



WORLD BANK

Fighting Cholesterol

Mokra Gora School of Management
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Panel 4: Public Sector Reform

Loup Brefort
World Bank Serbia

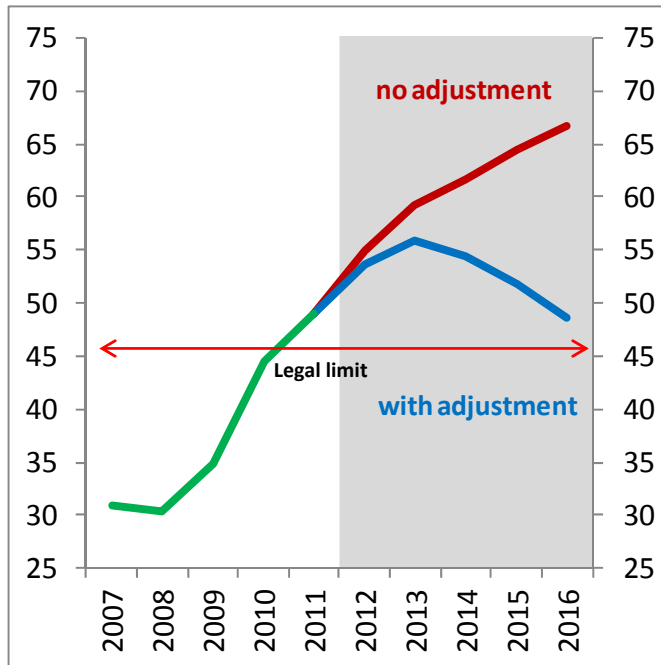
The Source of Cholesterol

- Public debt will reach 55% of GDP by end-2012
- Two main sources:
 - **deficit** likely to reach over 6 % of GDP in 2012
 - structural deficit 4-5 % of GDP
 - revenues underperforming due to crisis
 - expenditures contained by ad-hoc measures (freezes etc.), not structural
 - **government guarantees** exploding over last 3 yrs
 - 2006-2008: increasing by 0.3% of GDP per year
 - 2009-2011: increasing by 1.4% of GDP per year
 - stock reached 6.8 % of GDP
- in addition interest rates increasing last few years

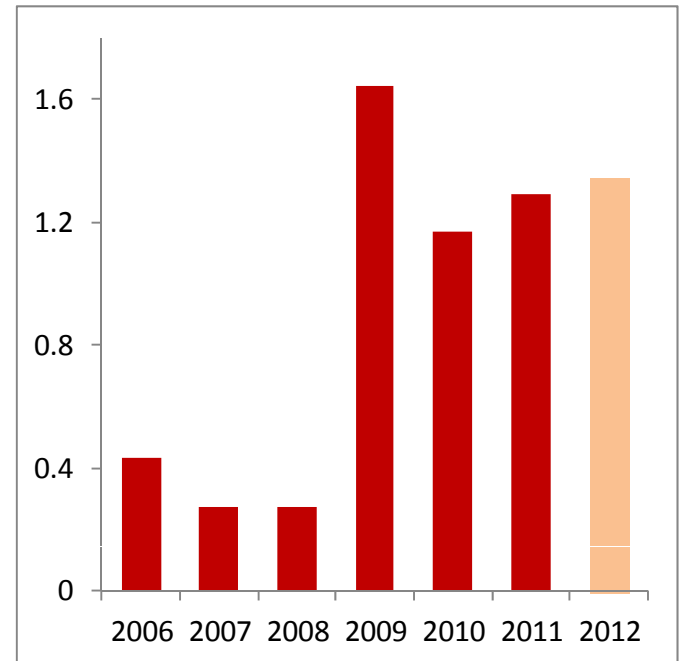


(Reform) Procrastination is Costly

Public debt as % of GDP
(Red line on current policies)



Newly issued guarantees in % of GDP



Source: Fiscal Council

Good and Bad Cholesterol

- Good – borrowing to invest in future growth
 - Hard infrastructure
 - roads and railroads, energy, high-tech communication technology...
 - Soft infrastructure
 - Education & skills, Innovation, customs & phyto-sanitary modernization to support exports ...
- Bad – borrowing to finance current consumption
 - Public sector salaries
 - 12.6 % of GDP compared to average of 10.1 % of GDP in EU10
 - average wages significantly higher in public than in private sector ?
 - Pensions
 - 14 % of GDP compared to average of 8.4% of GDP in EU10
 - Excessive subsidies
 - About 3% of GDP higher than EU average
 - Needed to “compensate” for weak business environment ?



