James Roaf, head of the IMF mission for Serbia.
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“No wage increase. Not this year and maybe not next.”

Economic growth is strengthening, and major successes have been achieved in fiscal consolidation and reducing financial sector risks. The biggest challenge now and a key focus for the mission is structural reform, says James Roaf, head of the IMF mission for Serbia, in the interview for NIN. “We're now approaching the halfway point of the program with the IMF, and we have a new government with a renewed mandate for implementing necessary reforms. So this review offers a good opportunity to step back and consider how Serbia is progressing towards the overall objectives of the program.”, says Mr. Roaf who will start technical negotiations for the latest review of the stand-by arrangement on the day when this interview is published in NIN, prior to the beginning of the formal negotiations with the Government and NBS representatives on Monday, June 13th.

What will be the main topics of conversation between the the IMF mission and Serbian authorities?

Put bluntly, Serbia still needs to move from an economic mindset focused on the public sector – as guarantor of employment or living standards, or worse as a cash-cow to be milked to the private sector as the engine of growth, employment and incomes. As of now, in a population of over 7 million, only about 1.2 million have taxpaying jobs in the private sector, while the public sector supports 0.75 million workers and 1.7 million pensioners. These numbers illustrate why Serbia’s program, with IMF support, is focused on creating conditions for new jobs in the private sector rather than preserving employment in the public sector.

The budget deficit is lower than arranged. Would that be enough for Serbia to be given a pass for being late in terms of structural reforms, such as layoffs in the public sector, reform of state enterprises, etc?

The budget deficit turned out much better than projected in 2015, and I'm hopeful that there will be some overperformance in 2016 too. At the same time, recognition of "skeleton debts" and other factors have meant there has been less success towards the ultimate objective of reducing Serbia's high public debt, which we project to end this year still close to 80 percent of GDP.

But no degree of fiscal improvement would warrant delay in structural reforms. Failure to address the long-standing structural weaknesses in the Serbian economy would mean slower growth, higher unemployment, and delayed convergence towards Western European living standards. It would ultimately undermine the fiscal improvement we've seen so far, and would also likely delay EU accession.

Will the IMF agree to let Serbia increase pensions and salaries in the public sector within this year? Can Serbia continue to increase pensions and salaries by the end of 2017?

Any discussion of public sector wages and pensions needs to start from the very challenging demographics I mentioned already. The public sector employs more than the private sector would for the same job, also paying higher wages. And for every worker paying into the pension system, there is a pensioner drawing a pension. This is why the original program depended not only on significant cuts in public employment, but also a complete three-year freeze in wages and pensions.

Now, in the event, the strong fiscal overperformance in 2015 created space for some increases in wages and pensions. And the real value of the increases has been much better than usual, as inflation has been far lower than anticipated. Looking forward, we have to ask whether further increases are warranted, and whether they can be afforded. Here I would note that expectations need to be adjusted to the low-inflation environment. We've also seen significant delays in the government rightsizing reforms, meaning the reductions in the public wage and pension bills are progressing more slowly than intended. This suggests that not only are wage and pension increases out of the question for 2016, but unless the government can identify significant new fiscal savings at this point we do not see space for them in 2017 either.

What about the layoffs in the public sector? Fiscal Council of Serbia believes that the number of 75.000 people who need to be laid off would be too great. What do you think?

The government is not yet in a position to say for sure what the final number of layoffs should be. Important preparatory work has been conducted by the ministry of public administration, the World Bank, and others, but the new government including key spending ministries such as health and education will need to translate this work into clear plans for areas where staff can be reduced, as well as areas where more staff are needed. Indeed, even more important than cutting overall numbers is the process of reallocating resources to ensure more effective delivery of public services in the future. That's why we talk about "rightsizing" rather than just downsizing: we don't want to see across-the-board cuts, we want an intelligent approach. But this will often involve rethinking some "protected interests" such as the education curriculum or the existing school and healthcare networks. And in the end, if there are smaller fiscal savings from rightsizing, there would have to be bigger savings in other areas.

Serbian authorities claim that the price of electrical energy won't increase. Will you insist on that increase?

As with any aspect of the program which is Serbia's program, supported by the IMF, this is something we will have to come to an agreement on during the mission. As you know, so far the program has envisaged gradual increases in electricity prices over a number of years, as one element within the restructuring of EPS which will create space for long-overdue investment in infrastructure improvement and rehabilitation.

Are you satisfied with the pace of reforms in the state enterprises, such as EPS, Srbijagas, and Serbian Railways?

This is a "glass half full, glass half empty" kind of question. Would I have liked to see faster progress? Definitely. But neither would I have predicted things to move as far as they have, on the basis of past program performance and the complexity and difficulty of restructuring these enterprises. Either way, now is a make-or-break period for the new government to reinvigorate these reforms. Probably the most important immediate issue in this area is to agree on severance terms for the large excess employment in EPS and the railways. Far-reaching restructuring is needed to get these enterprises onto a viable footing, so they can deliver better quality services and avoid needing taxpayer bailouts.

