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**INSTITUTIONAL UNDERDEVELOPMENTS AS THE OBSTACLE  
TO THE ECONOMIC GROWTH: RENT SEEKING SOCIETY IN SERBIA**

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**Abstract**

*The paper deals with the rent seeking preferences of the economic policymakers in Serbia which define their opportunistic motives in economic policymaking. Bearing in mind that, in broadest sense, rent seeking concept implies actions of individuals or interest groups on changing the public policy so that the income would directly or indirectly be distributed to their benefit, this in macroeconomics gives politicians the opportunity to collect rents for themselves or their close associates, using primarily the fiscal policy. Depending on conditions and characteristics present in an economy, rents can occur in different forms, such as salaries and other types of incomes of state officials or funds used for financing political parties. Since the process of rent seeking involves using political process, by individuals or groups, for the purpose of obtaining a share of other people's wealth, the motivation for rent seeking is directly related to the easiness with which the political process can be used for making profit on other people's account. Simultaneously, rent seeking is also influenced by general social and economic terms of existing corruption and monopole privileges, which provide the politicians with vast opportunities to obtain different forms of rent. Exactly these characteristics are present in Serbia and for this reason the incumbents' in Serbia can be considered "rent seeking" politicians; they are interested not only in winning the elections, but in getting tangible rents for themselves when they are re-elected and when they can exploit their political power. It is possible to notice certain significant episodes in the pre-electoral use of economic policy in Serbia since 2000. Elements of political motives can even be observed in the model of economic growth that has been applied, which has been based on the aggregate demand, and on one of its components - domestic demand. The socio - economic conditions in Serbia, including underdevelopment of the institutions that enable rent seeking activities are the key obstacle for the achieved economic growth.*

**Keywords:** rent seeking, new democracy, corruption.

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**Review**

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**1. Introduction**

Macroeconomic models recognize two political motives which determine the behavior of policy makers: the opportunistic and the partisan. The opportunistic motive for policymakers is reflected in their preference to remain in power, or to come to power. The partisan motive of the economic policymakers involves the use of economic policy in order to implement certain partisan - ideologically motivated economic goals. While partisan motivation results from ideological differences between the parties (generally the right-wing and the left-wing ones), opportunistic behavior erases the ideological differences regarding economic goals of the political parties in power. Thus, when they are in the position to create economic policy, they behave similarly - generating political macroeconomic cycles. These cycles generally imply expansionary fiscal, and in the economies with insufficiently independent central bank, also expansionary monetary policy during the election period, regardless of the ideological orientation of the party in power.

The existence of "political business cycles" means that the politicians in power are rewarded for improved economic performance - a "strong economy" (e.g. economic growth or lower

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unemployment rate) by increased chances of winning re-elections. It is assumed that they are able to implement the pre-election monetary and fiscal expansion in the right moment so that the positive effects occur just before the elections, while the negative consequences (e.g. inflation) are generated after the elections. There is also the condition that the voters are characterized by some form of limited rationality or have restricted access to information (information asymmetry). This allows the economic policymakers not to be punished for their pre-electoral economic policy manipulation, because they manage to conceal it and present it as a part of their own competence. In order for this to be realized, apart from the politicians prone to manipulation, it is essential that the voters are insufficiently experienced and do not know the motives and methods of electoral economic policy manipulation.

In addition to the many specific characteristics of political macroeconomics in transition economies, which include more prominent pre-election economic policy manipulations, especially fiscal policy manipulations through political budget cycles, than in the developed market economies, which are also the countries with developed democracy, in transition economies, the opportunistic behavior of the policymakers is present more often than the partisan behavior (Akhmedov and Zhuravskaya, 2004, Brender and Drazen, 2002, 2005, Persson and Tabellini, 2003, Shi and Svensson, 2002, 2006). The differences originate primarily from the fact that these are the "new democracies" whose political, as well as economic, institutions are insufficiently developed. Therefore, parallel to the process of economic transition, these are also undergoing the process of democratic consolidation. In many countries, an additional force for these processes originated from their striving to join the European Union, which required the introduction and stabilization of democratic norms and institutions (Cichowski, 2000, p. 1249).

In the literature, it is well known that the development of a market economy doesn't require the existence of a democracy, whereas the development of a democratic system requires the existence of a market economy. However, empirical evidence on transition economies shows that the development of democracy results in increased support for market economy, while the opposite is not true - market economy does not result in the support for the development of democracy (Grosjean and Senik, 2008). Therefore, the process of consolidation of democratic systems in transition countries is viewed as one of the important prerequisites for the development of market economy, and economic reforms should be conducted in order to consolidate the democratic system which also includes the construction, implementation and development of specific democratic institutions (Acemoglu and Robinson, 2006).

Table 1: The success in the processes of economic transition and democratic consolidation in 2011

Country	Democratic Score <sup>1</sup>	Regime Classification	Transition indicators <sup>2</sup>
Albania	4.04	Transitional Regimes	3.50
Armenia	5.43	Semi-Consolidated Authoritarian Regimes	3.44
Azerbaijan	5.43	Semi-Consolidated Authoritarian Regimes	2.89
Belarus	6.57	Consolidated Authoritarian Regimes	2.11
Bosnia	4.32	Transitional / Hybrid Regimes	3.05
Bulgaria	3.07	Semi-consolidated Democracy	3.72
Croatia	3.64	Semi-consolidated Democracy	3.72
Czech Republic	2.18	Consolidated Democracy	/ <sup>3</sup>
Estonia	1.93	Consolidated Democracy	4.05
Georgia	4.86	Transitional Regimes	3.50

<sup>1</sup> Rating scale is from 1 (the highest level of democratic progress) to 7 (the lowest level of democratic progress).