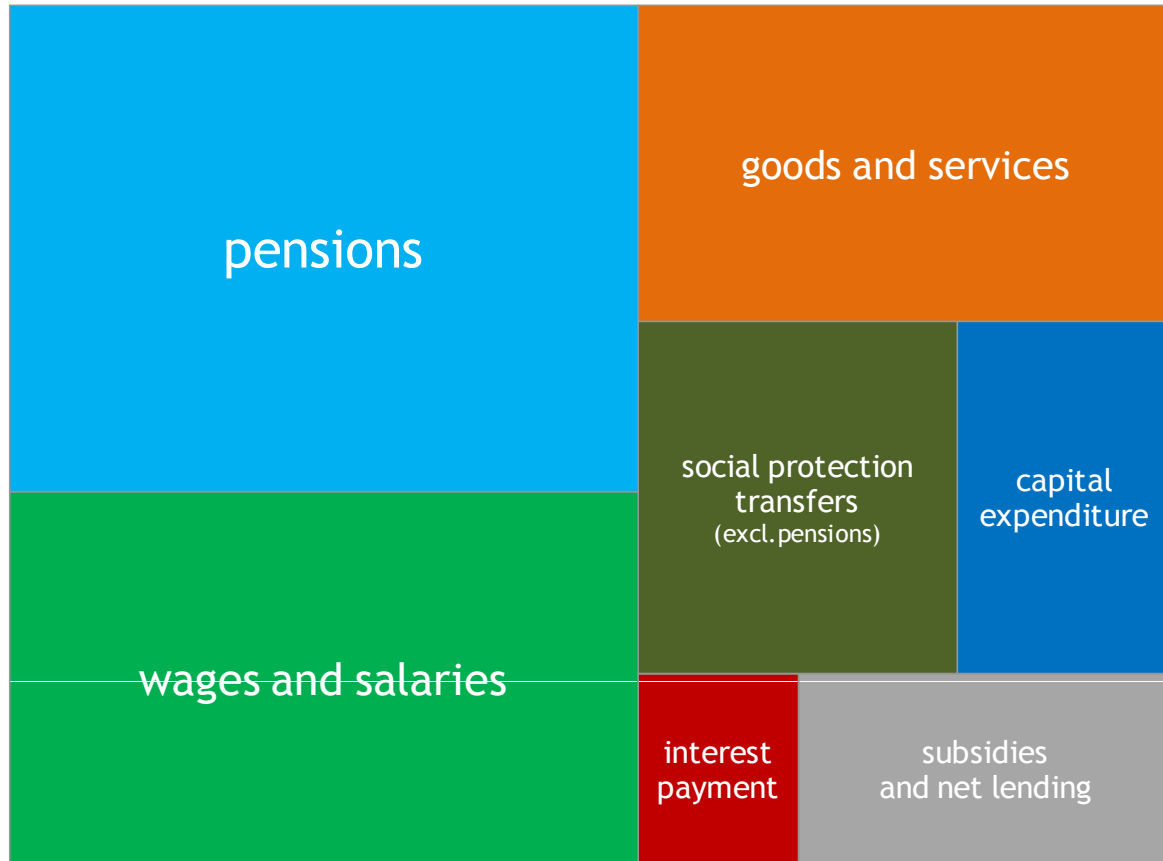
Public expenditures: 45 percent of GDP (EUR 14 billion annually)

- Revenues (contributions) of the **Pension Fund** cover only 55 percent of what is spent on pensions, as a result deficit of the pension fund is **EUR 1.96 billion!**
- Growing problem with the **Health Insurance Fund**: for 2012 it is estimated that it will run deficit of **EUR 520 million**. It also has high stock of accumulated arrears.
- Public sector wage bill: high and growing (about 440,000 people working in the public administration)
 - In transition economies, the ratio of wages in the public sector to GDP per capita is between 1-1.5. In Serbia , it is 2.05!



Pension and wages represent 54% of total consolidated expenditures

Serbia: Structure of consolidated general government expenditures in 2011



Prescription

- “Do More with Less”: push reforms of public sector, health, education;
- Change the structure of expenditures: more for infrastructure (both hard and soft) and for better targeted social protection; less for unviable enterprises that have turned into “unemployment agencies” (gross overstaffing);
- Improve “Doing Business” environment; sharpen the blade of the “Guillotine”;
- Public enterprises: demand improvement in productivity and better services; not the “property” of parties or interest groups;
- Apply clear criteria for public spending: does it contribute to building the future or does it simply “plug the holes” of the present (recurrent expenditures)?



Political feasibility

- The scenarii ?
 - “Be brave and bold”
 - ... and position the economy / yourself well for the next election
 - “Muddle Through”
 - ... and pray for Europe to resume robust growth !
 - Increase state intervention further to re-kick growth
 - ... and explain how it will be financed ?



“Be Brave & Bold”

- Very tough in the first two years, but reaping the benefits in later years of mandate
- Socially hard to “sell”, but invest in honest & credible message and well targeted social protection;
 - Latvian outgoing government got re-elected in a landslide on a “blood, sweat and tears” platform !
- Message of social equity: so far impact of crisis mainly borne by private sector
 - Sure, freezing of wages is tough ... put 400,000 employees of the private sector **LOST** their jobs !
- Get serious about corruption
 - public surveys show this is one of the foremost expectations from citizens



“Muddle Through”

- Continuation of the current policies: steady in mostly the right direction but very slow & partial
- Hope that Europe’s resumption of growth will “pull” growth in Serbia
 - In the meantime, likely that public debt will continue accumulating (last in past few years)
- Possible but really a “gamble” on the future:
 - Big risk that markets will consider that Serbia has passed a vulnerability threshold with “bad” cholesterol (debt) and will “punish” it with high interest rates
- If funding dries out, could lead to the economic nightmare seen in the 90s with hyperinflation

