

Libertarian Club Libek

# Economic Freedom Country Audit Serbia 2016



| research



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## Introduction

In the field of economic policy, the motto of Libek - Free and Responsible - includes above all advocacy for the higher level of economic freedom and responsible management of public finances.

As an organization that has since its inception been fighting for the advancement of economic freedom in Serbia, we are greatly pleased that in October 2016 we became the national partner of the esteemed Canadian think tank, the Fraser Institute, which publishes on an annual basis the global Index of Economic Freedom of the World.

Through this collaboration, we became a member of a global network that includes over a 100 influential think tanks in the world. Libek's mission is, among other things, to influence the perception of policy decision makers and the wider audience about the importance of better rankings of Serbia in the Index, in which Serbia currently takes the 101st out of 159 places.

This report is the result of fruitful cooperation between Libek and the Fraser Institute, especially during the preparation, conducting and follow up activities of the conference Economic Freedoms in Serbia, that took place on the 10th of October 2016 in Belgrade.

The conference that was divided in 5 theme oriented working groups following the Index of Economic Freedom in the World, attracted a vast number of participants - experts, researchers, representatives of public institutions and academia. Main conclusions from the working groups were later used to create a set of recommendations that are a crucial part of this report. Key topics from the working groups were later thoroughly investigated by interviews with relevant experts conducted after the conference.

Main goal of this report is to pinpoint the most critical areas in the field of public expenditures, rule of law, monetary policy and free international trade in order to foster conditions for prosperity.

Libek is an educational and research center established in 2008, active in the fields of education, research, public advocacy and publishing, with a special focus on development of a new entrepreneurial culture in Serbia. We believe that our society is able to move very quickly to a path towards prosperity, with the establishment of conducive institutional framework.

Together with our partners and associates we continue in our fight for a free society of responsible individuals.

Miloš Nikolić  
President of Libek

## About Fraser Institute

Fraser Institute was established in 1974 in Canada. During the time when majority of Canadian citizens believed that state management of economic resources is a necessary way towards economic development and increase in standard of living, the Fraser Institute achieved a substantial impact on public opinion towards the importance of private entrepreneurship and market competition for these goals.

Science based research is at core of Fraser Institute's activities. The Institute thoroughly covers topics such as fiscal policy and taxation, healthcare, education, economic freedom, energy policy, natural resources and aboriginal policy. Research is conducted by employees within the Institute, or associated scientist - economists, member of the academia and public policy analysts. Researcher community gathered around the Fraser Institute numbers approximately 350 members from 22 countries, among which 6 Nobel laureates.

Mission of the Institute is to improve the quality of life of Canadians, their families and future generations by studying, measuring, and broadly communicating the effects of government policy, entrepreneurship and choice on their well-being. Institute's vision is a free and prosperous society in which individuals prosper due to greater freedom of choice, market competition and personal responsibility.

Fraser Institute is headquartered in Vancouver (British Columbia), and has regional offices in Calgary (Alberta), Toronto (Ontario) and Montreal (Quebec).

More information about the Institute, as well as its research, can be found on the webpage [www.fraserinstitute.org](http://www.fraserinstitute.org) ■

## Size of Government

*Size of Government measured by public expenditures, although in line with many other European countries, still is overwhelming in comparison to successful transition countries. High expenditures on pensions and wage bill of public sector employees, as well as subsidies to state and private owned enterprise, lead to very high current transfer expenditures. Furthermore, the state is present as an active stakeholder in the market, providing not only public but also private goods, and high labour tax wedge has negative consequences on labour market. The solution lies in the program of privatization and market liberalization, and in decrease of public consumption through expenditure controls and lowering the number of public sector employees, in order to create fiscal space for lowering labour taxes.*

### Important recommendations

- Decrease in public consumption from the current level to 40% of GDP up the most
- Lower tax wedge on income from labour
- Discontinuation of linear approach in the process of decrease of public sector employees and transition towards the functional approach, based on performance analysis and redefining the role of the state
- Decrease of the role of the state in the economy by implementing a wide program of privatization of state and public enterprises, and increase in competition through market liberalization in areas where public enterprises continue their operation
- Redesigning the system of parafiscal surcharges.

## Sound Money

Serbia has a very bad history of inflation. Hyperinflation during 1993 completely destroyed confidence in the national currency, which has not yet been restored leading to a high level of euroization of the economy. Inflation rate has until recently remained volatile and frequently high. Optimum monetary and currency regime is one of the issues where there are significant differences in opinion, even though Serbia does not have efficient monetary policy due to euroization and the importance of the exchange rate for the economy. Restrictive regulation in the area of foreign currency usage which is necessary for exchange rate sustainability effectively restricts transborder transactions.

### Important recommendations

- Open a broad expert consultation on the choice of monetary and exchange rate regime
- Abandon the dinarization policy, due to lack of success in this area, since it is directed towards its visible consequences and not its causes
- Lower the very broad corridor for inflation targeting
- Lift all the restrictions on opening and possession of foreign exchange bank accounts abroad for domestic residents.

## Legal System and Property Rights

Legal system and property rights in Serbia receive the lowest rank in the Index of Economic Freedom of the World. Judiciary is perceived as partial and systematically prone to external influences, especially those political, and quality of verdicts is questionable, leading to the overburdening of secondary courts. Enforcing of verdicts is an exceptionally cumbersome process.

### Important recommendations

- Abolish constitutional articles derogative to judiciary (especially Article 4)
- Reform the election system, by inclusion of some traits of direct elections. Possible examples could include the previous election system in Autonomous Province of Vojvodina or the current election system in Croatia
- Abolish the current two phase election process in appointment of judges - the first one in the Parliament by the MPs and the second one by the High Judiciary Council. Judge appointment system should be conducted in a single phase and should avoid the Parliament - judges should be appointed by the High Judiciary Council directly.
- Establishment of taxation sectors at Administrative courts.
- Specialize work procedures within courts. A certain amount of work processes should be taken away from judges and assigned to clerks and administrative assistant.