<sup>2</sup> EBRD's measure of progress in reform includes in 2011 six transition indicators: large scale privatization, small-scale privatization, governments and enterprise restructuring, price liberalization, trade and foreign exchange system, competition policy. The scale is 1 (the lowest level of transition progress) to 4.33 (the highest level of transition progress).

<sup>3</sup> There is no transition indicator for the Czech Republic since it "graduated" from the EBRD at end 2007.

Hungary	2.61	Consolidated Democracy	4.05
Kazakhstan	6.43	Consolidated Authoritarian Regimes	3.06
Kyrgyzstan	6.11	Consolidated Authoritarian Regimes	3.39
Latvia	2.14	Consolidated Democracy	3.89
Lithuania	2.25	Consolidated Democracy	3.94
Macedonia	3.82	Semi-consolidated Democracy	3.55
Moldova	4.96	Transitional Regimes	3.28
Montenegro	3.82	Semi-consolidated Democracy	3.22
Poland	2.21	Consolidated Democracy	4.00
Romania	3.43	Semi-consolidated Democracy	3.67
Russia	6.18	Consolidated Authoritarian Regimes	3.22
Serbia	3.64	Semi-consolidated Democracy	3.17
Slovakia	2.54	Consolidated Democracy	4.05
Slovenia	1.93	Consolidated Democracy	3.61
Tajikistan	6.14	Consolidated Authoritarian Regimes	2.89
Turkmenistan	6.93	Consolidated Authoritarian Regimes	1.67
Ukraine	4.61	Transitional Regimes	3.28
Uzbekistan	6.93	Consolidated Authoritarian Regimes	2.28

Source: Freedom House, EBRD

The opportunistic models of political macroeconomic cycles, which are, precisely because of the preferences of the politicians in unconsolidated democracies and overall political and institutional characteristics of these countries, considered dominant over the partisan model, recognize the possibility that in the pre electoral period the economic policymakers manipulate policy instruments - primarily fiscal policy (e.g. increasing the supply of public goods without increasing the tax burden). In this way, the politicians in power send signals to the voters about their own competence, increasing the chance of winning re-election. It is assumed that the partisan - ideological differences do not exist or are negligible.

In pre-electoral period, fiscal manipulation is more present than monetary manipulation, primarily because monetary policy is left to the independent central bank, and because low and stable inflation appears as a generally accepted economic policy objective, which is best guaranteed by a central bank that does not use monetary expansion. In such circumstances, the politicians in power are left with fiscal policy as a possible source of manipulation - by generating political budget cycles. Fiscal policy provides an opportunity to target pre-election manipulation towards specific groups of voters (structures of the electorate), with the aim of winning them over. Therefore, instead of macroeconomic expansion, the expected form is fiscal expansion through the expansion of certain fiscal expenditures, or reducing certain tax burdens. This allows avoiding significant budget deficits, which are always a reason for punishing the politicians in power, thus pleasing the voters who are "fiscal conservatives"; and changing the structure of government expenditures is attributed to the effectiveness and competence of the government.

The reasons for the lack of clear ideological differences between political parties in the post-communist countries can be partly attributed to the fact that the politicians have opportunistic motives and smother their ideological differences with the aim to remain in power, or to come to power; and partially, it can be attributed to the fact that, when deciding in elections, the voters pay less attention to the ideological orientations of the parties than the voters in consolidated democracies (Van der Brug, et al., 2008). Instead of ideological orientation, political profiles of the parties in these countries are determined by other important factors, such as their religious or national affiliation. In part, the reasons for such behavior can be found in the previous repressive regime in which these issues were put aside, so that the wave of democratization also produced the awakening of religious and national feelings in these countries. This process is related to the process of disintegration of multinational socialist states and the formation of national states (Czechoslovakia, the USSR and Yugoslavia). In this case as well, the country's commitment to European integration with the imposed standards of democratic norms and institutions facilitated

the formation of national states and alleviated the nationalist orientation, of course, resulting in a more rapid economic development.

In the opportunistic models that primarily explain the manipulation of economic policy in the "new democracies", the most prominent are those in which the opportunistic behavior of the policymakers occurs as a result of their motivation to stay in power so that they can remain in the position to appropriate the rents. Such opportunistic behavior of the policymakers is motivated by their rent-seeking activities, but it also results in similar aspirations of the opposition politicians. This further reduces the ideological differences between political parties, primarily focused on opportunistic behavior, the key motive being remaining in / coming to power when they will be able to appropriate significant rents. The prerequisites for this are that the political process, the level of development of the institutions and the general socio-economic conditions allow for the appropriation of various forms of rents because the rent seeking process involves the use, by individuals or groups, of the political process for the appropriation of a part of the wealth of others. The motivation for rent seeking activities directly depends on the ease with which the political process can be used to achieve gains at the expense of others. Particularly important factors are the presence of corruption and monopoly privileges, in which the politicians in power have significant opportunities for the appropriation of various rents. These characteristics largely correspond to unstable democracies, rather than the developed democracies.

