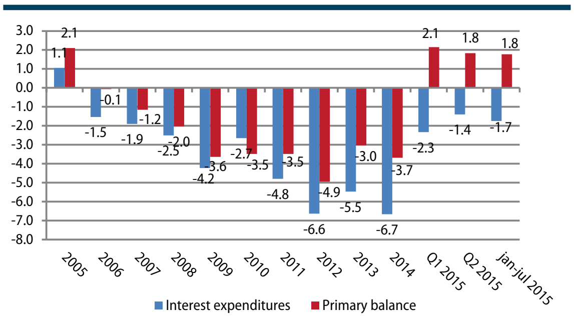
6. Fiscal flows and policy

In the period April-July 2015 consolidated fiscal deficit stood at RSD 18.2 billion, about 1.4% of the four-month GDP, while in the first seven months of 2015 consolidated deficit totaled RSD 39.4 billion (1.7% of GDP) and primary surplus ran at RSD 40 billion (1.8% of GDP). Period January-April saw a slowdown in revenues, but they were still above the targeted level – this mainly refers to excise revenues and social security contributions, while revenues from VAT met the projections. This slowdown in revenues suggests that the government should continue and intensify its efforts to reduce the size of the shadow economy non-selectively and systemically. Otherwise, the initial achievements could be lost. Expenditures continued to fall moderately, due to reduction in wages, pensions and subsidies. After being at a very low level at the beginning of the year, public investments (primarily in infrastructure) increased sharply, but still were below the projected level (2.7% of GDP in the period April-July). Fiscal deficit for 2015 is expected to narrow to 3.5-4% of GDP, and be much smaller than in 2014 and much below the targeted level. This is the result of reduction in the shadow economy, high-pressure collection of non-tax revenues and one-off revenues, and slow pace of certain expenditures (investments and severance pay). On the other hand, positive effects of heightened economic activity on tax revenues were offset by lower-than-projected inflation rate. Excluding the effects of temporary and one-off factors, 2015 fiscal deficit is estimated at 4.5% of GDP. Possible revision of the key consolidation measures (wage and pension reduction) at the end of the year could reverse the downward trend in fiscal deficit in 2016 and thus damage the credibility of the consolidation program. Instead, the initial success should be used to accelerate deficit reduction in the next two years down to much below 3% of GDP, because, by European standards, this is the upper limit of sustainability, meaning that deficits of 3% are considered excessive. Additionally, the extraordinary fiscal room should be used to scale up public investments in 2016 (by 0.5% of GDP), because they act as a much stronger stimulus to economic activity than current consumption. Public debt (including the debt of local self-governments) totaled 75.3% of GDP at the end of July, and is expected to reach about 78% of GDP at the end of 2015.

General tendencies and macroeconomic implications

Fiscal deficit totals RSD 39.4 billion (about 1.7% of GDP) in the first seven months of 2015

Graph T6-1. Serbia: Consolidated fiscal balance and primary balance (% of GDP)[1]



Source: *QM* calculations

Consolidated fiscal deficit stood at RSD 18.2 billion in the period April-July 2015, which approximates 1.4% of the four-month GDP. In the same period, Serbia had primary surplus of RSD 20 billion (2.6% of the four-month GDP).[2] In the first seven months of 2015 consolidated fiscal deficit totaled RSD 39.4 billion (about 1.7% of GDP), and the budget balance before interest payments was in surplus (primary fiscal surplus) of RSD 40 billion (about 1.8% of the four-month GDP).

Fiscal deficit much below the targeted level in the period April-July

In the period April-July 2015 fiscal deficit accounted for 8% of the annual target, compared with 28% in the preceding years. This indicates that fiscal results continued to outperform the projections, mainly because high-pressure collection of non-tax revenues and one-off revenues continued, tax revenues remained above the projected level, and some spending was delayed or very low (severance pay and public investments).