What is the line that the IMF will not cross in terms of promises that Serbia made to the IMF?

This is not the best way to think of our relationship. The IMF is using its technical know-how and experience to support Serbia's own economic reform program. The program is a living document, which can change as economic circumstances and political priorities change. The bottom line for the IMF is that the program continues to meet objectives that we can support, including growth, employment, and fiscal sustainability. Internal consistency is important: for example if the government decided it no longer wished to pursue a particular expenditure saving measure, it would need to find another measure to take its place.

Does the IMF agree with Serbian Prime Minister Vucic and National Bank of Serbia's forecast about real growth of Serbia's GDP of 2,5 percent in this year?

We have seen a very welcome acceleration of growth in the first quarter including strong exports and investment, reflecting improved confidence as a result of the economic program. So during the mission we will be revising up our projection for 2016 as a whole, though I don't know yet if it will be as high as 2.5 percent.

What are the greatest challenges of Serbia's fiscal consolidation within one year?

Over the next year the fiscal consolidation is due to deliver a key milestone, in turning the public debt ratio around to a decisive downward path. It's vital that this remains on track, which will mean not only tight control of the wage and pension bills, but also to avoid any additions to the debt from losses in public enterprises or other potential liabilities.

National bank of Serbia's Foreign Exchange reserves have decreased for 1bn Euros since the beginning of the year. Will the the IMF insist on fewer interventions by the National bank of Serbia on the foreign exchange market in order to keep dinar stable?

The program conditionality includes a reserves floor, but reserves remain ample and I would not expect this condition to be breached despite the intervention that has taken place. So this is more of a conversation between the IMF and the NBS, with a lot of mutual respect on both sides.

In general we suggest accepting some more day-to-day movement in the exchange rate. Now that both the fiscal deficit and inflation are well under control, we believe that people will gain increasing confidence that small movements in the exchange rate are normal and do not signify that the dinar is about to collapse. This will also help develop the private foreign exchange market, and ultimately strengthen confidence in the dinar. But these should be gradual changes and we fully understand the NBS's desire not to push too quickly to a fully floating exchange rate, given deeply ingrained memories of monetary instability.

Serbian authorities often use the IMF as an excuse for politically unpopular measures. How do you comment on the recent statement of Serbian Prime Minister Vucic that the IMF and the World Bank "are choking him like a snake chokes a frog" to deal with the problems in RTB Bor and Resavica mine?

There may be some colorful language but overall I think the government has been very clear about why state-owned enterprises need to be restructured, and I believe the public also appreciates well that losses from these enterprises can no longer be allowed to undermine the government finances or to crowd out priority spending such as on infrastructure. And for our part, the IMF understands the social importance of some of these companies, especially those located in depressed regions. But in the end the only way to ensure any future for these companies is restructuring to address the sources of the losses, including excess employment. By making them viable again, they can contribute to local development more than surviving on subsidies.

A critical element here is transparency. Losses can be hidden in complex corporate structures, or they can be hidden in nonpayments to suppliers or in pricing to captive customers but sooner or later they will come back to hit the government accounts. Bringing these hidden costs into the light is a key step in the restructuring strategy. The full costs of maintaining excess employment in some of these enterprises can be very high amounting to paying workers to do dangerous work with little or no economic value. This is not a viable regional economic development strategy.

Are you satisfied with the way Serbia is handling the problems in enterprises in restructuration?

Again, I like to see the glass as half full. Under the program we monitor the 17 state enterprises that received extension of bankruptcy protection until May this year. By their nature these are the most difficult cases. The mission will review progress but we have seen some major successes in enterprise resolution like the sale of Zelezara while in some other cases plans do not yet appear to meet the program objectives of establishing viable entities that will not need additional state support.

When can Serbian citizens expect the increase of the standard of living?

This is always a short-run challenge in a program. At the start, incomes usually fall as excess budget deficits are brought under control. But after the initial period, the benefits of the program in terms of incomes and employment become apparent as growth resumes, and when supported by reforms it reaches much higher levels than before. There are many examples in the neighborhood that show how reforms deliver dramatic increases in living standards just look at Poland compared to Ukraine, which both started with similar low income levels in 1989. Poland made determined reforms and now has income at two-thirds of Western European levels. During this time, Ukraine was unable to carry reforms through effectively and now has incomes at barely a quarter of Poland's. I am confident that Serbia with its strong human capital and history as a center of trade and commerce can follow a successful path. As I mentioned earlier, investment and growth are already accelerating, so I hope people will soon start to see the improvements for themselves.

Some economists and politicians think that Serbia doesn't need the IMF, because they believe that the IMF cares only about the interests of the most developed counties rather than those of Serbia. How do you comment on this?

This is really a baseless kind of accusation. My team and I are fully dedicated to supporting Serbia in its reform process with our knowledge and advice. I am glad that I don't hear this in my many interactions with both official and private sector representatives, which hopefully reflects an understanding of the work we do and our interest in seeing Serbia's reform program succeed in delivering growth, stability and jobs.