## 2. Economic Policy and Preferences of the Politicians in Serbia

Serbia, as a country whose economy is in transition, and simultaneously in the process of consolidating the democratic system, is characterized by the aforementioned specifics of political macroeconomics applicable to "new democracies". The most important ones are related to the dominantly opportunistic behavior of the policymakers - often motivated by rent-seeking activities, extreme political instability that has for years reflected in frequent political elections (at various levels - from local, parliamentary, to presidential). Lack of political distinction between the parties is another feature of the political process in Serbia, with significant consequences for economic policy. This lack of distinction is especially true of unclear economic programs and economic goals of the political parties in Serbia, which impedes a clear differentiation between the left-wing, the right-wing and the center parties (Table 2).

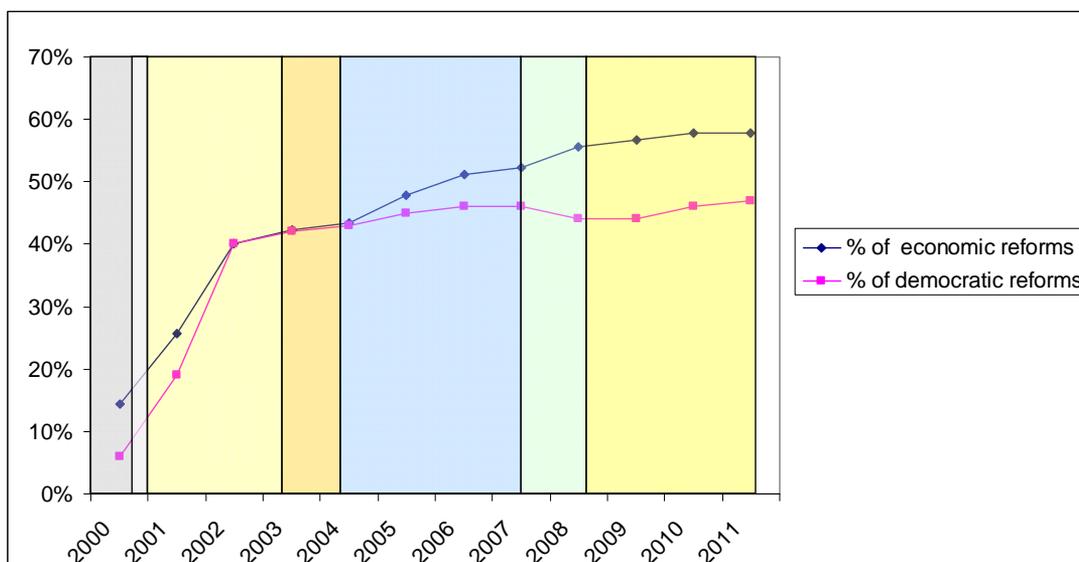
Table 2: Ideological orientation of the political parties in Serbia

<i>Political party</i>	<i>Ideological orientation/Economic goals</i>
Democratic party	centered – left-wing party; market oriented with modest government intervention primarily to reduce market failures and in order to overcome economic crisis
Serbian progressive party	right-wing party; national oriented; market oriented with significant government intervention primarily to reduce market failures and inequality
Socialist party of Serbia	left-wing party; national oriented; significant government intervention primarily to reduce market failures, inequality and in order to overcome economic crisis
G 17 plus	center party; market oriented with significant government intervention primarily to reduce market failures and in order to overcome economic crisis
Democratic party of Serbia	right-wing party; national oriented; market oriented with significant government intervention primarily to reduce market failures and in order to overcome economic crisis
Liberal democratic party	right-wing party; market oriented
Serbian radical party	right-wing party; national oriented; market oriented with significant government intervention

The fact that elections are won or lost depending on the economic results achieved has its specifics in Serbia, especially in connection with the slowdown of economic reforms which have occurred precisely because of the populist campaign promises and measures taken, as well

as the due to the fact that the governments in Serbia so far have lacked clear ideological and political orientation in the field of economy. The slowdown of reforms is a direct consequence of the lack of social consensus on the allocation of transition costs, as well as on the economic objectives that need to be implemented. Therefore, abandoning reforms paradoxically appeared as a way to win elections.

Table 3: Percentage achieved in transition indicators and indicators of democratic reforms in Serbia<sup>4</sup>



Sources: EBRD and Freedom House

If the economic policy in Serbia since 2000 is observed through the assumptions of political macroeconomics, it is possible to notice certain significant episodes in the pre-electoral use of economic policy - especially fiscal policy. Elements of political motives can even be observed in the model of economic growth that has been applied, which has been based on the aggregate demand, to be more precise, on one of its components - domestic demand, whose growth has exceeded the GDP growth, and has primarily been financed by foreign capital inflow based on privatization and loans. Growth generated in this way, although significant on average - about 5.5%, resulted in internal and external imbalances that are even more significant if one takes into account the industrial aspect of growth in which three industries (trade, transport and telecommunications, and financial services) the non-exchangeable goods, contributed to about 75% of the overall economic growth. This testifies that there has been no clear strategy of transition and economic growth, but accidental economic developments, which the government tried to influence in the pre-electoral periods, without significant long-term outcomes. This model of growth, however, allowed fast growth of living standard above the rate that would correspond to real economic growth, increasing the chances for the economic policymakers to stay in power. Political manipulation of the economic policy in Serbia has been grossly limited by the necessity of maintaining macroeconomic stability, primarily through the goal of maintaining low inflation rate, and intensifying the economic and political reforms that had been started.