1 Primary fiscal balance (balance without interests) is the difference between the total public revenues and the overall public expenditures subtracted by expenditures on interest payments.

2 Analyses of fiscal trends are based on the Ministry of Finance data on public revenues, public expenditures and public debt, and on other available data on macroeconomic trends.

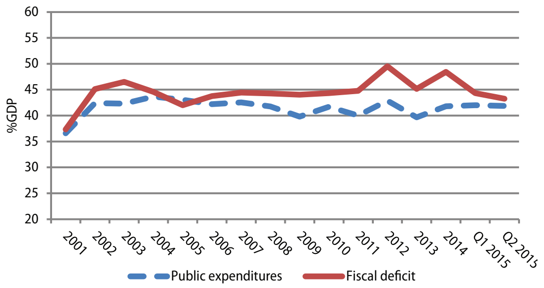
Tax revenues slowing down, but remain above the projected level

In the period April-July rise in excise revenues, revenues from VAT and social security contributions (based on reduction in the shadow economy) slowed down, and some segments even experienced a slight decrease in revenue compared with the preceding period. However, excise revenues and social security contributions remained above the targeted level, while revenues from VAT met the projections. Although tax revenues exceeded the projections in this period, the upward trends detected previously slowed down which suggests that the government should continue with the measures that led to these good results (frequent inspections and penalties for taxpayers engaged in the shadow economy) in order to preserve them. Additional improvements require implementation of additional measures (ban on sale of new industrial products at markets, comprehensive reform in the Tax Administration etc.). Otherwise, the initial results of the government's efforts against the shadow economy could be lost. On the other hand, public investments rose steeply in the period April-July (compared with the preceding four-month period, and the last year's level) primarily because large infrastructure projects were paced up. However, these investments are still below the targeted level.

Consolidated deficit expected to narrow to RSD 140-160 billion (3.5-4% of GDP) in 2015...

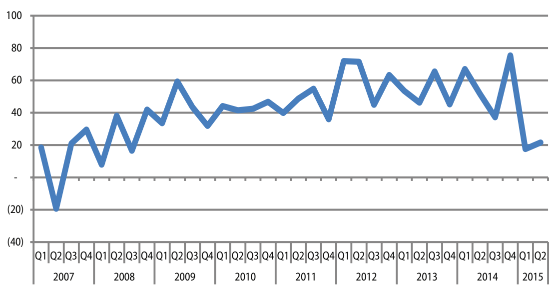
In the previous years, fiscal deficit recorded in the first seven months of a year accounted for around 50% of the annual deficit, on average. However, in the first seven months of 2015 it accounted for around 17% of the annual target. If the trends from the preceding years had continued in 2015, fiscal deficit would have totaled RSD 115 billion in the period January-July 2015. This leads to conclusion that fiscal results were much better than expected. Different dynamics of dividend payout (dividends are now paid at the beginning of a year), considerable one-off revenue inflow (for the license for 4G network, from the Agency for Insurance of Deposits etc.), and delays to and slow pace of some spending (severance pay and public investments) contributed much to such results. However, even if we exclude the effects of these factors, fiscal results achieved in the first seven months are much better than the projections, because reduction in the shadow economy pushed up tax revenues. Namely, effects of the reduction in the shadow economy are estimated at additional RSD 25-30 billion (0.6-0.7% of GDP) of tax revenue. If the current trends continue by the end of the year, consolidated fiscal deficit will stand at RSD 140-160 billion, or 3.5-4% of GDP.

