# Serbian Government in Spending Dilemma

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How tight do the government's purse-strings have to get before it starts cutting funding to industrial giants?

Serbia's government is about to come under strong pressure to slash its spending, and since there are few areas left where cuts can be made, economic experts are asking whether ministers will at last have to consider privatising or closing state-run industries.

In December, the International Monetary Fund, IMF, will ratify an agreement designed mainly to reduce the vast imbalance between faltering exports and the rush of imports. Since exports cannot be easily increased given the moribund state of Serbia's economy, imports will have to come down drastically.

The IMF believes the best way to achieve that is to slash government spending so as to reduce local demand for imported goods. Curbing wage increases in the large public sector and implementing redundancies would reduce people's spending power.

"The generator of the trade deficit is government consumption," explained Professor Danica Popovic of Belgrade University's Faculty of Economics. "Consumer imports need to be cut by a cut in budgetary expenses. The only way to cut these [imports] is through the wages that are being paid by the government."

Imposing across-the-board pay reductions in the public sector, or decreasing expenditure on already poorly-funded areas such as healthcare and other services, would be politically difficult.

Some economic analysts interviewed by IWPR believe that the state-subsidised industries are the most likely target for savings. Others disagree, arguing that privatising and in some cases liquidating insolvent firms spells political suicide for any Serbian government. Instead, they predict further attempts to trim costs across the board.

The process of liquidating and privatising the numerous unproductive state firms ground to a halt after the death in March 2003 of reformist prime minister Zoran Djindjic.

Kick-starting the stalled process is an outcome the IMF wants to see happening anyway, so it will be a welcome side-effect even if it is not the main aim of the economic programme to be signed off in December.

Economists and political analysts say the government has little choice but to accept the IMF's terms if it wants to continue receiving loans and turn the economy round.

The number one priority for the IMF is to reduce unsustainably high import levels, fuelled by a consumer boom within Serbia. People are buying cars and household goods, often on bank loans.

Serbia's export performance is consistently poor –a consequence of its stagnating, obsolescent industrial sector.

As a result, between January and September this year, Serbia ran up a trade deficit of close to five billion US dollars, an alarming figure because it was 50 per cent higher than in the same period of 2003.

Apart from having a distorting effect on the economy, the imbalance is a worry because the government has had to dig into its cash reserves to cover the shortfall in the balance of payments, of which the trade balance is the main component. That creates a drain on reserves which threatens Serbia's ability to repay its debts, which earlier this year were estimated at a high 75 per cent of gross domestic product, GDP, the standard yardstick.

According to Zoran Petrovic, director of the treasury department at Raiffeisen Bank Serbia, "A continued deficit in foreign trade is not sustainable for the Serbian economy, and will only jeopardise obligations to pay foreign creditors."

The IMF's representative in Belgrade, Harald Hirschoffer, told IWPR that the deficit on the external balance of payments is the single biggest issue facing Serbia's economy. The IMF is concerned about a rise in micro-level consumption in Serbia, fuelled by people buying imported cars and other consumer items.

High government spending is seen as one of the main factors driving consumption, so the IMF views cutbacks here as the most effective tool for curbing imports. "Demand needs to be constrained and savings increased at macro levels – this means bringing down the budget deficit, and consumption with it," said Hirschoffer.

Government spending is expected to exceed its revenue by 2.5 percent of GDP in 2004 – a figure well within the requirements of both the Maastricht Treaty and the Stability Pact, which stipulate that national deficits should be less than three per cent of GDP.

The negotiations with the IMF will end with Belgrade being obliged to cut its target budget deficit figure for in 2005 by one-third – requiring savings of nearly 170 million dollars – with the budget deficit reducing from 2.5 per cent of GDP to an estimated 1.6 per cent.

Both ministers and the public in Serbia are resistant to further cuts in spending. Deputy Prime Minister Miroljub Labus was recently quoted by the daily newspaper Politika as saying additional cutbacks were "impossible".

While baulking at spending cuts, the authorities are already taking other measures to reduce consumption. Taxes are shifting from income to consumption, with the introduction from January 2005 of value-added tax. An IWPR source at the National Bank of Serbia said that governor, Radovan Jelasic, is considering reducing availability of the loans which feed consumption and thus stimulate the flow of imports.

But changing the tax structure and dampening people's enthusiasm for taking out loans will not be enough to meet IMF demands, so expenditure cuts seem inevitable.

Speculation about job cuts has triggered promises from the government that it will not reduce the wages of doctors, university lecturers and civil servants, whose salaries are already low.