<sup>4</sup> Total scale of progress in transition according to the EBRD transition indicators goes from 9 points (0% achieved reforms) to 38.97 points (100% achieved reforms). Rating scale for democratic score is from 1 (the highest level of democratic progress) to 7 (the lowest level of democratic progress).

Since the parliamentary elections in 2001, all the governments in Serbia have been coalition governments, characterized by the existence of multiple coalition partners (these have mainly been the pre-electoral coalitions) of different ideological orientations. Coalitions have usually gathered around the common goal of coming to or staying in power, and much less around common political or economic goals.

In the period immediately after the political changes in 2000, the key objectives were economic and political reforms. It is therefore not surprising that the first coalition government had the most results in the implementation of reforms until March 2003, according to the transition indicator (EBRD) and the indicators of democracy (Freedom House). Nevertheless, this period was characterized by extreme political instability that ended in the assassination of the Prime Minister in March 2003. At the same time, public support for reforms was sinking, so that the results of political elections in Serbia since 2002, at different levels, indicate the declining voter support for the pro-reform and pro-European forces, imposing a significant fear of a return to previous policy. In these circumstances Serbian political elite made decision to postpone major reforms (this can be seen in the work of the second government (since 2004)), and to chose more populist economic policy in order to "purchase" voters' support in elections, primarily by fiscal policy (Prascevic, 2008).

Although the political abuse of economic policy was justified by preventing the return of former political powers and to earlier policies (prior to October 2000), already the second coalition government (minority government) was support by a party that had been the ruling party until 2000. Thus, these differences were slowly blurred, and the latest government (2008) was formed by the parties that until 2000 had been key political rivals, who previously signed "an agreement on political reconciliation" in October 2008. Another important political event that affected Serbian political scene also took place in autumn 2008 when the largest opposition party until then - Serbian Radical Party split, and it had been the key holder of anti-reformatory and anti-European ideas. After that, a new party was formed, which has since become the strongest opposition party, but with a new rhetoric in connection with the reform process and EU accession. Along with this "rapprochement" of political rivals, despite the highly unfavorable economic developments in Serbia (high unemployment, occasional threats related to the growth of inflation, slow economic growth) due to the impact of the global economic crisis on Serbian economy, and the wrong model of economic growth based on consumption – again as the simplest way to implement populist economic policies in order to stay in power, the key issues that determine the voters choice are still political (EU accession and the attitude towards solving the problem of Kosovo).

The political abuse of economic policy in Serbia related to fiscal policy because the shifts in fiscal policy precisely coincided with electoral cycles in Serbia and with great political instability in the period from 2006-08 (parliamentary elections announced in November 2006, Parliamentary elections in January 2007, new government formed in May 2007, Parliamentary elections announced in March 2008, and parliamentary elections in May 2008, new government in July 2008). Expansive fiscal policy in the previous period was related precisely to those elements of fiscal expenditures which prove the hypothesis of political budget cycles with a specific feature of discretionary use o privatization revenues for government expenses. The pre-election period saw a significant growth of the so called discretionary public spending - public investments, subsidies, budget loans and the like.

In 2006, the government started the implementation of the *National Investment Plan*, financed by privatization revenues with the aim of financing public investments into four sectors – education, health, infrastructure and economy. In the medium term, all these investments should have led to positive results for the production potential of the country, and thus for future budget revenues. In the period between 2006 and 2008, there were the following changes in fiscal expenditures and revenues, which were rooted in politics:

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- significant increase in the salaries in public sector during the electoral years 2006 and 2007,
- launch of the National Investment Plan in 2006,
- subsidy programs for enterprises (small, medium and those that were being restructured) in 2006,
- reduction of income tax and the introduction of non-taxable earnings in 2007,
- reduction of some tax rates - tax on transfer, VAT for certain products, total exemption from payment of VAT for first time home buyers in 2007.

Fiscal trends in Serbia also proved that the amount of public debt is positively correlated with the degree of political polarization between different governments, the length of the mandate of the government and the prospects that the government is not re-elected (Alesina and Tabellini, 1990). The political polarization imposed the budget deficit in Serbia as the *strategic variable*, by which the current government affects the future government's fiscal policy. The deficit in Serbia extended with the following:

- an increase in the degree of polarization,
- an increase in the degree of uncertainty.

### 3. Specifics of Rent Seeking Preferences in Opportunistic Models

In order to implement rent seeking preferences in opportunistic models it is necessary to consider to which extent can political representatives use their political power to appropriate rents for themselves at the expense of the voters, and to what extent the voters can change incentives of politicians to make rent-seeking activities more inadequate?

