

Presentation for the Danas Conference



Reforming Serbia's Public Sector

Bogdan Lissovolik

IMF Resident Representative
in Belgrade

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Structure of presentation

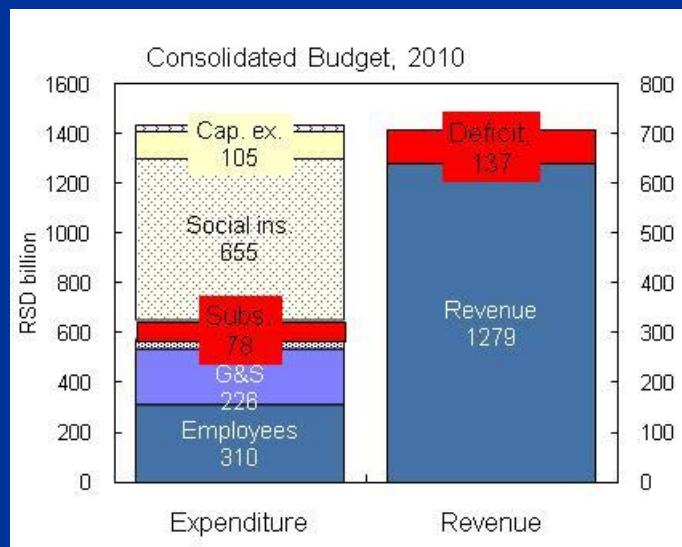
- Why reform?
- Defining time and scope of reforms
- Principles of reform
- Examples:
 - Tax administration
 - Public wage bill
 - Other large spending sectors (health, education, infrastructure, etc.)

Why reform the public sector in Serbia?

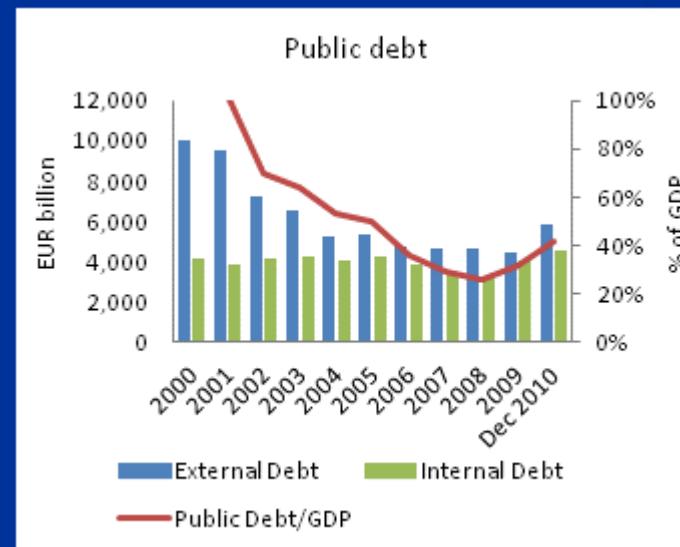
- **To boost broader economic growth.** Public sector in Serbia is oriented at consuming, not producing – it is the pillar of the “old” growth model – *need rebalancing toward investment and better public services...*
- **To fix fiscal accounts.** Need adjustment after crisis, otherwise the public debt burden would stifle the economy. New useful fiscal rules are in place, but they do not by themselves ensure results.
 - Deficits are higher than sustainable deficits (1% of GDP)
 - Revenues are set to decline as percent of GDP by 2015;
 - Public debt growing rapidly (and will rise with restitution)

Reforms needed to trim...