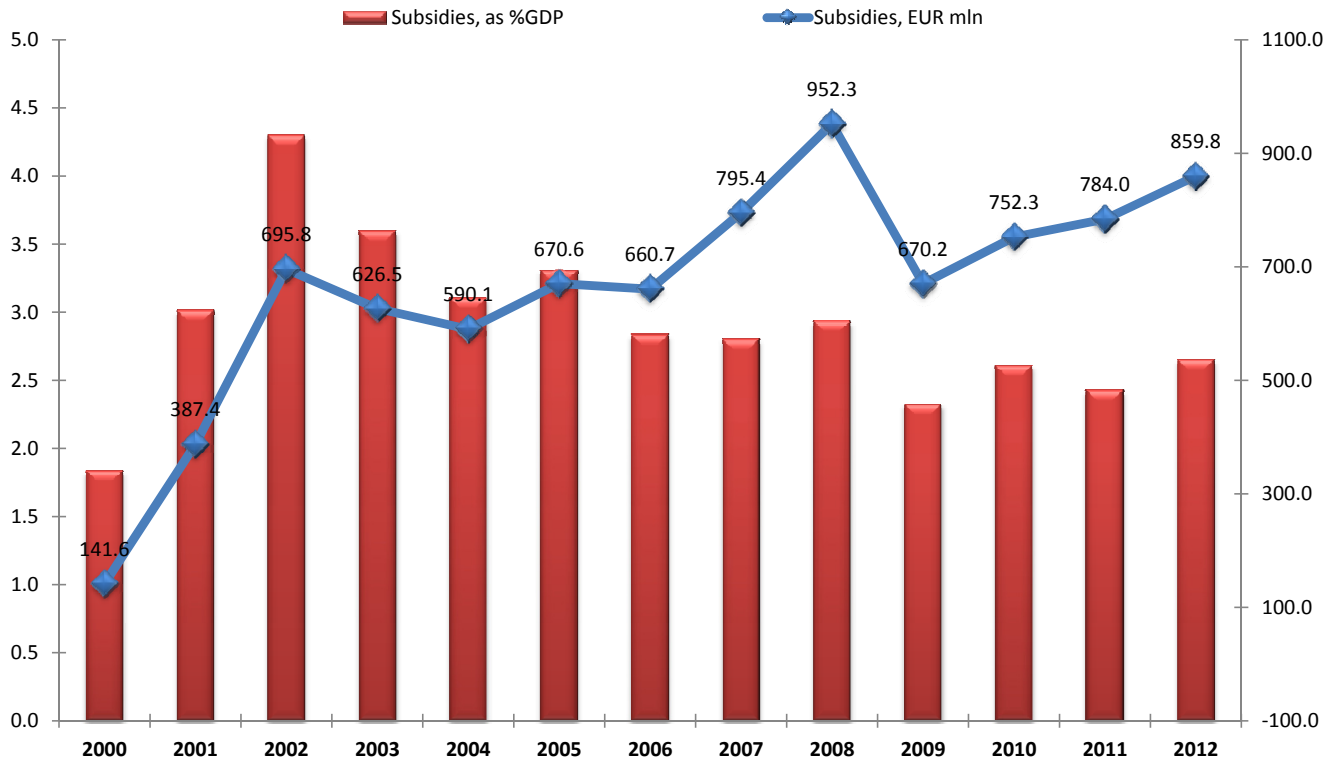


Focus on State Interventions

- Many of enterprises in the portfolio of the Privatization Agency are “holes without bottom”.
 - Some have been 7 or even 12 years in so-called “restructuring” with no improvement in sight
- State Development Bank: accountability, management, transparency may well be serious problems
- Policies of financial incentive to attract FDI are bringing results ... but expensive
- Who is going to pay for this?



Subsidies are already high ... are they having a sustainable positive impact?



Fiscal cost of “non-private enterprises”: There is more than meets the eyes

"Cash" transfers (annual average of 2010 and 2011)

	Direct subsidies	Payments for called guarantees	Transfers to cover pension/HIF arrears	Total
Privatization Agency portfolio	94	0	172	266
State Owned Enterprises	160	76	12	248
Municipal Enterprises	223	0	n/a	225
Total	477	76	184	737

Soft budget support (end-2011)

	Stock of Government guarantees	Arrears to state entities	Arrears to public utilities	Total
Privatization Agency portfolio	74	1,100	441	1,616
State Owned Enterprises	1,742	288	84	2,113
Municipal Enterprises	n/a	n/a	n/a	n/a
Total	1,816	1,338	525	3,729

What the WB Can Do to Help?

- Ready to assist the government in reversing the trend of worrisome increase in budget deficit and public debt.
- Budget support at very favorable terms in the context of agreed structural reforms program:
 - up to \$340 million could be made available in the next 12 months;
 - with further \$200 million in the following year.
- But we need a partner willing to move on Public Enterprises and public expenditures reforms!

