Moreover, postponing such painful operations can, and in all likelihood will, increase future losses, sufferings, and human sacrifices; the generalized social cost is, as a rule, incomparably higher than the benefits generated by the short run alleviations of the painful adjustments which will have to be performed some time anyway. It goes without saying that the laws have to be honored in the meantime; it is not up to the businessmen or to any individuals to choose what laws to respect and, quite clearly, the only right way of overcoming these absurdities is to change the laws. Until they are replaced by more sensible regulation, various costs and economic

losses will have to be endured. But, that is the logic of the rule of law: *Dura lex, sed lex*.

To clarify the issue thoroughly, the government's intervening into the described business decisions is not a result of just sheer ignorance and misunderstanding. Ruling authority keeps steadily an eye on coming elections and the opportunistic behavior directed towards the preservation of jobs pays handsomely in terms of votes expected to be reaped once this day of reckoning eventually comes. The objective function of the state bureaucracy and its principal, the political elite, is vastly different from the magnitude of profits, which is what business is believed to be maximizing. In other words the two strata are after different things and it is only natural that they behave differently and that conflict generating tensions predictably develop between them. It is also true – and this is a more subtle argument which unfortunately cannot be developed here to needed detail – that changing the point of view in assessing the consequences of privatization also results in a change of the objective function. From the point of view of the system as a whole – and that stance naturally pertains to the politicians – the effects of any action, including the privatization, are much broader: even the wages and salaries of those who keep their jobs in the described way are a part of the net effects! Businessmen maximize profits and the politicians and the bodies through which they act maximize a much wider magnitude, including wages of those who succeed in keeping their jobs and would otherwise go unemployed. There is then the well known difference in the horizon of the decision making: those who have done their basic economics know that the horizon of the business people is theoretically infinite; the horizon of the politicians and the public servants is badly truncated and doesn't extend much beyond coming elections. Three weighty reasons have been adduced for large differences of the objective functions of businesses and the government machinery: small wonder that they pull in vastly different directions and develop conflicts, most of the time not easily observed.

The elementary fact that capacities inherited from the past had not been able to survive in the competitive market environment, not to speak about their successful future development, has never been properly understood not only

by the public at large, but also by the circles considering themselves as professional. Equally is misunderstood the fact that the only people capable of realistically estimating the growth and survival prospects of the enterprises handed over from the demised self-managed economy are the newly emerging owners and entrepreneurs, and certainly *not* the government and its bureaucracy. A third important misunderstood element of this complicated game was the ingredient of motivation: again, the only set of actors with right motivation to find the optimal solutions for the ex-socialist firms were those who invested money in acquiring them and thus risked their own means; not only are they motivated to find the best option for the firm's utilization or disposal, but also to learn and to invest time and resources in a purposeful search for such optimal solutions. Still other poorly understood matter is that the government and the associated authorities have completely different objectives in attempting to influence the destiny of the firms following their privatization. These objectives are an upshot and manifestation of the political arithmetic rather than economic calculus.

The enumerated arguments are an understandable and predictable reason for economists opposing the urge and direction with which the politicians endeavor to divert the extant resources to the uses convenient from their point of view; political expedience is *not* identical with social rationality and the economists by the nature of their vocation could justifiably opt only for the latter. In particular, they should not insist on preserving the inherited firms as going concerns if, because of the above elaborated negative synergy, the *economically* optimal way to proceed is to dismantle them and their evidently misallocated resources deploy in other, potentially profitable options. The least the economists should satisfy as a professional imperative is *not to support the politicians in their misuse of resources and not to endorse the strategy of using them as a means of reaching the political goals*.

Deplorably, economic profession has not in its entirety lived up to the above mentioned professional standards. A number of economists have ardently supported politicians in their views as to how the resources could be used and subscribed to their ideas of how to manage the privatized firms. These economists have advocated the allocation

patterns which are out of line with requirements of economic efficiency and contrary to basic principles of rational resource use laid out in elementary economics textbooks. There are disturbingly numerous examples of such goings against the dicta of the profession, but a recent one [3] is more than representative as it comes from the well known economists acting in the capacity of the editors of a collection of professional papers, with one of them (Cerović) highly placed as president of the scientific association of the economists. To cut a somewhat longer story short, the above mentioned editors took the stance coinciding with the politically inspired endeavors to preserve the jobs at any price, thus trading the incomparably larger benefits in a somewhat longer time perspective for the ephemeral short run effects, perhaps favorable if judged through criteria of prospective electoral harvest, but surely unsatisfactory in the truly important dimension of economic efficiency. The editors of the collection ignored all above adduced statements of the contradiction between the political expediency and economic rationality: difference in the effects to be included into (alternative) decision-making criteria, differences in the time horizons of decision-making, the fact that it is only the private entrepreneurs who are able and correctly motivated to assess the survival potential of the firms and the basic, unbridgeable difference in ultimate objectives between the political bodies and organizations, on the one, and the part of the public truly interested in economic advancement, on the other hand. Despite the fact that interests and power, and not theories and knowledge, play a decisive role in the political life, and thus in development and current economic policies, economic expertise is not without significance and certain, even though marginal, influence. If true to its vocation and loyal to established scientific principles, economics profession can at least exercise a healthy pressure on the politics to come closer to the criteria of promoting genuine social welfare. A significant part of the profession does *not* stand up to this undeniable calling. This is a fact of life which can only be deplored. It turns out that an insufficiently developed economics science and profession are just a part of a much larger nexus of low level of development of the economy and the society at large.

