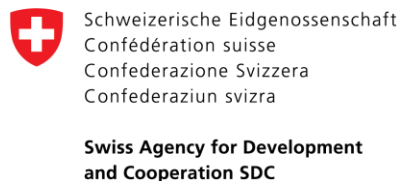




# Reducing inequalities - pathway to sustainable development

“Like cholesterol, inequality can be either good or bad. “Good” inequality rewards effort and leads to better performance, while “bad” inequality wastes human potential.” – Francisco Ferreira.



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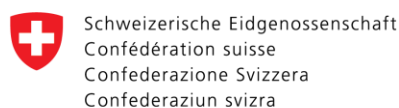
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This policy paper is a result of desk research and series of interviews with Serbia’s leading experts in the topics of different inequality dimensions such as education, pension system, taxation, social protection, labour law, trade unions, labour market, etc. Their discussions, suggestions, examples of good/bad practises were inspiring and they helped us significantly in preparing this policy document. List of experts is, alphabetically by surname: **Dragan Aleksić, Mihail Arandarenko, Milojko Arsić, Marija Babović, Gorana Krstić, Dragica Pavlović Babić, Saša Randelović, Mario Reljanović, Zoran Stojilković, Marko Vladislavljević, Jelena Žarković Rakić**



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## 1. Introduction and summary

**(In)equality is one of the core principles of Sustainable development goals (SDGs) as an important determinant of economic and social dynamics.** In(equality) is a rather subtle mechanism which determines economic efficiency, standard of living and cohesion of society through providing incentives and setting various limitations on individuals. Even more so in developing countries like Serbia, than in developed ones. Moreover, inequality and poverty traps became more exacerbated by the outbreak of COVID-19 crises which disproportionately affected vulnerable groups. Therefore, it does not come as a surprise that the concept of (in)equality lies at the core of the main SDG principles. Its importance is recognized directly (SDG10 – Reduced inequalities), especially for women (SDG5 – Gender equality) and it is overarching principle in poverty reduction (SDG1 – No poverty), healthcare (SDG3 – Good health and well-being) and education (SDG4 – Quality education). Besides putting these in place, policies aiming at generating decent and productive jobs (SDG8 – Decent work and economic growth), often through innovation (SDG9 – Industry, innovation and infrastructure).

**Inequalities in Serbia are high and mostly driven by the labour market inequalities, failure of welfare state mechanisms to reach some vulnerable segments of society, gender inequalities and inequalities in education.** One of the reasons behind relatively lower redistributive power *vis-à-vis* other EU member states lies in inadequate tax-benefit system. At the same time, gender inequalities are also notably present, especially in the domains of power, money and time use of women. However, **all policies should be ex-ante analysed in respect to efficiency-equality trade-off and conducted relatively simultaneously for optimal results.** In short, we give a general recommendation that the inequality is best resolved through creating decent employment. Necessary and hopefully parallel processes should encompass changes in income tax policy, education reform (from preschool to higher education), adjustments in some welfare state mechanisms, labour market institutions and Active labour market policies as well as adopting the new Law on gender equality. The National Economic Recovery Plan encompassing all relevant targets of SDG10 and a new Employment and Social Reform Programme (ESRP) that takes into account all relevant aspects of reducing inequality, including inequalities in income, consumption and access to basic social services, should be adopted. **In other words, it is necessary for Serbia to make a simultaneous improvement across all relevant inequality related SDGs.**

In section 2. (Concept of Inequality) we provide a basic theoretical overview of inequality, inequality indicators, implications and interconnection of inequality related SDGs. In section 3. (Income Inequality and Beyond) we provide some stylized facts on different forms of inequality in Serbia. In section 4. (Recent Government Efforts and Policy Gaps) we provide an overview of some recent efforts by the government when it comes to reducing inequality – or lack thereof. Finally, in section 5. (Conclusions and Recommendations) we provide some tangible policy recommendations in the most important areas for inequality reduction in Serbia.

