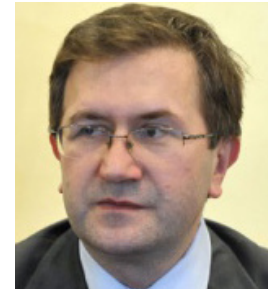


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## From the Editor



In the last couple of years, Serbia has made significant progress in basic transitional reforms and establishment of macroeconomic stability. Trade and capital flows with the world are liberalized, privatization is almost complete, inflation is stabilized at a low level, fiscal deficit is eliminated, interest rates have fallen, etc. While transitional reforms, such as privatization, are non-reversible in standard historical circumstances, macroeconomic stability is always exposed to risks, as evidenced by the experience of developed market economies, which occasionally face the crisis of public and external debt or the banking crisis. Therefore, maintaining macroeconomic stability will represent a challenge for Serbia's economic policy in the coming years.

Progress achieved in establishing macroeconomic stability and basic reforms contributed to a higher visibility of fundamental problems of the Serbian economy, which were in the second plan in the past due to acute problems such as high inflation, exchange rate instability or a possible public debt crisis. Problems such as poor contract and property rights protection, low competence of public administration and high level of corruption, poor management in public companies, and low efficiency of public investments are now emerging in the foreground. Above-mentioned problems indicate an unfavorable environment for entrepreneurship, investments and employment resulting in low level of innovation, low domestic private and public investments and low level of employment. The long-term existence of illegal construction, high level of gray economy and high level of corruption are visible manifestations of weak institutions, i.e. weak, inefficient state.

Experience throughout the history shows that in the condition of macroeconomic stability and favorable international circumstances it is possible to achieve high rates of growth, despite the existence of mentioned fundamental institutional weaknesses. However, the experience of countries with these institutional weaknesses, such as Latin American countries and some southern European countries, indicate that their growth periods are relatively short-lived and that, as a rule, they end up with macroeconomic instability and recession. As a result, these countries have a relatively large historical lag behind the most developed countries.

Therefore, the focus of economic policy in Serbia in the coming years, besides preserving macroeconomic stability, should be a progress in creating good institutions. Part of the mentioned reforms, which concern the completion of privatization and restructuring of public companies, tax administration reform and improvement in financial sector supervision, are contained in the new arrangement with the IMF. The second part of institutional reforms, such as the efficiency of the judiciary, enhancement of competition policy, suppression of corruption and other, is conditioned within the process of EU accession. Our experience, but also the experience of similar countries, shows that the existence of external incentives such as the arrangement with the IMF or EU accession give good results in some areas, such as establishing macroeconomic stability or basic transition reforms (privatization, liberalization etc.). However, in some other areas, such as efficiency of the judiciary and the state administration, management of public companies or suppression of corruption, domains of external incentives are limited. Progress in these areas depends primarily on the existence of the political will and the power to implement such reforms.

Based on the quality of institutions Serbia ranks at one of the last places in Europe, indicating that so far there has not been political readiness and / or strength to build good institutions. According to the World Bank rankings regarding the quality of government management, which includes criteria such as the rule of law, state efficiency, corruption level, etc., Serbia is ranked at 12th place out of 14 Central and Eastern European countries - only Macedonia and Albania are ranked worse. Similarly, according to the ranking of the World Economic Forum - based on the quality of the institutions Serbia is second to last in Central and Eastern European countries.

The absence of political will can be explained by the fact that the existing state of institutional mess gives greater political power to the ruling elite, including the prospect of its enrichment as well as the enrichment of entrepreneurs close to the governing circles. One characteristic of such condition is that the State serves political party interests, rather than political party serving the State. The potential for such behavior is

particularly high in conditions of long-standing political dominance of one party, weak political competition, and the control of key media by the ruling party, as in that case, information regarding weaknesses and misuse of power in the government have a hard way of reaching voters.

Additional reasons can be found in deeper social embeddedness of bad institutions, meaning that a large part of the population is trying to fit into such institutions, rather than demanding creation of good institutions. Examples of willingness of a wide mass of citizens to fit in bad institutions are mass employment of political party members, negligence and lack of dedication in public sector companies, gray economy, corruption, purchases of faculty diplomas, illegal construction, ... The government selectively tolerates such conduct as it facilitates political control of the society. The examples of selective encouragement of such behavior are tolerance of illegal construction even after the announcement of the zero tolerance for illegal construction, occasional write-offs of tax debts, legalization of PhDs issued by faculties which were not accredited for doctoral studies, employment of party activists with suspicious degrees in state administration, selective punishment of corruption based on political affiliation etc. The social embeddedness of bad institutions is a powerful, but not insuperable obstacle to establish the institutions that will create good foundations for high and long-term sustainable growth of Serbia's economy, in due time.

Given that main constraints for the realization of reforms are in the political system, it is certain that without its change there will be no significant improvement of institutions crucial to economic development. Some changes that would contribute to the creation of better institutions are the establishment of an equal political game, establishment of freedom in media, change of the electoral system in the direction of introducing elements of the majority system, direct election of the municipality presidents and the mayors, etc. Such changes would increase the chance to gradually form a competent, dedicated and honest state administration, increase the efficiency of management in public companies, improve

the quality of state education and health, strengthen the independence and competence of the judiciary, suppress the corruption, etc. Considering the above mentioned political factors, we estimate that it is quite uncertain whether Serbia will create some substantial progress towards creation of good institutions in the foreseeable future - certain formal progress can be expected primarily because of the European integration process and the IMF agreement.

Based on the experience of other countries, Serbia may expect to maintain growth at the level of the Central and Eastern European countries, provided that in the future it preserves macroeconomic stability and partly conducts institutional reforms conditioned by the IMF and EU agreements. Such growth of the economy, which would be carried by the overall progress in the region, would influence an increase in the country's development level and standard of living, but could not be regarded as satisfactory because it would not eliminate the historical gap which was, when compared to these countries, formed during the 1990s. To overcome this gap, it is necessary for Serbia to achieve one of the highest growth rates among the CEE countries for a longer period of time.

This issue of the Quarterly Monitor, besides regular chapters dedicated to the analysis of macroeconomic trends and policies, will have two Highlights. In the first Highlight, Mladen Stamenković analyzes the ranking of Serbian universities on the Shanghai list, as well as the possibilities for their progress in the future. The paper suggests that the advancement of research in social sciences, according to which the universities from Serbia are poorly ranked, presents a possibility for improving the overall ranking of universities from Serbia. In the second Highlight, Nemanja Vuksanović analyzes the position of youth in the labor market in Serbia. This Highlight explores the employment of young people, stability of jobs they are engaged in, how much they earn and what it depends on.