## Freedom to Trade Internationally

*Inclusion to international trade flows is of utmost importance for small open economies such as Serbia, since relatively small number of goods and services can be produced efficiently only for domestic market. International trade has been significantly liberalized after 2000, but there are still many problems in this area which serve as non-tariff trade barriers to trade. This is mostly visible in the field of product certification and standardization, and the customs office does not have sufficient capacities. Even though Serbia has implemented trade agreements with its major trade partners (the EU, the Russian Federation), Serbia alongside Bosnia and Herzegovina remains the only country in Europe which is not a member of the World Trade Organization (WTO).*

### Important recommendations

- Include changes in the GMO regulations that will allow sales of GMO products, as a necessary step towards the WTO membership. It is possible to introduce obligatory GMO labeling, in order to inform consumers.
- Encourage bilateral trade negotiations with WTO member states, in order to hasten necessary procedures regarding Serbian accession.
- Decrease the level of non-tariff trade barriers to trade, by the complete harmonization of quality and standardization regulations with the EU regulations. Eliminating obligations for some products to pass through the same accreditation procedure (once in the EU country of origin, and for the second time in Serbia).
- Visa policy revision, in order to broaden the scope of countries whose nationals can enter Serbia without a visa. Increase the level of harmonization with Schengen area countries in this regard, and simplify the national framework by elimination of stay periods of different length.
- Reduce the level of restrictions of the central bank that concern capital flows and further liberalize the capital account.



## Business Regulation

*Business regulation quality is an important determinant of business environment. Although recent reforms steps were taken (redesigning of inspections and construction licenses) business regulation in Serbia is perceived to produce high costs to private sector. Improvements in the current regulatory framework would have significant positive effects on the development of private sector and economic growth, and would also present an obstacle to corruptive practices that are still significantly present.*

### Important recommendations

- Revise the existing regulatory framework in order to eliminate authority overlapping among different state institutions. Implement a wide range of deregulation, based on a broad dialogue between representatives of state institutions and business community. Lowering administrative burden of the private sector.
- Change way the EU regulation is transported into the national legislation from simple adoption of Croatian regulations into a full legislative process, with a stronger emphasis on adoption of solutions from EU countries with good regulatory framework (Scandinavian countries, the Netherlands, the United Kingdom)
- Liberalize regulations on foreign currency and e-business, which in practice pose a heavy burden on business conducted over the Internet
- Conduct reforms of the tax administration, by increasing its capacities and level of expertise. Shorten timeframe for tax determination for lump tax payers, introduce more electronic services, and reform the secondary level of decision making.
- In regulatory process, move away focus from the regulation itself to a preferred state, with quantitative objectives and indicators.

## Labour Market Regulation

Recent introduction of the new Labour Code alleviated many problems in industrial relations increasing the level of labour market flexibility. This reform is perceived as one of the most successful ones in the country. These improvements have not yet been translated to values of the Index of Economic Freedom of the World, due to data time lag. However, there are still many problems which were not solved with the new law: restrictions on vacations, short horizon of fixed-term contracts and employment agencies for leasing of labour. The minimum wage determination is very restrictive, and its determination and level have a significant influence on unemployment and shadow economy activities, especially for seasoned workers, those living in rural areas and with lower qualifications.

### Important recommendations

- Increase the maximum length of fixed-term contracts from 24 to 60 months, a measure from which most benefits will accrue to the young and the senior workers. Abolish all restrictions on these contracts, such as providing reasons for using these contracts instead of normal contracts.
- Completely change the way the minimum wage is determined. It should be determined outside of inefficient and politically oriented social dialogue, with the introduction of an automatic formula based on the level of prices and the median wage. Its level should be lower, below 40% of the average wage instead of the current level of 50%.
- Abolish all restrictions on vacation days. The way it is used should be completely determined between the employer and the employee.
- Lower rigidities arising from firing regulations. This mostly concerns to changing the current formulation that a reason for firing should not be “a felony” but “conducting a felony”, which would eliminate the situation in which it is necessary to wait for an official court proceeding.
- Benefits during pregnancy sabbatical should become a relation between employees and the state only, by eliminating the employer as a necessary intermediary in this process.

## Regulation of Credit

Banking sector in Serbia is burdened with many regulations. As a result, there is a lower level of competition and services are more expensive for their customers. High needs for budget deficit financing can squeeze out private investments through increase in interest rates. Although there were very bad experiences with state banks in previous years, the state in Serbia still is direct or indirect owner of certain number of banks, and the regulation restricts the possibility of owning accounts in foreign banks.

### Important recommendations

- Decrease the number and share of state banks in the banking market. Commercial Bank and Postal Savings Bank should be privatized in cooperation with international financial institutions. MTS bank should stay a part of the company Telekom Srbija, and its ownership status should be determined with the status of its mother company, which should also gain a private owner.
- Increase transparency of decision making within the Development Fund, in order to restrict discretionary powers of the management which can be politically influenced, in line with recommendations of the Anticorruption Council. Loans transfer via private banks interest rate subsidies instead of a public institution should be considered, as a mechanism that guarantees higher efficiency in the process of debtor analysis, lowering the risk of NPLs and political influences. A complete dissolution of the development Fund should also be considered.
- Decrease regulatory barriers to market entering for new banks, in order to attract new foreign banks and increase competition.
- Increase the quality of insolvency regulations in order to increase recovery rates.
- Liberalize regulations of the central bank regarding the possibility of owning a bank account in a bank abroad.

Belgrade, December 2016  
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