## 2. Concept of Inequality

**Inequality is generally identified as income inequality in the public discourse.** While inequality is a very broad and deep concept in general, one of the most tangible and frequently used measures is **disposable income inequality**.<sup>1</sup> It measures the distribution of disposable income within a country, or even between countries. It is noteworthy that the disposable income encompasses all types of income – wages, dividends, rents, pensions, social security benefits, remittances and similar, net of taxes. Countries with higher concentration of income are more unequal (and vice-versa). Of course, there are several indicators for measuring it, but we present here only those that are used most frequently:

- **Gini coefficient** which measures inequality across the whole population. Theoretically, it takes values between 0 (perfect equality) and 100 (one citizen receives all the income). In practice, values of Gini range between low 20s (for example socialistic countries during 1980s) and high 60s (some countries in Africa).
- **Income quintile ratio** (or S80/S20) which represents the ratio of income shares of the wealthiest 20% of population to the poorest 20% of population.
- **Income share of the bottom 40%** which represents the share of income of the poorest 40% of population.
- **At-risk-of-poverty rate** which measures the share of people with a equivalized disposable income below the at-risk-of-poverty threshold, commonly defined as 60% of the median equivalized disposable income. This measure is also known as the relative poverty rate.<sup>2</sup>

**One might wonder, why would we even care about (income) inequality? It turns out that besides ethical considerations, the (in)equality is an important determinant of economic and social dynamics and outcomes.** As Francisco Ferreira famously noticed, inequality is a lot like cholesterol, can be either good or bad. When it is too low, "effort-to-reward ratio" is low – individuals have little incentive to put in additional effort, invest or risk. In other words, very low inequality could mean egalitarian society, but also inefficient and slow-growing economy. On the other hand, when inequality is (too) high, those that are poor (or worse-off) could have a hard time obtaining proper education and healthcare. Moreover, opportunities and political power can be concentrated among the rich (or better-off), forming a sense of societal injustice. In other words, high income inequality is also detrimental for economic growth, as it wastes human potential and does no help when it comes to building strong institutions and democratic society. To wrap it up, the question of inequality could be viewed as an interplay of ethical and efficiency considerations and trade-offs.

**Question of inequality is especially important for developing countries like Serbia.** There is a significant difference between implications of high (or low) inequality depending on the

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<sup>1</sup> Survey of Income and Living Conditions (SILC) is main data source for measuring poverty and inequality indicators in European Union and countries in the process of EU accession. Statistical Office of Republic of Serbia (SORS) conducts SILC since 2013, based on EU-SILC methodology.

<sup>2</sup> Although not an inequality indicator per se, At-risk-of-poverty rate is important indirect measure of inequality.

level of development of certain country. For instance, if we take two countries with the same level of inequality, but different overall standard of living (GDP per capita), relative position of those that are worse-off (at the lower level of income distribution) could differ dramatically. In other words, being relatively poor in developed country could imply much higher standard of living than being relatively poor in developing country. Moreover, efficiency losses due to high inequality are higher for developing countries than developed (IMF, 2014; OECD, 2015). At this point the fact that the standard of living in Serbia is around 60% lower than in the EU and around 23% lower than in Bulgaria<sup>3</sup> becomes very important.

**This is largely a consequence of several factors – taxation system, unfavourable labour market outcomes and inadequate social security mechanisms.** More precisely, employment in developing (or underdeveloped) countries is often insufficient and of low quality, while coverage (and sometimes amounts) of social security benefits tends to be lacking as well. Also, if the inequality (and poverty) is too high, it tends to be perpetuated by itself, as citizens of lower socioeconomic background do obtain significantly lower education and healthcare than their better-off peers. In other words, children of those that are poor have a relatively high probability of ending up in poverty trap.

**Income inequality should be analysed in combination with other inequality indicators.** Although inequality is often considered as inequality of income, it should be observed together with inequalities in education opportunities and outcomes and various regional and gender inequalities as well. Also, inequality analysis is inseparable from labour market analysis. However, in this paper we will not try to answer chicken and egg question of what comes first – inequality or inefficiencies. Instead, we will illustrate causalities and analyse them in the common concept, eventually providing a set of tangible policy recommendations.

**Comprehensive framework of SDGs is a very useful tool for reducing inequality and grasping its sense.** It is clear that multidimensionality of inequality requires equally multidimensional approach. Framework of SDGs is a perfect fit in that sense, as it identifies all its aspects – those that are directly connected and those that are more subtle. It is clear that, success in terms reducing inequalities (SDG 10) is achieved through simultaneous progress in fulfilment of the interlinked goals - especially decent work and economic growth (SDG 8), reducing poverty (SDG 1), quality of education (SDG 4), healthcare (SDG 3), as well as gender equality (SDG 5). Afterall, (in)equality lies at the very core of Leave no one behind principle which governs the SDGs. As limited resources limit opportunities of those that are worse off, empowering these vulnerable segments of society through ensuring equal opportunities (SDG10.3 - Ensure equal opportunity and reduce inequalities of outcome) and progressively increasing their income (SDG10.1 By 2030, progressively achieve and sustain income growth of the bottom 40%) should be a top of Serbia's priority lists.