Supplementary determinants of the Serbian economic downturn

The present state of the economy of Serbia can be seen as a very complex and highly intertwined nexus of numerous forces at work which are impossible reliably to enumerate, not to speak about precisely determining their contribution and relative weight. What one can hope the most within the constraints of a paper of limited length is just to single out some of them and to outline in broad terms their likely impact. The present economic adversity of Serbia is too wide, too varied and too deep to be squeezed into the precincts of a single paper. The important fact is that all of the forces contributing to the present precarious situation are significantly interconnected and that, along with their isolated contributions, one should bear in mind the effects of their interaction and, not infrequently, of their destructive synergy. The damage produced by the collection of broadly differentiated interacting factors is certainly bigger than hypothetical sum of contributions of individualized factors had they been in the position to act in isolation. Particularly interdependent are external and internal stability: the rate of inflation can be tempered by allowing increases in external deficits and, contrariwise, serious efforts to establish external equilibriums generate pressures on internal front, working towards augmenting the rate of inflation.

The first really pressing problem has already been adumbrated in the first section and consists in the absence of domestic savings and practically all investments having ultimately been financed by external sources. The inflow of such resources, defined as the sum of the FDI, the donations from abroad and increase of foreign indebtedness has been variously estimated as approximately ranging between 12 and 15 billion euros. Such abundant inflow has provided a unique opportunity to raise the rate of growth far above what is naturally affordable by the economy and what could be deemed as sustainable in the long run. That would have raised the economy on a permanently higher growth trajectory, so that, once these temporary sources of finance are dried up, the economy would continue growing at GRG, the one sustainable on the basis of own resources. Being applied to significantly raised

levels of the GDP, that standard rate would permanently generate substantially greater *absolute increases* in GDP. Exploiting the unrepeatably inflows of external resources would have enabled the economy to generate higher GDP (increases) on a permanent basis. That singular chance went unexploited. Current consumption was raised to a much higher than appropriate and unsustainable level instead. Once used to the relatively high consumption which had been increased in the described way, the consumers are extremely reluctant to adjust it downwards and to return to the consumption levels and patterns consistent with the available production potential. One could speak about the aggregate consumption hysteresis consisting of the impossibility of its return to natural levels conformable to the universally acknowledged low levels of the GDP.

The authorities have been selling the social capital and channeled it into consumption. This amounted to unduly combining the stocks and flows, and creating havoc in the functioning of the economy. Consuming capital means eating into the economic substance of the society and is harmful enough by and in itself. However, there is more to it. As a significant part of the privatized assets had been sold for foreign exchange, privatization (and growing foreign indebtedness, too) meant an additional strong inflow of foreign exchange completely independent of the current functioning of the economy. Such extraordinary increase of the foreign exchange supply meant equally unnatural appreciation of the Dinar, with an overwhelming avalanche of imports and heavy competitive pressure on most sectors of the domestic economy. Exporting sectors became unprofitable because of the appreciated currency and the rest of the economy lost sales and profitability under the pressure of the swollen imports. Hence the so-called scenario of the scorched land. There is a subtlety here that needs to be clarified. The receipts from privatization, largely denominated in foreign exchange, the government sells to the NBS. This operation results in an increase of the quantity of the dinars, and thus augmented monetary mass should lead to depreciation of the domestic currency. However, the government proceeds to spend so acquired extraordinary means. The aggregate demand rises and the rate inflation increases. As the *real exchange rate* depends positively on the nominal rate and negatively on the level

of domestic prices, with nominal rate being more or less fixed, the ultimate result is yet appreciation. The scorched land scenario comes fully to the fore.

With consumption tending to remain at temporarily and unjustifiably heightened levels, the affordable GDP doesn't give the necessary savings; on the other hand, with ceased or drastically reduced external inflows, the possibilities to finance domestic investments are also drastically reduced. The country appears to be doomed in the sense of not being able to reach the investment volume needed for normal growth. Prolonged stagnation seems to be an apt shorthand expression for the rather bleak economic future of this country. The authorities came up with a so-called *new economic model* which a number of economists found bizarre [9]: the growth was not pertinently speeded up when significant supplementary resources were available, and now when they are on the road to be dried up, the government announces revival of growth in unexplained miraculous ways. All relevant evidence points to a rather unexciting economic future of the country, with likely prolonged stagnation and with possible painful episodes of protracted declines.