Consumption-driven deficits



Rebounding public debt

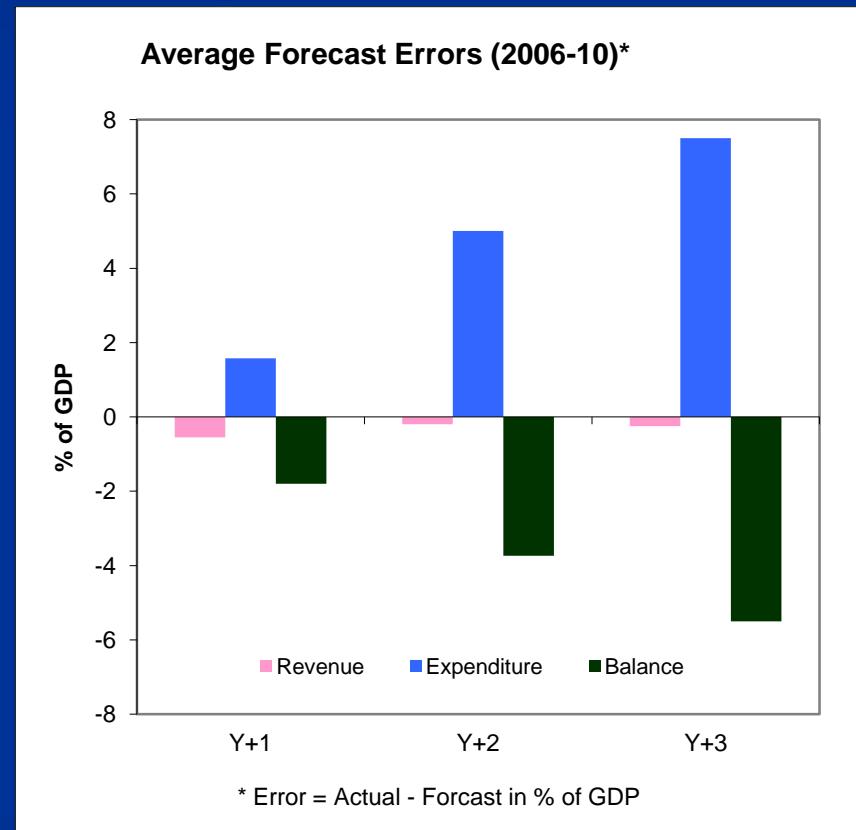
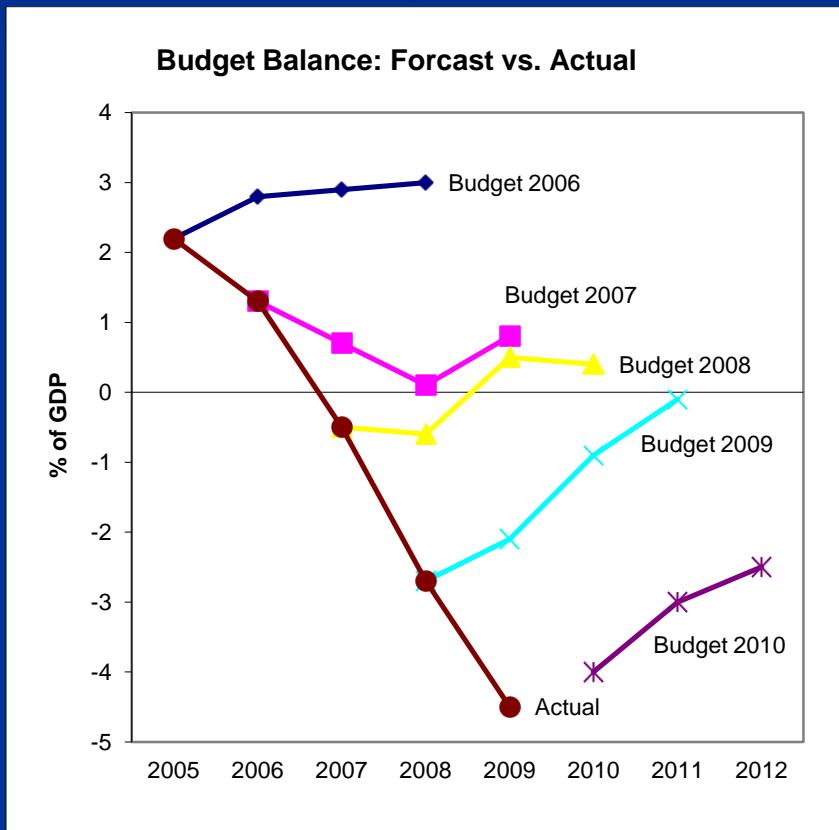


No chance for healthy economy if fiscal accounts get out of control: key immediate risk is public wage/pensions hikes

Inadequate medium-term expenditure planning/control is weakening the fiscal position...