**COVID-19 pandemic has disproportionately affected people at the bottom of the income distribution.** The crisis seems to have affected vulnerable groups of societies across the world and Serbia is not an exception. COVID-19 crisis has delivered the toughest blow low-wage earners, informal workers and other workers in sectors with lower wages, such as

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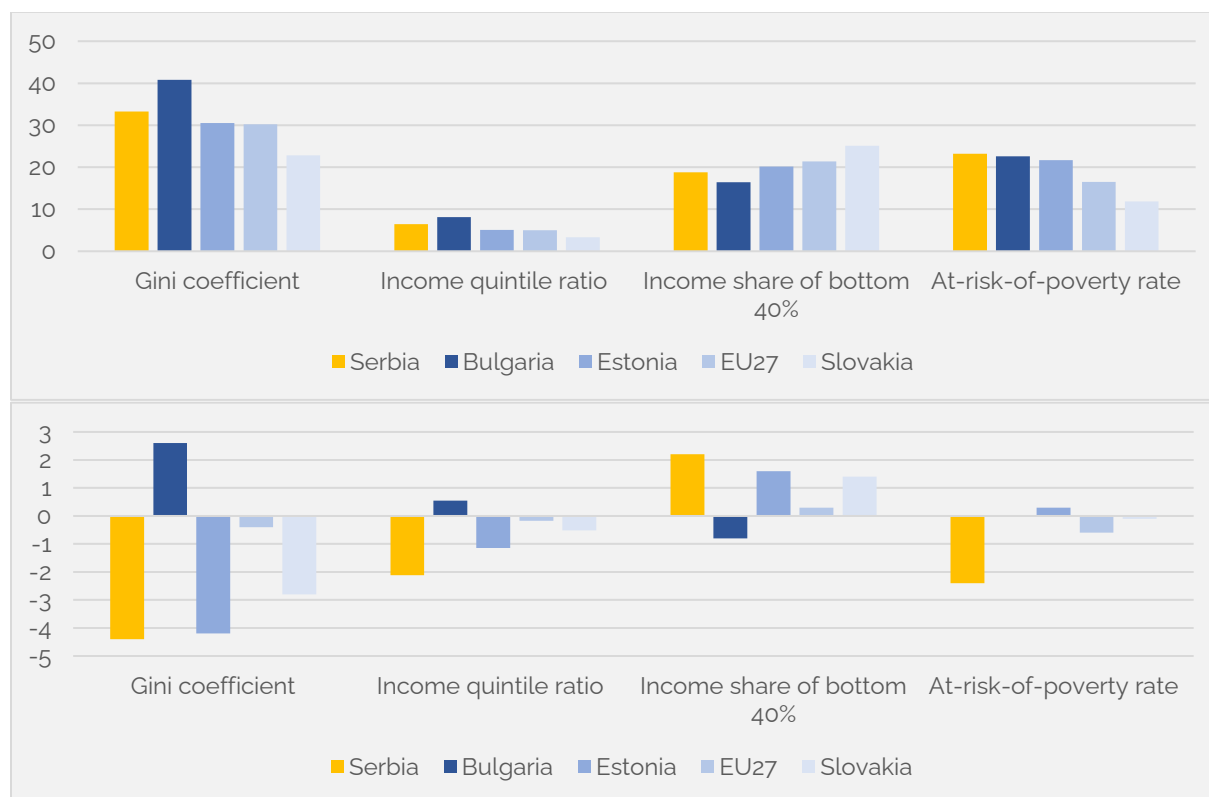
<sup>3</sup> Based on 2019 GDP per capita in Purchasing Power Standards (Eurostat).

personal services and tourism (CEVES, 2021). However, government aid in Serbia was flat both for enterprises and people, without targeting the most disadvantaged groups.

### 3. Income Inequality and Beyond

**Income inequality in Serbia continues to be among the highest in Europe, in spite of recent improvements (SDG10 – Reduce inequalities).** After some improvements over the last few years, Gini coefficient in Serbia stood at 33.3 points in 2019 making it one of the highest in the EU (Graph 1). In fact, while the EU average stood at 30.2, only Bulgaria (40.8 – the highest inequality in the EU), Romania, Latvia and Lithuania had higher Gini coefficients (and therefore higher inequality). On the other hand, Slovakia seems to be the most egalitarian country in the sense of income distribution. Now, the difference between Serbia and the EU average might not seem like large, but it certainly has some strong implications. First, the difference in other inequality indicators that are easier to interpret might be more illustrative. For instance, income quintile ratio in Serbia is around 6.5 (5 in the EU), indicating that the wealthiest quintile receives 6.5 times higher income than the poorest quintile. Also, similar stands for the income share of the bottom 40% and at-risk-of-poverty rate. Moreover, having in mind theoretical finding and practical implications from the previous section, these information carry even more weight.