Another grave difficulty of the Serbian economy is the oversized burden of the public consumption. It fluctuates between 40% and 44% of the GDP which is too much of a load for such a feeble and underdeveloped economy. It is instructive to plunge a little more into the distant past and consult the historic records of now developed countries. The startling finding is that they had incomparably lower share of public expenditures in the GDP when they were at the present Serbian development level. Thus, for example, the USA had that share at some 10% at the beginning of the 19th century – for times less than that of Serbia today. Generally speaking, developed countries had much lower public consumption shares at the development levels comparable to that of Serbia today. The burden of public consumption is much too high in Serbia, with visible signs of its unsustainability not only in the medium run (the long run should not be even thought of in this context) but even in the current situation before our very eyes [6, pp: 6-8]. There are clear signs of the excessive and socially harmful behavior of the government regarding the intensity and the form of spending the public money: rapid growth

and perplexing number of various agencies with dubious social contribution, oversized and overpopulated public service, bulky and counter indicated collection of ministries, overlarge parliament and, above all, glaring discrepancy in wage levels between the public and the private sector. The government takes and consumes *too much* and the relations between the state and the rest of the society have taken the form of an exploitative *class relation*.

Excessive burden of public consumption means high taxes and, for some time, rapid increase of public debt, which has to be serviced and ultimately takes again the form of increased and heavy taxes imposing ever higher burden on the economy. With an economy which is exceedingly weak on other grounds (institutional vacua and mismatches, low competitiveness, enormous pressure on the part of the huge imports, the fragile and largely unsustainable economic tissue taken as a legacy of the socialist past...), this load of public expenditure and accompanying taxation is simply stifling the economy. It is important to realize that the burden of taxation falls significantly on the economy no matter what aggregate is taken as the taxation base. Tax incidence theory teaches that the economy carries a good deal of the burden even if taxes are imposed on seemingly innocent base as personal consumption. Irrespective of the base, taxes produce the changes in prices which generally impact heavily on business profitability even if businesses are not the formally designated taxpayers. Taxes increase the prices paid by the consumers and reduce the prices borne by the producers, the distribution of the impact depending on the respective elasticities of demand, vs. supply: the lower the relevant elasticity, the higher the share to be borne by the group to which the elasticity applies. Thus, in the case of inelastic supplies, the burden will largely fall on the producers even if the consumption is nominally chosen as the tax base. For a thorough discussion see Stiglitz [11, pp: 491-509], and then for the case of a monopolistic market structure see [11, pp: 510-516]. Therefore, the resultant weakened financial strength of the economy makes it unable to pay regularly the obligations to the business partners and dangerously growing arrears mean breakdown of the system and destruction of the valuable market mechanisms. Add to this that the government itself

is one of the major illegitimate debtors to the economy – recent estimates run up to more than a billion of euros of the unpaid dues to the business firms – and there follows the conclusion that it is not only the case that the government becomes more and more unable to meet its obligations *because of the lack of revenues*, but also that such financial weakness leads to the erosion of the very foundations of the market economy.

The high taxation burden is an extremely unwelcome legacy of the past: many items on the expenditure side of the budget are the result of the irresponsible huge awarding of a broad multitude of various rights and privileges, many of them coming from the socialist times. This is another sad example of temporal interdependencies of the growth performance and welfare indicators. Since many budgetary obligations are fixed by laws, they are difficult to revise. The generally low level of income is also a binding constraint in any eventual attempt to save on budgetary expenditure by cutting components which construe the sources of income for large masses of the impoverished recipients. The radical reform will have to be undertaken, but the present authorities are unwilling to undertake such a politically risky venture. However, the more it is delayed, the graver and the more difficult to resolve the problem grows. If the authorities fail to resolve it in an organized, planned way, it will be surely resolved by the merciless balance relations and by life itself. But, this latter way of reconciling consumption with the available means is obviously going to be much more painful.

Conclusion

Few professionals would disagree with the statement that Serbia is in an utmost critical economic situation. Eventual disagreements can only appear when it comes down to identifying the causes of such development. Whatever the causes, the hazards of facing a range of serious imbalances and the lack of savings to fuel the growth process remains as a disturbing feature of the current and prospective economic realities of Serbia. The problems loom large and the ways and means for facing them are not on the horizon. Worse than that, the government does not seem to have an even approximate strategy of overcoming the

mounting hazards. It has indulged into heavy borrowing, including raising credits by the commercial banks, in order to pay for current expenditures. That looks like a recipe for disaster. To put a lethal stamp on all of that, the government does not seem to be overly preoccupied with this dramatic scenario. Elections are coming and that evidently absorbs the most of its energy and creativity. There are alternatives as they always exist, but, like in the Greek tragedy, none of them leads to a satisfactory resolution. So far no actor can be discerned with sufficient determination and power to undertake the socially painful and politically risky steps. Who will clean the Augean stables among those who eventually survive this socio-economic thriller?

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