

Political economy of the post-crisis economic growth and development model in Serbia

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Paul A. Samuelson, 2000

‘It is axiomatic, that always the affluent will hope to use their money power to resist populist demands to have the government help the masses, at their expense’

New Growth Model in Serbia – generic scenario

Area	Old model	New model
Main sources of growth	Demand, consumption, imports, Non-tradables Services	Investments, Exports, Tradables Manufacturing
Monetary and exchange rate policy	Appreciation of the dinar to absorb FDI and remittances	Depreciation of the dinar to lower ULC and boost exports
Fiscal policy	Expansionary in good times, led by increase in public sector salaries and pensions	Reduction in public spending and restructuring in favour of public investment
Sectoral policies, Institutions	Captured by interest groups	Supportive to sustainable growth

New growth model, generic scenario

- Significant reduction in public expenditures share in GDP and restructuring of public spending in favour of public investment
- Severe reduction in the share of pensions in GDP
- Depreciation of the dinar to promote exports
- Tax system reform to promote employment and growth
- Privatisation of key public enterprises to increase efficiency

Distributive consequences of (a generic) New Growth Model, consistently deduced

- Drastic reduction of public sector wages
- Drastic reduction in real pensions
- Consumer basket of the middle class hit hard;
- Business elite suffers huge capital losses;
- Progressive taxation of personal income hits middle and top class; worker families benefit from the increase in employment, not in real wages;
- Rent of political class reduced

New growth model – winners and losers according to generic scenario

Area	Winners	Losers
Monetary and exchange rate policy	Forex creditors Families on eurised incomes	Forex debtors Families on fixed incomes
Public expenditures reduction	Population at large in long term	Population at large in short term Public sector workers Pensioners
Sectoral policies, institutions	Population at large	Politicians, Tycoons

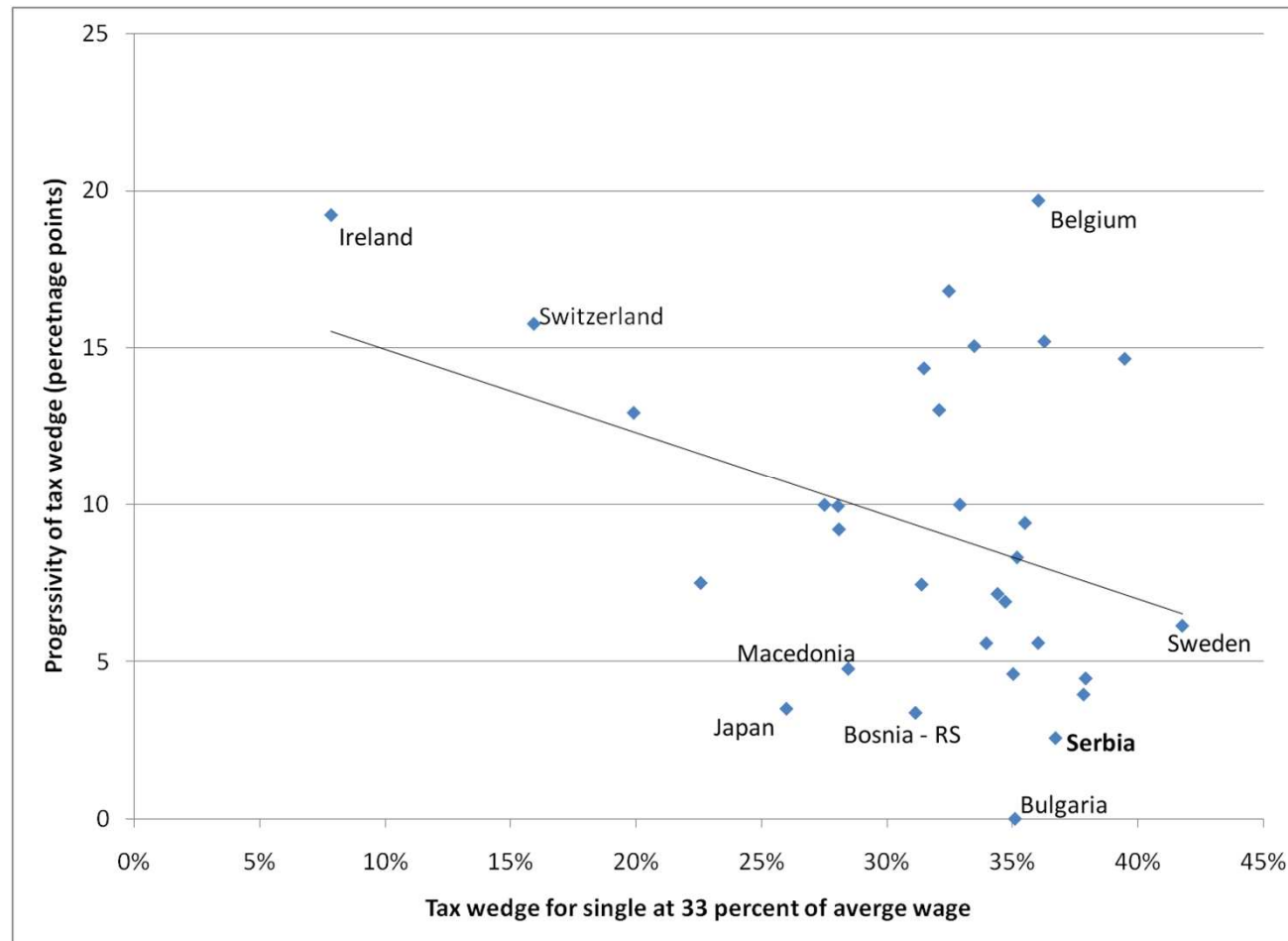
Post Crisis Model – operational scenario in Fiscal policy