Figure 1: Income inequality indicators for Serbia and selected countries in 2019 (top) and 2015/2018 changes (bottom)



Source: Eurostat, authors' calculations

**Labour market is often identified as important determinant of inequality.** Namely, labour market outcomes and indicators (employment, unemployment, inactivity) and (distribution of) wages are directly related to levels of inequality and poverty. Other thing being equal, higher levels of decent employment should directly lead to lower inequality. Higher levels of employment, other things being equal, should lead to more competitive wage distribution as well, again leading to lower inequality. On the other hand, inactivity and unemployment (especially long-term) have the opposite effect.

**Although main labour market indicators improved in last years, Serbia is still lagging significantly when compared to EU countries.** Labour market in Serbia is characterized by high inactivity of working age population (32% vs. 27% in the EU), especially women (39% vs. 32% in the EU). Consequentially, these imply low employment rates – 61% for population between 15 and 64 years and only 54% for women. Serbia has high share of people living in households with very low work intensity<sup>4</sup> (11.9% vs. 6.2% in EU; SILC, 2019). Also, one of the traits of labour market in Serbia is high informal employment<sup>5</sup> (18%) and vulnerable employment<sup>6</sup> (24%). These, together with the relatively high NEET rate<sup>7</sup> (20% vs. 14% in the EU) are very important determinants of current and future inequality and poverty outcomes (LFS, 2019). In other words, one of the main reasons for high inequality (and poverty as well) comes from underperformance of labour market (and the economy) which fails to activate inactive population and generate decent jobs. This could be further attributed (at least to some extent) to insufficient investments in Active labour market policies (ALMP) which generally amount to less than 0.1% of GDP.

**There are also notable regional differences in labour market outcomes.** For instance, employment rate in Belgrade region (65%) is 8 percentage points higher than in Southern and Eastern Serbia (57%), while unemployment rate is almost 6 percentage points lower. Also, wage differences are widespread. For example, one of the richest Belgrade municipalities (Vračar) had 66% higher net wage than national average in 2019. On the other side, Svrlijig (municipality in Nišavski district) had average wage as much as 34% lower than national average. In other words, the difference in average net wages between municipalities with the highest and the lowest average wage was almost 55,000 RSD in absolute value (corresponding to the average net wage in Serbia). Among other factors, these patterns led to high regional differences in poverty rates as well. Mapping poverty at the municipality level based on Census data in 2011 and SILC 2013 shows that municipality Novi Beograd had at-risk-of poverty rate of 4.8%, whereas municipality Tutin had at-risk-of poverty rate of 66.1% (SORS and WB, 2016). Therefore, almost two thirds of population in Tutin was at-risk-of-poverty.

**Unequal access to educational opportunities (SDG4 – Quality education) is one of the important determinants of wage inequality and inequalities are widespread in education, starting from the preschool...** Serbia is still far from reaching Barcelona target goals, defined

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<sup>4</sup> The very low work intensity refers to households whose working-age members worked between 0 and 20% of the total number of months they could have possibly worked during a referent period (SILC definition).

<sup>5</sup> Informal employment is defined as workers in unregistered firms, workers in registered firms but without formal labour contract and no social and pensions contributions paid and unpaid family workers (LFS definition).

<sup>6</sup> Vulnerable employment is calculated as share of contributing family workers and own-account workers in total employment (ILO definition).

<sup>7</sup> Share of young population that is not in employment, education nor training (LFS definition).



as 90% of children attending formal childcare aged 3 until mandatory school age and 33% of the children aged under 3 years. When it comes to coverage of children by preschool education, there are big disparities between regions, settlement type and socio-economic status of parents. The share of children from poorest strata amounted to 9%, whereas from richest 82%. By employment status of parents, coverage amounted to 61% if both parents are employed, 29% if one parent is employed and 10% if both parents are unemployed. Therefore, preschool education is more often attended by children of educated, employed parents mostly from urban areas. In other words, children who will mostly benefit from preschool education are least covered by it (Vuković, 2017).<sup>8</sup> One of the factors that contribute to preschool inequalities is shortage of places. For instance, in 2019/2020 school year 6,902 children were not enrolled due to shortage of places, while 11,680 were enrolled over the existing capacity (SORS, 2020).