That leads some analysts to believe that the government will finally turn its attention to the tricky but long overdue business of divesting itself of the big state enterprises inherited from the Milosevic era, which run on government subsidies.

“The major point is the subsidies for the public sector, which need to be restructured,” said Petrovic.

Limited privatisation came to a stop with Djindjic’s death, and the government still has to pay out huge amounts to subsidise these industries. Perhaps the most famous example is Zastava, an industrial giant based in the town of Kragujevac with a staff roll of thousands. Its armaments division has been in decline since the collapse of socialist Yugoslavia’s army, while the cars rolling off its production line are obsolete designs that are little in demand at home or abroad.

Many of these firms would not survive on their own in their present state, with excessive staff rolls, obsolete production systems, and massive debts owed to Serbian banks. While they still account for a hefty chunk of Serbia’s overall output, they are uncompetitive abroad – the reason why export performance is so poor.

These industries are ripe for restructuring and privatisation, though some are in such bad shape that they are doomed to liquidation.

The government has kept its plans close to its chest, but Petrovic of Raiffeisenbank expects the state electricity and oil companies to be among those restructured first.

“The government has to deal with the NIS oil company and the EPS electricity supplier, as both have excessive labour forces and are inefficient to the core,” he said.

The reluctance of successive governments to tackle the privatisation issue so far is due to the potentially explosive consequences of inflicting large-scale redundancies on big firms on which entire communities depend.

Misa Brkic, economic analyst for the Belgrade weekly Vreme, believes the government's policy of placating the electorate is a classic example of short-term thinking that may end up costing the nation dear. The authorities have consistently been "ready to buy voters’ favour by handing out high pensions and salaries”, he said.

Professor Popovic thinks winning over employees of big state-sector firms could prove easier than expected if they are offered redundancy and re-training packages to cushion them against the impact. Popovic said many workers would welcome a cash pay-off that freed them to pursue the second jobs that they often rely on already.

“Employees at these factories often only receive their salaries once every three months if they are lucky,” she said. “They are not well-paid jobs, and in many cases it is only simply written down that they are employed.”

The big question is how such schemes would be paid for. Retraining, pay-offs and pensions would all drain large sums from the government purse at a time of severe cutbacks.

One solution is to seek outside assistance. Prime Minister Vojislav Kostunica “must guarantee donations from the West to make a social security net", said Popovic. "This is what happened in Poland, Czech, Slovakia and Estonia, all of which experienced the same problems."

The World Bank has already promised Serbia an aid package worth 550 million dollars over the next two-and-half years if the government ratifies and implements the IMF’s demands. The bank says up to 70 per cent of this sum might be allocated to reforming pensions and cushioning those employees most affected by restructuring.

Popovic says the IMF agreement poses a critical dilemma for the prime minister and his team.

“Kostunica has no choice but to pursue these reforms,” she told IWPR.

Other analysts disagree with this view, citing the extreme caution that Kostunica has always displayed on the issue of privatisation. Even a government of more adventurist spirit would try almost anything before it started dismantling firms that employ virtually the entire adult population in some areas.

“I don’t think they are going to be tackle these large firms,” Dusan Pavlovic, a researcher at the Jefferson Institute in Belgrade, told IWPR. “The large state owned enterprises such as the electricity and railway companies are not going to be touched.”

Pavlovic explained, “These enterprises have a huge amount of employees – Kostunica is afraid of the social bomb. His compassionate conservatism will not allow for it. There is also the issue of the tycoons who are involved in these firms – they don’t want to lose their share.”

Instead, Pavlovic sees the cabinet going for a gentler cure, “Tight spending combined with an industrial production recovery and earnings from smaller privatisations could allow the government to achieve a smaller deficit without touching large companies like [national airline] JAT.”

And trimming costs all round will help, too. “Wages in the public sector are going to be harmonised with productivity from next year - this will help the government keep a low deficit,” said Pavlovic.

The armed forces could be another likely target for big cuts.

“The greatest burden will be felt by the military,” predicted Brkic. “This will be a good opportunity for Serbia to subsidise the military in line with its economic capabilities.”

One obstacle to aggressive cost-cutting measures would come if there was an early parliamentary election, which some observers anticipate in the first few months of 2005. Such an election would encourage parties to adopt populist policies that run counter to IMF demands. To protect his political flank from a swing to the ultra-nationalist Serbian Radical party, Kostunica may shirk unpleasant decisions.

Whether the election takes place or not, this government or the next one will have to face up to the mounting pressure to impose unpopular measures on its already disaffected and weary voters.

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**Location:** Africa