- Primary goal: reduce fiscal deficit, not public revenues
- Limit public debt to max 45% of GDP introducing fiscal rules and Fiscal Council
- Restructure public spending – reduce public sector wage bill from 10 ¼ to 8 % of GDP and pension bill from 13 to 10% of GDP by 2015

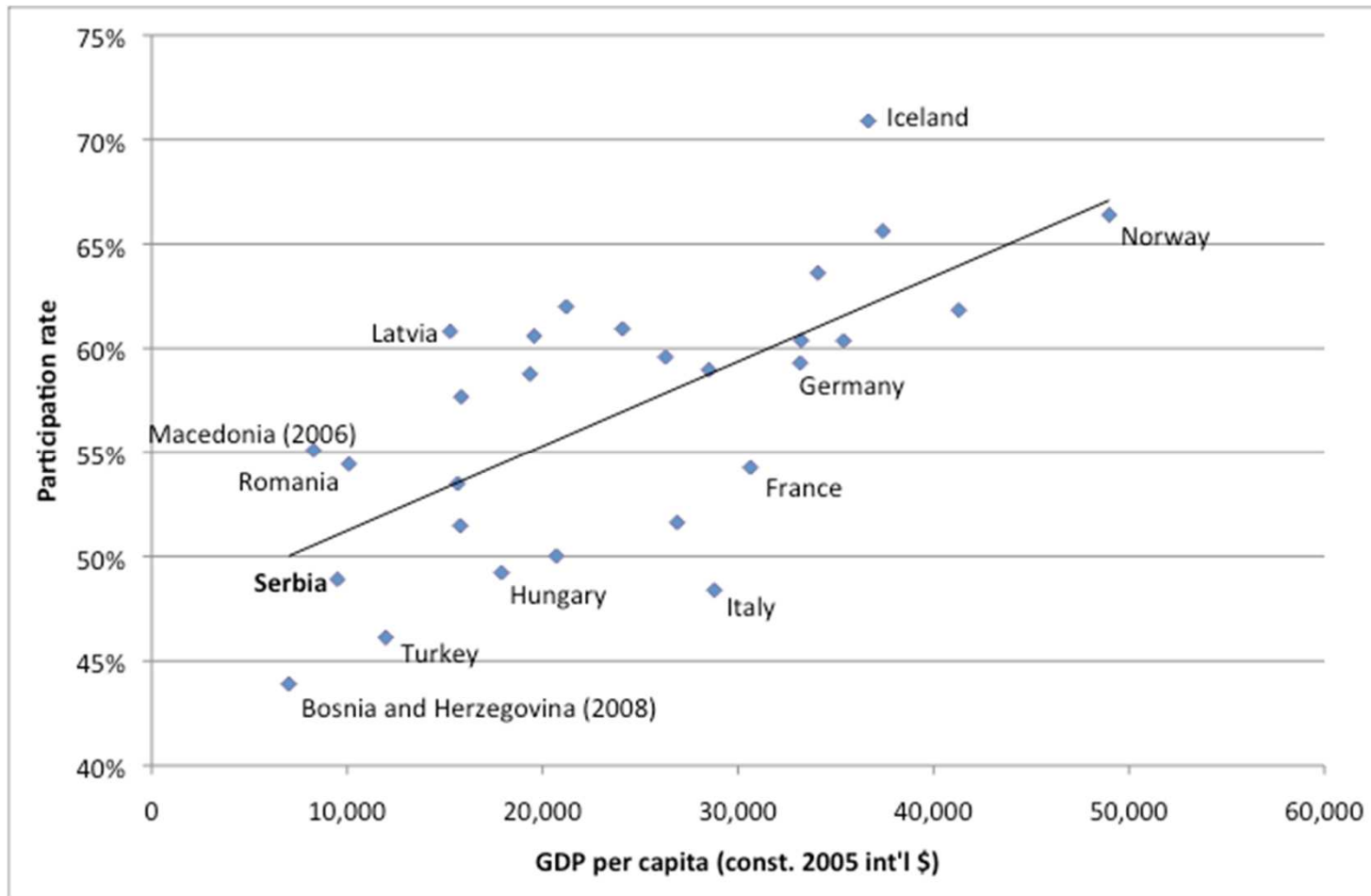
Revenue-neutral taxation reform according to Post-crisis model

- Reduce taxation of labour (reduce SSC burden by $\frac{1}{3}$ or $\frac{1}{4}$) – across the board tax reduction, every employee and employer is better off
- Increase taxation of consumption (increase VAT rates by 3 or 4 pp, from 18 to 21 or 22%)
- Allegedly, reform should boost employment and reduce consumption (press: ‘VAT increase against unemployment’)

Goals of labour tax reform: reduce tax wedge, increase progressivity



...Increase participation and employment



‘Post crisis’ taxation reform: who are the losers (ex ante static analysis)

- Absolute losers, by definition – families without formal employees – pay higher VAT, but no benefits from lower SSC:

Include: farmers, pensioners, other informal workers

- Relative losers: families with one formal employee, and more informally employed and dependants – the more children, the higher losses

Post-crisis Tax reform: Winners and losers, cont'd

- Likely relative winners: families with more formal employees and less dependants
- If losses and gains cancel each other in total, it is envisaged that the poor, vulnerable, old-age, informally employed, rural, deprived, multi-children families should subsidise and try to preserve living standards of formally employed, prime-age, well off, urban, childless and one-child families

Winners and losers if taxation reform within the Post-crisis model is implemented (Keynesianism for the rich, monetarism for the poor)

Area	Winners	Losers
Public expenditures reduction	Government	Population at large Pensioners Public sector employees Women
Taxation reform	Formally employed Public sector employees	Informally employed Pensioners Poor Children