### **...to secondary and tertiary education.**

Inequalities continue further in secondary and tertiary education. A young person whose parents have primary school education is 79 times less likely to complete university compared to a person whose parents have higher education.<sup>9</sup> Students of lower socioeconomic status have lower educational aspirations – the difference sometimes being quite drastic. For example, 87% of secondary school students of higher socioeconomic status expect to complete university education in comparison to just 41% those with low socioeconomic status (OECD, 2018). Generally, students from more vulnerable groups tend to underachieve in mathematics and reading – 25% of students of lowest socioeconomic background are twice as likely to underachieve (or achieve below the basic levels) in all domains (Ibid.). However, it should be emphasized that these problems are not specific for Educational system in Serbia, as these patterns are visible in other OECD countries as well, often at even larger extent. Still, general problem of the education system of Serbia remains the overall underperformance *vis-à-vis* other OECD countries on average.

**Children from vulnerable groups were even more vulnerable and deprived of education during the anti-pandemic measures.** TV and online education due to state of emergency caused by COVID-19 pandemic probably increased inequalities in education. Children from vulnerable households that did not have adequate resources (TVs, smart phones, pc, tablets, internet connection, etc.) were unable to follow classes during lockdown, especially Roma minority.

**Vocational education systems have been unable to respond effectively to the structural changes over the last two decades, often leading to intergenerational transmission of inequality.** In that sense, upper-secondary vocational education seems to fail to provide skills that support access to the labour market. Moreover, high proportion of children attending vocational schools whose parents also attended such schools, leading to intergenerational transmission of inequality, as these jobs traditionally tend to pay lower wages (Žarković Rakić *et al.*, 2019)

**Serbia lags behind most of the EU when it comes to gender equality as well (SDG5 – Gender equality).** Improving the position of women and their participation in the political, economic and social life is one of the backbones of sustainable development. In that regard,

<sup>8</sup> <http://mons.rs/education-prospects-in-serbia>

<sup>9</sup> <http://mons.rs/education-prospects-in-serbia>

one the most renowned indicator is Gender Equality Index (GEI) – a composite indicator used to monitor gender equality, published by the European Institute of Gender Equality.<sup>10</sup> The indicator is based on core domains, work, money, knowledge, time, power, and health and two satellite domains – violence and intersecting inequality. This analysis was conducted in Serbia in 2014 and 2016, showing that even though the situation is improving, a lot of ground still has to be covered. In 2016 Serbia stood at the 22<sup>nd</sup> place, with the most pronounced differences in terms of power, money and time use (Babović, 2018). On the other hand, the gap seems to be the lowest in the domains of health, knowledge and work (Ibid.).

**Welfare state mechanisms in Serbia sometimes fail to reach vulnerable groups, therefore generating pockets of poverty and inequality.** Monetary social assistance (MSA) has a huge exclusion error, since around 90% from the lowest decile do not receive MSA (UNICEF, 2014). The coverage of children by child allowance decreased significantly in the last couple of years, as it amounted to 25.1% in 2012 and 17.7% in 2019 (SORS, DevInfo). Also, there is a large share of people over the age of 65 who do not have the right to an old-age pension – as much as 12% (GIZ, 2020).

#### 4. Recent Government Efforts and Policy Gaps

**Issues related to inequality, including those related to both income and consumption, are not considered as a priority in public policies in Serbia (BOS, 2020).** In that regard, even though some aspects indirectly affecting inequality such as poverty and social inclusion are given somewhat more attention, strategic documents addressing it directly, such as the National Economic Recovery Plan which considers all relevant targets of SDG10, seem to be missing. Some aspects are only partially covered by Employment and Social Reform Programme (ESRP) and similar documents, which is why there is a suggestion that a new ESRP that takes into account all relevant aspects of reducing inequality, including inequalities in income, consumption and access to basic social services, should be adopted (Ibid.). Moreover, there is generally a low level of preparedness for monitoring inequality through the SDG framework (Ibid.). Law on Social Welfare for instance does not address some aspects regarding inequality and poverty optimally. For example, the amount of social benefits is below the absolute poverty line, while the mechanism itself in some cases destimulates formal employment (Ibid.). Also, the fact that no government institution is explicitly in charge of inequality issues is indicative as well. Therefore, it does not come as a surprise that inequality was not especially prominent topic in the media – in the period between 2014 and 2017 public debt and savings were mentioned 18,523 times, whereas inequality 52 times.<sup>11</sup>

**Suboptimal tax-benefit system is often blamed as one of the key generators of high inequality.** Gini coefficient for gross and net wage differs slightly, which indicates that wage taxation in Serbia almost entirely lacks progressivity<sup>12</sup>. Also, the redistributive effects of social protection mechanisms in Serbia are significantly weaker than in the EU – from relatively small allocations for child benefits to poor pension coverage, especially for women (CEVES, 2018;

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<sup>10</sup> <https://eige.europa.eu/>

<sup>11</sup> <http://mons.rs/rastuca-nejednakost-podaci-i-percepcije>

<sup>12</sup> Tax rate on income is flat at 10%, while very limited progressivity comes from non-taxable part of the wage, which is relatively low (16,000 dinars, or 25% of the average wage).