Models can assume that the budget constraints apply to the use of tax revenues for government expenditures ( $g$ ) and "rents" ( $r$ ) appropriated by politicians in various ways - through funding the parties in power to private use of a part of resources when providing public goods (Persson and Tabellini, 2000, p. 70).

$$\tau y = g + r,$$

$$0 \leq r \leq \bar{r}, \quad \bar{r} = y$$

(constraint for the amount of rents appropriated by politicians is tax basis)

Whether the politicians will choose an optimal policy for elections from the voters' perspective (low taxes, without appropriating rents), or the policy of high taxes and substantial rents, depends on numerous factors, among which the most important ones are:

- the extent to which the politicians are forced to realize the policy they announced after coming to power,
- the extent to which there are ideological differences between the political parties participating in elections.

The most favorable results for the voters are achieved in a situation where political parties are in advance committed by the policy they announce when participating in elections. The policy in this case being fiscal policy, namely: the amount of tax and the amount of government expenditures. It is assumed that all voters do not prefer the rent that would be appropriated by politicians and that there are no ideological differences between the political parties competing in the elections (they are perfectly substitutable). In this case, no political party will be motivated to go before the voters with the policies of higher taxes and positive rents, which would automatically turn the voters to vote for those political parties that offer lower taxes and do not appropriate rents. This provides optimal result (efficient equilibrium) for the voters, because the award of winning elections for the politicians is so significant, that they will be honest in disclosing their policy.

However, if there is no effective electoral competition between the parties, this will enable the appropriation of rents. The inefficiency of competition in this case refers to the prominent ideological differences between the political parties that compete in the elections and the ideological preferences of the voters themselves. This prevents substitutability between political parties and the parties can even come forward with a platform of fiscal policy in which taxes are higher, with the appropriation of rents. Even in a situation of complete transparency, since the political parties are not complete substitutes, the fiscal policy announced is not the only factor that determines the election results. (Table 5)

Table 5: Results in fiscal policy and rent appropriation

<i>Specifics of political parties commitments</i>	<i>Specifics of political parties related to ideological differences</i>	<i>Results in fiscal policy and rent appropriation</i>
Political parties are in advance committed by the announced policy and complete transparency	No ideological differences between parties (perfectly substitutable)	Optimal result (efficient equilibrium) for the voters – efficient taxes without rents
Political parties are in advance committed by the announced policy and complete transparency	Substantial ideological differences between parties (no effective competition – they are not complete substitutes)	Inefficient fiscal policy – high taxes and appropriation of rents

Another important factor in determining the election results, but also in formulating fiscal policy, which is announced by the political parties, is a number of voters who are ideologically committed, i.e. the number of voters who are not ideologically committed, and who will change their preferences regarding political parties and punish the political party which announces the policy of higher taxes and which wants to generate - appropriate rents. This creates electoral uncertainty, resulting in a situation where the higher the uncertainty (uncertainty about who will win the elections) the greater the tendency for the appropriation of rents. Also the increase in rent seeking motives of politicians is affected by the reduction of transaction costs related to the appropriation of rents, with the costs being the costs imposed by the transparency of budgetary and administrative procedures. In this case, rent-seeking motives of the politicians occur as a result of uncertainty regarding the election results. The voters at the same time receive an optimal amount of public goods, but pay higher than optimal taxes. With this margin, the politicians appropriate rents. High rents and inefficient government expenditures are associated with the ideological dispersion and electoral volatility.

These aforementioned two results occur in situations where politicians are in advance committed to the policies that they announce during the election campaign. However, it is more realistic to assume the possibility of discretionary decisions of the politicians after the elections, which then change their policy with the aim to increase taxes and appropriate rents. First, we can assume that there are no ideological differences. The cost of transforming private output in the public goods is also introduced ( $\theta$ ), so that the state budget constraint becomes (Persson and Tabellini, 2000, p. 74):

$$\tau y = \theta g + r,$$

The higher value of the variable  $\theta$ , the more expensive is the public goods. The value of the variable  $\theta$  is realized after the elections by the winner.

Since the political parties announce their political platforms in advance, when the cost of providing public goods is not fully known and since it is externally determined it influences the amount of efficient tax, in a manner that the amount of effective taxation grows with its growth.

If we assume that there is a possibility that the winning political party is forced to keep the promises, in a manner that the one that tries to break the promises could be stopped: and we

also assume that the costs of providing public goods are transparent, but also verifiable, the voters will prefer the political party that provides them with the greatest expected usefulness, taking into account the expected value of the expenses for providing public goods. Political parties thus offer voters a contract that can be fully enforced, and a combination of enforcement, verifiability and electoral competition is sufficient to ensure effective policy. If, on the other hand, the expenses for providing public goods are not verifiable, then the condition that it is possible to force the political party to keep the promise is not sufficient. Namely, the post electoral motives may take the winner into a position where even though the costs of providing public goods are low, the winner can claim that they are extremely high. Such a politician - the winner of the election puts this difference in his pocket in the form of rent. The more public activities whose costs cannot be verified, the more pronounced the tendency towards rent-seeking. Therefore, rent seeking is more prevalent in the countries with greater political instability, while the politicians prefer the non-transparency of public activities in order to deceive the voters and appropriate rents.

However, the most unsustainable assumption is that related to the possibility that the elected politicians are forced to implement the policies that they have announced. Taking into account the competencies that they have, it is highly unlikely that any judicial body can compel them to do so. In such circumstances, with the absence of external imposition for the winners in the elections to comply with the campaign promises regarding fiscal policy, the voters will suffer catastrophic consequences.

