China-CEE Institute
中国—中东欧研究院

ISSN: 2560-1601

Vol. 12, No. 2 (RS)

November 2018

Weekly Briefing

Serbia Economy briefing:

Serbian Public Finances

IIPE

China-CEE Institute

Kiadó: Kína-KKE Intézet Nonprofit Kft.

Szerkesztésért felelős személy: Chen Xin

Kiadásért felelős személy: Huang Ping

1052 Budapest Petőfi Sándor utca 11.

+36 1 5858 690

office@china-cee.eu

china-cee.eu

Serbian Public Finances

Abstract

Due to Serbian Government measures and some favourable external circumstances, Serbia implemented a successful fiscal consolidation - from a fiscal deficit amounting to 2.2 billion Euros in 2014, by the end of the year 2018 surplus is noted, while the public debt has been decreased from over 70% to less than 60% of GDP. Regarding that the crisis has been avoided, the fiscal policy in 2019 and the upcoming years must cope with two major and related challenges, remaining after the successful consolidation: 1) improving the structure of public finances and 2) low economic growth.

Current developments in Serbian economy are favorable as observed in the last quarter of the year 2018. The growth rate reached 4.4%, the rate of inflation dropped to 2%; interest rates are lowered; instead of deficit of 0.6% of GDP, as it had been planned for 2018, a surplus of 0.7% is achieved. The better fiscal result comes from increase in public revenues compared to plan, of approximately 50 billion dinars, and lower execution of public expenditures, of approximately 15 billion dinars. The main reason for the increase in public revenue is to certain extent more favourable trend in the labour market (higher than expected growth in employment and average salary). More favourable trends in the labour market were reflected in higher revenue collected from contributions and salary tax that led to exceeding the plan of approximately 25 billion dinars. Apart from that, an additional sum of about 20 billion dinars was collected from profit tax, compared to the budget plan, but this is a consequence of overly-conservative planning during the budgeting process at the end of last year and not so much a consequence of major changes in economy profitability. On the public expenditure side, the only savings made were those for interests, which will be about 14 billion dinars lower than planned. Dropping of interest expenditures can be explained in several reasons:

1) faster than planned public debt decrease,

2) reduction in interest rates for new government borrowing and

3) appreciation of the dinar in real terms, being that the majority of the public debt comes with interest paid in foreign currency. Direct consequence of appreciation is that public revenues increased by about 50 billion dinars, while expenses decreased by approximately 15 billion, due to reduction in interest payments.

It is great achievement that public debt has decreased from 70% to 60% of GDP and still is approaching the safer zone of 50% of GDP. Partly, this is due partly due to better fiscal results, but even more prominently, due to a large upward revision of the GDP. By the end of 2018, public debt is likely to drop below 55% of GDP, which is an unexpectedly good result. What is interesting is that the drop in public debt, compared to GDP, is the result of a relatively good fiscal result only to a minor extent. The greatest contribution to the lower share of debt in GDP in 2018 came, actually, from upward revision of the data on nominal GDP, which was performed by the Statistical Office of the Republic of Serbia (SORS) on the 1 st of October 2018. With this revision, the SORS determined that Serbian GDP was almost 2.5 billion Euros (6.5%) higher than previously thought and applied this modification to all data from 2015 onward. Since the public debt is now divided by a significantly higher GDP, the share of public debt in GDP automatically dropped, in a single day, by about 4 p.p. – from about 60% of GDP to about 56% of GDP - although there has been no significant debt repayment. By the end of 2018, we expect the share of public debt in GDP to be further lowered below 55% of GDP, due to the budget surplus (no need to take on new loans to cover the deficit) and the government will have paid off some loans from previous years from its deposits. It is important to point out that, due to the large upward revision of the nominal GDP, the share of public debt in GDP will drop below 50% much faster than was previously expected - most probably as early as 2020. For countries like Serbia, this limit is important as it is estimated that below that point, there is no imminent danger of a public debt crisis. Once reached, this will represent an important result in the stabilisation of Serbia's public finance.

The pension system and the salary and employment system even with the successfully implemented fiscal consolidation, still have major structural weaknesses - unreformed public enterprises, unsustainable local government budgets, insufficiently efficient Tax Administration, non-reformed education and healthcare systems etc. At that, the two by far the largest and most significant systems in the public sector, the pension system and the general government salary and employment system are currently not properly regulated. These systems were still maintained in the unsustainable, crisis-management regimes for the large part of 2018 (the temporary pension and public sector salary cuts and employment ban were in force) - which now need to be left behind, moving into a system that will be sustainable in the long-term. In the second half of 2018, the Government began taking certain steps to repeal these temporary measures. At the end of September, the Law on Pension and Disability Insurance was amended to terminate the temporary pension cuts, but at the same time, some other - quite debatable - changes were introduced. In addition, new laws are being drafted to bring about permanent (systematic) regulation of the general government salary system. What is, however, very bad is the fact that, when the temporary pension cuts were being annulled, the formula for future pension indexation with inflation and economic growth was also deleted, while the new Law gave the Government discretionary power to increase the income of individual groups of pensioners independently of the amount of contributions they had paid in during their career. Such an arbitrary pension system cannot be sustainable and it is not economically just; in addition, it is completely contrary to the basic legacy of the European pension systems that had been established several decades ago. This is why new, systematic and objective rules for calculating all pensions and their annual indexation need to be established.

When comes to salary system as important part of fiscal policy, Government's efforts in regulating the general government salary system are moving in the right direction. Two issues were identified and addressed: 1) that it was unjustified to have an arbitrary decision every year on the increase in salaries for the employees of the different parts of the public sector and 2) that it was unjustified to have employees who perform the same (generic) work with the same employer (state) be paid different amounts if they work in different ministries or institutions. However, in the process of regulating the general government salary system, numerous challenges remain. First, the range between the lowest and highest salary in the general government must not be too narrow. Pandering to populist demands of the most numerous groups of public sector employees leads to a homogenization of salaries, i.e. it leaves no room for an adequate increase in salaries for the most proficient and most responsible jobs in the government. The market punishes such mistakes quickly and efficiently, as can clearly be seen already through the shortage of medical professionals in healthcare, but also in some other government sectors. Second, the unique pay grade system must include (and control) all major general government segments, i.e. the salaries of employees in the military and the police cannot be excluded from the future regulated system. Third, a detailed register of employees and their salaries (including all bonuses), comprising all general government jobs must be compiled and published as soon as possible - something that other European countries have done (e.g. Slovenia). Fourth, in 2019, the employment ban needs to be lifted in a controlled manner, as there is already a serious shortage of employees in key segments of the general government (healthcare, inspections etc.).

Conclusion

In spite of the facts that imply that Serbian fiscal policy can be described as successful, significant challenges remain. In forthcoming period it is important to work on reforming the financial system and supporting the economic growth. Even the growth rate of 4.4% anticipated for 2018 is not sufficient to overcome Serbia`s legging behind CEE countries. Serbian Fiscal Council argues that the optimal solution since 2019 would be a budget deficit of 0.5% of GDP and public debt below 50% of GDP. These two goals can be accomplished by: (a) reducing the public debt ratio by 2.5 percentage points; and (b) encouraging the economic growth. For this purpose it is necessary to: (a) reduce the fiscal burden on earnings, and (b) increase the share of public investment in GDP.

At the same time attention should be paid towards Serbian market economy present temptations: low rate of domestic investment, private and public; insufficient growth rate; shadow economy and high rate of repayment of foreign debt.