Arandarenko, Krstić and Žarković Rakić, 2017). The Commitment to reduce inequality index (CRI)<sup>13</sup> confirms these findings. The CRI is a composite index which measures government actions in social spending, taxation and labour rights. Namely, according to this index, Serbia stands at the 73<sup>rd</sup> place among 157 countries. Moreover, Serbia ranks the 144<sup>th</sup> based on taxation policies<sup>14</sup>, 73<sup>rd</sup> based on social spending, 57<sup>th</sup> based on labour rights and wages (DFI and Oxfam, 2017).

**Minimum wage had negligible effect on inequality in the past.** Aleksić (2020) showed that positive effects of increasing minimum wage on inequality only slightly supersede the negative effects. First reason is that significant number of low wage earners do not have right on minimum wage (informal workers and similar). Also, there is a widespread practise that part of the wage is envelope wage, i.e. workers receive minimum wage legally, and the rest being envelope wage. Therefore, employers only adjust the increase in minimum wage so that the part of the envelope wage reduces for the increase in the minimum wage. The net effect of increase in minimum wage in these instances is zero, as just the share between official minimum wage and envelope wage part changes. Additional reason could lie in the practice the worker must return part of the minimum wage (officially paid) to his employer by informal canals. Therefore, some workers in the private sector earn below statutory minimum wage. Additionally, some employers reduce the real minimum wage by increasing working time. Moreover, due to high tax wedge on low wage earners, increase in minimum wage could lead to lay-offs of minimum wage earners. **Wage inequalities also persist between private and public sector, public wage premium being the highest at the lower part of the wage distribution (Vladislavljević, 2020).**

**Trade unions historically play very important rolls in equality among workers.** Empirical evidences show that reducing power of trade unions reduces their influence on setting wages and increases wage inequalities. Based on International Trade Union Confederation, Serbia is among the countries which systematically violates workers' rights. Unions are marginalized, with extremely low influence on policies and labour regulations. Weak unions give significant open space for workers exploitation. Coverage of workers by trade unions is low, and it is significantly lower in private than in public sector.

**The new Law on gender discrimination is stuck in procedure since 2016, while the one that is still in force is inadequate.** The Committee on the Elimination of Discrimination Against Women (CEDAW) suggests that the law which is still in force is not adequate and that it has to be changed. The current system in the form of Coordination Body for Gender Equality lacks financial resources, transparency, manpower and even adequate organisational structure. Moreover, vertical coordination on local levels is also underdeveloped, while local units for gender equality do not have sufficient institutional power. Regarding Strategy for gender equality for the period 2016-2020, action plan for period 2018-2020 was not even adopted by the government, therefore there was no systematic implementation of strategy in place in the last two years.

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<sup>13</sup> The index is developed by Development Finance International and Oxfam in 2017.

<sup>14</sup> Tax pillar in this index measures the degree to which country is designing its tax system with an intent to be progressive; the degree to which it is collecting taxes progressively; the amount of taxes it is collecting compared with its tax base and its potential level; whether the country is engaging in harmful tax practices.

**Efforts to reduce inequalities could be financed through reforming public enterprises and cutting unnecessary spending.** It goes without saying that effort to reduce inequalities would require additional investments in key areas – education, social protection, healthcare and active labour market policies. These resources could be to some extent financed through reforming local public enterprises and reducing the amounts of subsidies they receive. For instance, Fiscal Council in 2017 estimated that around 0.4-0.5% GDP could be saved through these efforts (FS, 2017). Additional illustrative example is marathon New Year and Christmas decoration, especially in Belgrade, lasting for almost 6 months during the year. Namely, even though these endeavours bear relatively high fiscal costs, there is no empirical evidence what marginal contribution of decorative lightening to the touristic revenues in Belgrade is.