#### **4. Corruption and Rent Seeking Preferences of the Politicians in Serbia**

Opportunistic behavior of the policymakers in Serbia in the period since 2000 is evident. It, however, is not only motivated by the desire to remain in power, or in the case of opposition parties to come to power, and to thereby provide an opportunity to influence the political decisions concerning political and economic future of the country. Another, more practical and tangible motive is the opportunities that the politicians who come to power have at their disposal various forms of appropriation of rents.

The socio - economic conditions in Serbia that enable rent seeking activities are following:

- underdevelopment of the institutions,
- inefficiency of the legal system,
- underdevelopment of democratic procedures,
- the presence of monopolistic structures in the markets,
- weak antimonopoly legislation,
- the specifics related to the functioning of coalition governments where portfolios are distributed among the coalition partners,
- management of public enterprises is executed based on the distribution between the coalition partners at the state administration level,
- the parties influence on the work of regulatory bodies and agencies.

Similar factors that operate at the state national level, are also present at the local government level (municipal authorities and local public enterprises), as well as in the relationship between state national and local government levels.

An especially important role in encouraging rent seeking activities in Serbia is attributed to extremely pronounced corruption (Shleifer and Vishny, 1993), which is considered the key issue in Serbia. The smallest progress in the democratic reforms in Serbia has been made in the area of eradication of corruption and it can be compared only with the slow reforms of the legal system, the two interconnected segments of democratic reforms (Table 6). According to the indicators of reform progress in the judicial framework and independence and corruption, comparing to the overall democratic score, we can find that these reforms are far behind all other democratic movements in Serbia. However, corruption is not only a constraint for the development of a

democratic system and a social problem, but it is essentially an economic problem which leads to a significant redistribution effects.

Table 6: Indicators of progress of certain democratic reforms in Serbia

Year	Judicial Framework and Independence	Corruption	Democratic Score
1999-2000*	5,75	6,25	5,67
2001	5,50	6,25	5,04
2002	4,25	5,25	4,00
2003	4,25	5,00	3,88
2004	4,25	5,00	3,83
2005	4,25	5,00	3,75
2006	4,25	4,75	3,71
2007	4,25	4,50	3,68
2008	4,50	4,50	3,79
2009	4,50	4,50	3,79
2010	4,50	4,50	3,71
2011	4,50	4,25	3,64

Source: Freedom House

\* Data in the period before 2004 are given for Yugoslavia (Serbia and Montenegro).

Corruption in Serbia does not result from the erosion of moral principles, but the result of an abuse of power by state officials with the aim to obtain their own benefit. This directly leads to a redirection of resources into rent seeking activities, with the effects of a significant decrease in efficiency and slowing down economic growth. In general, the concept of *rent seeking* involves actions of individuals or interest groups with the aim to change public policies in order to directly or indirectly redistribute income in their favor. These activities are related to:

- changes in tax structure,
- changes the structure and components of government expenditures, changes in overall state regulation within the economic system.

Depending on the conditions and characteristics that are present in an economy, rents may occur in various forms, such as salaries and other forms of income for public officials, or funds for financing political parties. Rent seeking is supported by overall socio-economic conditions with underdeveloped institutions and corruption, which facilitate the abuse of policy for the benefit of individuals or interest groups.

Viewed in the context of political macroeconomics, opportunistic motivation of politicians can be determined by the desire to come to power or to stay in power, in order to implement rent seeking activities and obtain additional financial benefit. Rent seeking activities are aimed at generating some form of monopoly or special position for business entities, and in the case of political macroeconomics, it is a special position that political parties wish to achieve that would enable them to obtain financial and political benefits that they otherwise would not have had. Of course, the necessary condition for this is for them to be in power. This is why they are willing to use additional resources to achieve their goal. These rent seeking activities might be related to improving the position of some interest groups, or individual structures of the electorate, who in turn, would supported the politicians in the elections and facilitate their victory.

A special segment of the rent seeking activities in Serbia is related to interest groups. Interest groups are interesting to politicians in the pre-electoral campaign because their individual (special) interests can be met, by generating significant benefits for individual members of the interest groups and imposing small costs on other voters. If certain policy imposes small additional cost to voters, and in addition they have difficulties to recognize that policy, they will not be

interested in punishing the politicians who satisfy interest groups. On the other hand, the politicians who want to achieve victory in the elections will be motivated to support the realization of the interests of the interest group members, using state funds (through fiscal and monetary policy), and in return they will gain the support and financial assistance of certain interest groups to win elections.

In this context, rent seeking activities imply the use of the political process by individuals or interest groups in order to acquire wealth at the expense of others. The easier the abuse of the political process, the greater the motivation for rent seeking activities are. Factors that could reduce the motivation for rent seeking activities and diminish the possibility of appropriation of rents are following:

- effectiveness of the legal system,
- minimal state interference in the functioning of the economic system (the introduction of trade barriers, employment assistance, provision of subsidies, price freezes, discriminatory tax policies)
- eradication of corruption.

Corruption occurs in many forms, but is disastrous for an economy, especially the one that is linked to the so-called predatory regulation, in which the state creates regulations by which it actually encourages entrepreneurs to evade the regulations by bribing government officials.