Serbia tends to overestimate the medium-term budget balance....

due largely to the underestimation of future expenditures...



Time and scope for reform

When/how to reform?

- **“Short-term:”** freezes – “forced” measures – are losing their appeal, may be politically unsustainable;
- **“Medium-term:”** rationalization through “smarter” measures – require deep knowledge, preparation, and proactive steps
- Key risk: vacuum between short-term and medium-term measures;

What is the “public sector”?

- Central government+
- Social security funds+
- Local governments+
- Public enterprises
- Key risk: loopholes to avoid reforms by manipulating the perimeter of the public administration (“agencies,” public enterprises) – countries like Greece and Portugal got “burned” on this;

What kind of the public sector is needed ?

That supports private sector productivity , being...

- Not too costly!
- With better public services:
 - Evenhanded regulation (Justice, regulatory bodies)
 - High public safety (police)
 - Good human capital (education)
 - Long working lives (health)
 - Effective services/investment (MoF, Infrastructure, public enterprises)

In a market economy the state often is a referee : good and professional government knows its comparative advantages and limited role



These steps would also redress Serbia's poor cross-country business environment rankings!

How to “do more with less”? (see report from our WB colleagues)

Key goals:

- “More”: maximize quality of output
 - Tricky to define? Examples:
 - PISA scores in education
 - Health outcomes, etc.
- “With less”: minimize costs
 - What is a reasonable standard?
 - Cross-country spending %
 - Sectoral cross-country indicators: teacher/student ratios, hospital beds, etc.

Methods to achieve:

- Proper budget planning:
 - Realistic budgeting;
 - Programmatic budgeting;
- Professional, not “political” management (public enterprises, Ministries, etc.)
- Fair wage/remuneration policies;
- Sectoral reforms (below)

It's about boosting productivity through better planning and bottom-up incentives...

The Human Resource Side of Public Sector Productivity

Top priority

- Matching good people to responsible jobs
- Better and more on-the-job training
- Serviceable IT that is fully used
- Equal pay for “equal” work, true “productivity” bonuses

Perhaps not as urgent...

- Educate more people and better
- Adjust school/university curriculum
- Purchase state-of-the-art equipment
- Enhanced overtime compensation

The true bottleneck is not so much the education system but lack of opportunities to develop on-the-job skills and insufficient job-level meritocracy in the public sector, including lack of competitive hiring

Example I: Tax administration

(Productivity) objective:

- Collect maximum revenue – but in an even-handed way:
- Making doing business easy a key goal of the tax administration: would minimize shadow economy

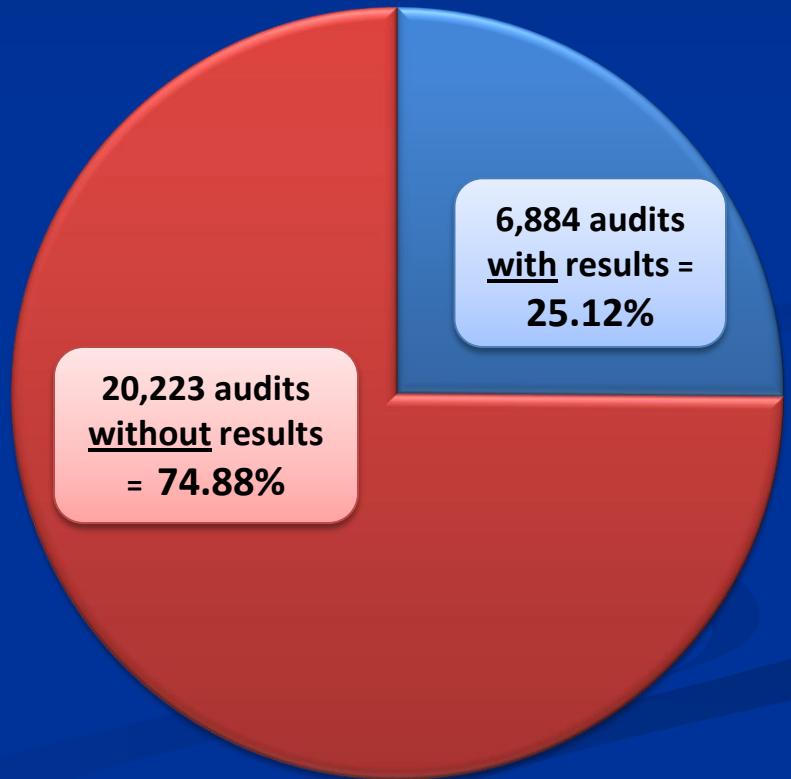
Main ways/methods to achieve:

- Rely mostly on voluntary compliance
 - Timely information to taxpayers? (summons, call center)
- Good analysis/knowledge of taxpayers for all collections
 - Call center?
 - Risk-based analysis?
 - Tax gap analysis?
 - Audits?
 - Proper IT system?

How can the use of tax audits be improved?

- Some 2,000 “auditors,” but many of them just process returns!
- More than 90 percent of audits are focused on micro- and small firms!
- 75% of audits did not yield results (the target should not be 0 though)

Tax audit results in 2010



Select audit cases from overall risk-based analysis...

Example II: public wage bill

Employment

- Attrition/hiring freezes
- Capping employment – how to redistribute?
- Reducing LG employment?
 - Voluntary separations?
 - Rationalizations?

Wages

- Freezes
- Indexation?
- Pay and Grade reform
- Trade unions – led adjustments

Why was the reform defeated? – what to do?

- (i) Poor Design? (excessive speed)?
- (ii) Public employee solidarity/compassion?
- (iii) Lack of political will? Layers of political appointees?
- (iv) Difficult labor market?
- (v) Adverse selection?

Serbia's public sector seems both overstuffed and overpaid

Central and Eastern Europe: Comparison of Public Labor Cost and Employment, 2008 1/

| | Government Wage Bill 2/ (in percent of GDP) W _g *L _g /Y | Public employment (in percent of total employment) L _g /L | Average public labor cost (in percent of total labor cost) W _g /W | Total Labor Cost (in percent of GDP) w*L/Y |
|------------------|--|---|---|---|
| Serbia | 12.7% | 22.2% | 127.7% | 44.7% |
| Latvia | 12.0% | 20.3% | 119.1% | 49.6% |
| Hungary | 11.6% | 21.5% | 107.7% | 50.0% |
| Estonia | 11.4% | 19.1% | 103.2% | 57.7% |
| Slovenia | 11.1% | 19.1% | 112.7% | 51.6% |
| Lithuania | 10.8% | 21.4% | 102.1% | 49.4% |
| Poland | 10.0% | 19.3% | 103.2% | 50.4% |
| Romania | 10.0% | 14.0% | 120.3% | 59.5% |
| Bulgaria | 9.0% | 17.9% | 119.4% | 42.1% |
| Czech Republic | 7.6% | 18.3% | 100.6% | 41.2% |
| Slovakia | 6.6% | 19.8% | 85.1% | 39.2% |
| Average of NMS10 | 10.0% | 19.1% | 107.3% | 49.1% |

Sources: Eurostat for 10 New Member States (NMS10); Statistical Office of the Republic of Serbia.

1/ Public sector defined as sum of public administration and defense, education, and health (NACE-Rev.2).

2/ Compensation of employees and employers' social contributions.

Other key areas of public spending

Where?

- Health care
 - (too much non-core personnel)
- Education
 - (low PISA, low hours)
- Infrastructure
- Pensions
- Social assistance
 - Untargeted benefits
- Public enterprises

How?

- Capitation method, DRG method is hospitals
- Capitation, school/classes consolidation
- Project planning and implementation
- Worker/pensioner ratio
- Expand targeted programs (MoP, child allowance)
- Case-by-case restructuring, greater transparency, control, privatization

Concluding remarks

- While economic growth is mostly private-sector-driven, a productive government is essential for unlocking it;
- Serbia's government has ways to go to improve its productivity;
- In a globalized and competitive world, neglecting public sector efficiency is an unaffordable luxury that costs the economy dearly!



Thank you!

Hvala!

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