**One of the more recent examples of policies that could have been designed to benefit reduction of inequality is the government aid scheme aimed at tackling economic crisis caused by COVID-19 pandemic.** Namely the program consisted of the direct aid to employers (to safeguard employment) and direct aid to all adult citizens. The direct aid to all employers lacked targeting and probably came at an unnecessarily high cost. Exercises conducted by CEVES show that as much as a half of the spent resources could have been saved (CEVES, 2020). Moreover, this program was of little help for the sizable pool of informally employed. Like aid for employers, direct aid for all adults was also flat – 100 euros for all adults, irrespective of their socioeconomic status. This scheme was easy for implementation, yet with limited effects on poverty and inequality, as it did not target those most in need. For example, parents with three or more children are the most vulnerable, yet they got the same amount of aid as any other two-adults household. In other words, either the same effect on inequality could have come at lower cost, or stronger effect could have been achieved for the same amount of resources.

**Recently, Serbia implemented New Law on Financial Support for Families with children.** It goes without saying that child allowance is very important for reducing child poverty and consequently inequality. Anić and Žarković Rakić (2019) analysed some of the novelties in the new Law, with special focus on new parental allowance. Parental allowance for third and fourth child increased significantly. Again, the policy was not targeted to those families most in need, since there is no means-testing mechanism. Still, the families with more than four children are not eligible for neither parental allowance nor child allowance for every additional child after fourth birth. Child allowance remained unchanged, both in coverage and amount, remaining particularly low. Also, the practice in most countries in Europe is the opposite, parental allowance (birth grant) are mostly lump sum payments, smaller amount, whereas child allowance is given continuously, and in most cases is not limited to four children. Also, the coverage of child allowance is much more extensive. Therefore, before implementation, ex-ante distributional effects should be carefully considered. Also, distributional effects should be monitored and evaluated ex-post.

**The last partial reforms of pension system resulted in the increased inequality among pensioners.** The minimum pension is extremely low (15,000 RSD). Implementation of Bismarckian pension system without progressive taxation led to high inequalities among pensioners, while recently implemented Switzerland formula will not resolve high inequality among pensioners, as the spread of highest and lowest pension is relatively high and coverage inadequate (especially women in rural areas).

Recently, government announced better monitoring of incomes from **freelancers** in order to increase tax revenues from those workers whose work was mostly unregulated. The regulation changed without investigating neither efficiency nor inequality effects for that group of workers. The new regulation treats them as regular workers for paying personal income tax and social security contributions, but in Law on labour and other regulations, they are not recognized as workers. For example, they do not have zero tax bracket for wage tax, neither minimum wage. The current problem of freelancers is actually the part of a broad and long-lasting problem of inequality that self-employed own account workers face continuously. **The inequality among workers with different employment contracts is widespread.** Government is going to reinvestigate regulation after strong protests by freelancers.

## 5. Conclusions and Policy Recommendations

**Inequalities in Serbia are high and mostly driven by the (labour) market inequalities, failure of welfare state mechanisms to reach some vulnerable segments of society and inequalities in education.** One of the reasons behind relatively lower redistributive power *vis-à-vis* other EU member states lies in inadequate tax-benefit system. At the same time, gender inequalities are also present, especially in the domains of power, money and time use of women, and these require decisive action as well. However, it could not be emphasized enough that all these policies should be ex-ante analysed in respect to efficiency-equality trade-off and conducted almost simultaneously for optimal results. Since strategic documents addressing inequality directly seem to be missing, the National Economic Recovery Plan encompassing all relevant targets of SDG10 and a new ESRP that takes into account all relevant aspects of reducing inequality, including inequalities in income, consumption and access to basic social services, should be adopted.

**One of the overarching goals is to reduce inactivity and unemployment through increasing decent employment (crucial components of SDG 8).** In other words, governments focus should lie at fostering and promoting innovative and modern job creation (SDG 8.5). This can be achieved by developing coordinated set of policies which would aim at nurturing the private sector, especially domestic MSMEs (SDG 8.3). Foreign directed investments should be attracted and subsidized only if there is (undeniable) positive impact on economic development, rather than on plain low-wage job creation. Agricultural production would also need specially designed set of policies, especially given that it is still the main source of income for more than 500,000 workers.

**Change the income tax policy.** A group of authors (Arandarenko, Krstić and Žarković Rakić, 2017) proposed that the current taxation system which monitors incomes from labour and capital separately should be abandoned in favour of tax that would combine income from capital and labour and tax them at a progressive tax rate of 10 to 30%.<sup>15</sup> Also, the authors propose to increase the non-taxable part of the salary from 25% to 50% of the average salary

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<sup>15</sup> After crisis in 2008, many countries with flat tax systems started to reinvestigate whether the progressive tax system would be more desirable option for equality considerations. Eventually, Slovakia switched to progressive tax system in 2013, followed by Czech, Albania and Latvia.