Rent seeking activities of the politicians in Serbia are related to the following major sources of corruptive behavior:

- specifics of the non-reformed public sector functioning,
- public procurements,
- measures to stimulate economic activities, especially investments,
- provision of public goods.

Each of these provides opportunities for the appropriation of rents by politicians/political parties in power at local or national level. Specifics of the political process that enable significant abuse by political parties, characteristic for the party-cratic countries where political parties dominate all segments of the society, causing significant politicization of Serbian society, and provide a significant appropriation of rents as a key motif of members of political parties to participate in political life. This, however, is not only true for the most senior leaders of political parties, but for the "ordinary" members as well, who expect some form of privilege based on their party affiliation. Many of these privileges are related to the public sector, which has not undergone proper reform in Serbia since the 1990s.

According to law, public enterprises in Serbia should perform activities of common interest, and should be established by the state or by local governments (Law on Public Enterprises, 2000). However, the political process in Serbia and the method of governance in public enterprises has led to the fact that these primarily have partisan functions – employment of party members, allocating significant financial resources, the appropriation of funds in partisan purposes (financing parties), political influence on the society and the results of future elections. Each of these forms is directly associated with some form of appropriation of rents by the political elite.

The extent of the impact of politicization of public enterprises on the overall economic trends is sufficiently indicated by the number of employees in these companies comparing to the total number of employees in Serbia. Public sector institutions in Serbia are still a significant employer, about 20% of the labor force (2008) is employed in the public sector. The politicization of public enterprises implies that the management of these enterprises works in the interest of political parties and individuals close to political parties. By definition, the management of these companies is the responsibility of the Government of the Republic of Serbia (it founds, manages

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and is responsible for the results of these companies). However, in practice, the management of these companies appears as a part of political bargaining between the coalition partners who, similar to the division of ministries in the government, also distribute management positions in public enterprises among political winners in elections. Therefore, public enterprises appear as the subject of the post-election coalition agreements, whereby the efficiency of the management and accountability for the results achieved in these companies is of secondary importance, and the citizens of Serbia are led to a conclusion that a position and a job in these enterprises is not obtained based on someone's qualifications and skills but solely because of their party affiliation.

Compared to the time in the 1990s when it was dominated by one political party Socialist Party of Serbia, management of public enterprises has not significantly changed even after more than a decade of intense economic and political reforms. Namely, the key criterion for the important functions in the public sector in Serbia is affiliation with the ruling political party. The same goes for their internal structure, so that even lower positions, even simple jobs require proper party affiliation (this is true for the entire public sector, not just public enterprises, but for all public services - hospitals, schools and other, as well as for civil servants in ministries and local government).

Given that unemployment is the biggest economic problem in Serbia, and that in some cities and regions in Serbia people are only employed in public administration or public companies, this results in a particularly privileged position of those employed in this sector, which raises the question of possible corruption and other non-transparent ways of hiring. Since economic trends do not provide a chance to the working age population to become employed, public sector employment in state administration can be considered a privilege, and given the specifics of the work contracts of the employees working in this sector, their position can be considered a monopoly, and attempts to become employed in this sector may be considered equal to rent seeking activities (and the earnings they get as a form of rent).

Employment in the public sector and public administration provides job security, social status and fair remuneration. Particularly attractive jobs are those in the newly formed state regulatory agencies. The attractiveness of employment in the public sector is shown in the fact that 16% of the citizens or their family members tried to get a job in this sector (for the three years preceding the survey), 23% of them got the job, and of those who get a job as many as 6% admitted to have given money, a gift or some other service to get the job. The recruitment procedures in this sector are characterized by a distinct lack of transparency indicated by the fact that 66.1% of those who did not get a job considered that this was due to nepotism or cronyism, and additional 14% believe that those who were hired had given bribes. Only 8% think that someone else had better qualifications and qualities to get the job (Vukmirović, D., et al., 2011, p. 29).

An important factor that facilitates political abuse of public enterprises and the public sector in general is the institutional underdevelopment, which implies absence of an appropriate set of rules, regulations and institutions that would ensure realization of public interests, prevent the influence of private interests and decentralized centers of power. The lack of legal framework and institutional arrangements in Serbia impedes efficient public sector management. Three sets of institutions are important: a) property rights over public enterprises, b) rules on transparency, and c) effectiveness of the control mechanism.

In addition to the politicization of public enterprises, public procurements appear as a particularly important source of rent-seeking activities in Serbia. In 2010, these amounted to EUR 2.6 billion, or about 10% of the GDP. They are also a major source of corruption, although the legislation has dealt with this area for several times since the year 2000 - the Public Procurement Act, 2002, the Amendments from 2010 and the preparations for the latest amendments to the Act. During the 1990s, this area was unregulated, with remarkable inefficiency in spending money, a limited number of companies that had the privilege of working with the state, so the competition almost never existed, and the whole process of selecting, contracting and execution was not transparent.

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The reforms in this area began with the adoption of the Act and other bylaws that should regulate this field in such a way as to prevent cases of "grand corruption", and so that the legislation is brought closer to that present in the EU. The basic requirements were the demands that the public procurements (tenders) are advertised in the media, that the procedure for selecting the best bidder is transparent, that as many bidders as possible compete in tenders, and that the number of concluded and executed contract is increased. The public procurement system included three important elements: a) preparation for public procurement, b) the procurement procedure with the selection of the best bid and concluding the contract, and c) execution of the contract. The system was decentralized so that each procurer defines their needs and executes the procurement procedures (Jovanović, P., 2005).