and to introduce the right to deduction for dependent family members. Some additional mechanism could be considered as well, such as tax on property and inheritance and present tax or increasing the tax rates and lowering thresholds for yearly personal income tax (tax on very high yearly wages). Another example of tax allowances that benefited low wage earners in former Yugoslavia were hot meal allowance and annual leave allowance.<sup>16</sup> We should bear in mind that **reforming tax-benefit system will reduce to some extent inequality of disposable income, but the reduction would be much lower if we do not cope with inequality of market income. Serbia has high inequality of both, market and disposable incomes**, therefore, we should fight on both fronts simultaneously. Additionally, **Household Finance and Consumption Survey developed for EU countries could be conducted in order to monitor wealth inequality.**

**Increase coverage of preschool education (SDG 4.2).** Increasing capacities and geographical coverage, especially in rural areas, would result in increasing coverage of children by preschool education, which would in turn reduce inequalities in education in the long run. Also, perception towards preschool education as solely *care institution* should be changed to encompass border scope of activities – educational and social.

**When it comes to primary to higher education levels, great strides have to be made to systematically improve outcomes** (not necessarily PISA scores *per se*) and facilitate transition from education to work

(SDG 4.3). Compulsory secondary school should be one of the priority goals as well. It is suggested that compulsory secondary education should start in 2030, yet it could be implemented earlier in the next few years. Better access to tertiary education for children with unfavourable socioeconomic background, especially from rural areas, will reduce inequality of market income.

**Fine-tune welfare state mechanisms.** The social security benefits should be more universal and better targeted in order to cover those who are currently left in poverty without any support due to very restrictive criteria. For instance, universal child allowance or almost universal exist in many countries. For example, both Slovenia and Croatia increased the coverage of child allowance recently, making it almost universal. If universal or almost universal child allowance is not a realistic scenario in forthcoming years, coverage and amounts of child allowance should be increased as much as possible. **Social pensions should be introduced** for elderly not covered by the ordinary old-age pensions (SDG 1.3). Social pensions would imply cost of between 0.3% and 1% of GDP, depending on the amount and the age threshold for social pension. The simulations were made on three age groups

**Municipality of Čajetina in Šumadija and West Serbia region can serve as a good example for increasing preschool education coverage.** Namely by investing and opening preschool groups in its five villages Čajetina outperformed Barcelona target for coverage of children under 3 years and almost reached the target for children 3-6 years. In 2019, the coverage of preschool children aged 3-6 in Čajetina was 89% (vs. 66% in Serbia and 81% in Belgrade region), while the coverage of children under three years stood at 46% (vs. 28%

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<sup>16</sup> Those two fringe benefits were untaxed and compromised significant share of wage for low-wage earners.

65+, 70+ and 75+ (Matković and Stanić, 2014). Also, **the amount of minimum pension should be increased**, potentially on the account of very high pensions.

**Some labour market mechanisms and policies need to be improved.** One of the most important mechanisms that worked well in the past are Labour market policies (**ALMP**). Although relatively successful, these have been insufficient in scope and size so far. Namely, although it was planned that ALMP reach 0.5% of GDP, they remained on the sub-0.1% level so far. Moreover, **focus should be expanded from the unemployed to inactive and low wage earners as well**. Investing in ALMP could increase earnings potential of workers at the left tail of the wage distribution, which will in long run reduce wage inequality. Additionally, to improve effectiveness and efficiency of its own policies, **government should monitor that minimum workers' rights are respected**, which could mean tendency to **eliminate (or at least) minimize informal employment**. For improving efficiency of labour dispute, labour courts should be established.

**The new Law for gender equality has to be adopted (SDG 5).** There is an urgent need for clear institutional mechanisms for fighting against gender inequality, and much better horizontal and vertical coordination. As currently there are no policies for tackling horizontal segregation in education, which transmits later to the horizontal segregation in the labour market. Systematically removing horizontal segregation by fields of education should be one of the priorities for gender equality. Better monitoring of discriminatory employers' practises is also mandatory.

**Last, but not the least, targeting errors regarding extraordinary (*catastrophe*) situations should be avoided in the future.** In the case of COVID-19 government support, apart from 100 euros of aid to all adults, pensioners were supported by additional 4,000 RSD, while children were entirely left out although they are one of the most vulnerable groups (including their families). It should be kept in mind that due to COVID-19 crisis pressure on welfare state and fiscal resources will probably increase.

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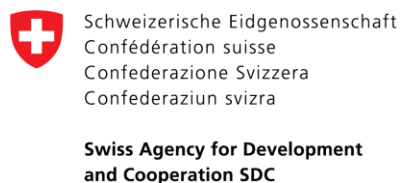
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