Two institutions were responsible for effective implementation of the Act and public procurement procedures: the Public Procurement Office and the Commission for the Protection of Bidders Rights. Improvements as compared to the previous period (to 2002) were evident, increased transparency in public procurements, which led to a greater number of bidders in a tender (in 2002 on average of 7.5 bidders participated, in 2003, 8.5 bidders, prior to the enactment of this Act on average less than 3 bidders participated). Thus, savings have been made in terms of expenditure – the reduction of inflated prices due to corruption and the like.

However, the next stage which implied increased discipline in the application of the Act, further improvements in the implementation of the regulations, greater involvement of relevant institutions, strengthening the capacity of relevant institutions for the realization of public procurements, were not fully implemented. Instead, there were "loopholes" that were then used as sources of corrupt activities, given that public enterprises and public sector institutions were managed by the party cadres, public procurement became a key source of rent-seeking activities that resulted in the realization of private interests of certain interest and privileged groups of businessmen, as well as private interests of politicians and entire political parties – through a specific form of their non-transparent and hidden financing.

The abuses associated with rent seeking can be noted in all three phases of public procurement:

- the procurers exaggerate when determining their needs (in terms of the properties, quality and quantity of goods, services and works), leading to unnecessary expenses because of the lack of control in terms of the justification of the public procurement,
- in the public procurement procedures, there is the problem of fixing the bidders, thus reducing competition, and bidders are not properly enticed to offer the best bids (so that big bids are broken up into several small bids that require a simplified and less transparent process, or where it is possible that a minimum of three bidders bid on the basis of internal request, not a public tender), the bidders agree in advance about their bids, and often these are related parties, tenders are fixed, and a phantom company gets the job,
- in the execution of the contract phase, the Act, the Directorate for Public Procurements, and the Commission for the Protection of Bidders Rights are not significantly involved, and this provides considerable opportunities for some corrections in the already concluded contracts in terms of quantity and quality of the goods and services offered, which means that the elements of contracts are evaded and costs are increased; costs are multiplied by means of annexes to contracts.

After 10 years since the first implementation of the Law on Public Procurement, it is evident that this area is highly corrupt, and that this is an area where institutional changes are necessary. The Law on Public Procurement is not sufficient, if not accompanied by appropriate legislation in the form of the law on concessions, the law on public private partnerships and the like.

As a special form of corruption, we can observe that related to the electoral process. Consolidation of democracy means having relevant processes related to the modalities, rules and

regulation of the electoral process (including the regulation related to the election campaign, party financing and media access). The most obvious form of corruption during the election process occurs in the form of vote-buying. At the presidential and parliamentary elections in 2008, the citizens (7%) were offered to vote in exchange for something - money, goods or a service, similar happened in local elections as well. At the national and local elections in 2008, when we observe the regions of Serbia, the most attempts to buy votes happened in the poorest parts of the country - Southern and Eastern Serbia (11% and 13%). Also, this phenomenon was more pronounced in rural than in urban areas (for the whole of Serbia it is over 8%), more often among male than among female voters, and it was more pronounced in the less educated and the poorer. (Vukmirović, D., et al., 2011, p. 30)

Corruption is a complex process that involves two parties, while it is not easy to determine who the victim is in this relationship, because it does not always mean that the party who gives a bribe is also the victim of corruption, it is much more likely that this is a third party or the society in general. This is why the problem of corruption appears as one of the major problems for citizens. In Serbia, this is a problem for 17% of adult citizens, immediately after the unemployment rate (32% of the population) and poverty low living standards (26%). Corruption is considered a major problem for the citizens of Belgrade (21%), while for the entire Serbia, citizens believe that it is on the rise (45%) or stable (45%), and only 10% believe that corruption has been reduced. (Vukmirović, D., et al., 2011, p. 36)

It is interesting to note the data on the perception of citizens about the prevalence of corruption in specific institutions/sectors. The first place belongs to political parties that as many as 62% of adult citizens of Serbia perceive to be involved in corrupt activities. 58% of the citizens believe corruption is present in local government, and 48% of the population believes it is present in state administration. Based on these indicators, important conclusions can be drawn regarding the public trust in institutions, as well as on the perception of their integrity. (Vukmirović, D., et al., 2011, p. 37)

Taking into consideration the perception of high corruption level of public officials and elected representatives, it is important to determine in which activities and procedures corruption usually occurs. Thus, it is perceived that the most corruptive behavior of public officials occurs in connection with facilitating employment for friends or relatives (90%), facilitating conclusions of contracts for companies close to them (80%), accepting valuable gifts in return for providing certain public services (70%), acceptance of small presents of appreciation for the provision of certain public services (70%), taking bribes from public procurement contracts (60%). In the corruption among selected representatives, the most dominant is that related to facilitating the conclusion of contracts with the companies close to them (80%), facilitating progress in the careers of friends (78%), using public funds for personal and family needs (65%), taking bribe from public procurements (61%), decision-making forced by private interests (59%) and election results manipulation (50%). (Vukmirović, D., et al., 2011, p. 38)

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