Graph T6-2. Serbia: Consolidated public revenues and public expenditures (% of GDP)



Source: *QM* calculations based on the MF data

Graph T6-3. Serbia: Seasonally adjusted fiscal deficit (RSD billion, in 2014 prices)



Source: *QM* calculations based on the MF data

…much below the last year's level and the annual target for 2015

Fiscal deficit of 3.5-4% of GDP would mean a considerable fiscal adjustment compared with the last year's level (by 3-3.2% of GDP), and would be much below the annual target for 2015 (by 2-2.4% of GDP). Wage and pension reduction, more efficient tax collection, and high-pressure collection of non-tax revenues and one-off revenues are the key factors that helped reduce fiscal deficit to below the *last year's level*. Economic activity exceeded the projections and was another factor that pushed up tax revenues. However, inflation rate was below the projected level so the positive effects of real growth on tax revenues were offset. Rising exports and growing investments are the key drivers of growth in 2015. This is good from the aspect of long-term sustainability of growth but does not have large revenue impact because these two components of demand are exempt from VAT and excise duty. Fiscal deficit was smaller *than projected* due to a high-pressure collection of non-tax revenues and one-off revenues, reduction in the shadow economy, low level of public investments, and delays in severance pay. Therefore, excluding the

Credible fiscal consolidation program should secure a steady reduction in fiscal deficit down to a sustainable level…

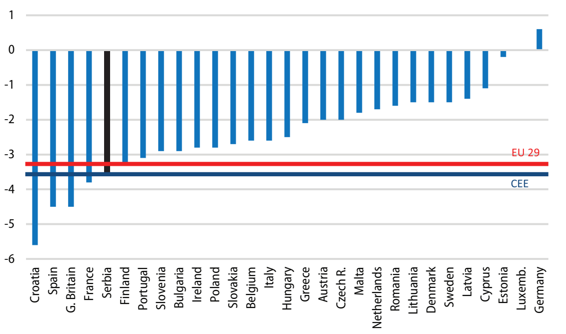
effects of one-off and temporary factors (non-tax revenues, delays in spending on severance pay etc.), fiscal deficit is expected to narrow to 4.5% of GDP in 2015.

Serbia's fiscal performance improved considerably in 2015 compared with the preceding years, and the achieved results are much better than targeted. However, deficit of almost 4% of GDP is still quite large, and therefore it would be economically unjustifiable to loosen the key consolidation measures (wage and pension reduction).

…so it is too early to loosen the key consolidation measures

Credible middle-term consolidation program should secure a steady reduction in fiscal deficit (continuous y-o-y decrease) down to the level much below 3% of GDP, because, by European standards, this percentage is the upper limit of sustainability, and according to Serbia's fiscal rules, this limit is set at 1% of GDP in the middle-term. Even if Serbia's deficit shrinks to 3.5% of GDP in 2015, it will be above the average for EU-29 (2.3% of GDP) and CIE states (2.4% of GDP), and only four European countries will have larger deficits. Possible loosening of some consolidation measures at the end of 2015 (through wage and pension increase), along with uncertain further reduction in the shadow economy, and the risks stemming from serious delays in structural reforms, could push up the deficit in 2016, and Serbia would remain among European countries with the largest fiscal deficits. Economic growth is not expected to contribute much to deficit reduction in the future, because exports and investments as the key drivers of a sustainable economic growth in Serbia do not have large fiscal impact.

Graph T6-4. Serbia and EU: Fiscal deficits in 2015 (% of GDP)



Source: *QM* and European Commission

The extraordinary fiscal room should be used to scale up public investments

Accordingly, more ambitious fiscal goals should be set in the next revision of the arrangement with the IMF (in November 2015), namely, considerable deficit reduction in 2016, and continuation of such trend in 2017, down to much below 3% of GDP. At the same time, the extraordinary fiscal room should be used to scale up public investments, as a strong stimulus to economic activity, because they result in higher fiscal multiplier than current consumption.

Analysis of the dynamics and structure of public revenues and public expenditures

Public revenues went up moderately (by 2.5%) in the period April-July 2015 compared with the same period last year, primarily because non-tax revenues grew steeply (by 40%), while tax revenues suffered a real drop (by 1.4%). However, public revenues slowed down in the period April-July because real y-o-y increase (by 3.5%) was lower than in the preceding period, and real revenues went down compared with the preceding four months (by 0.7%).

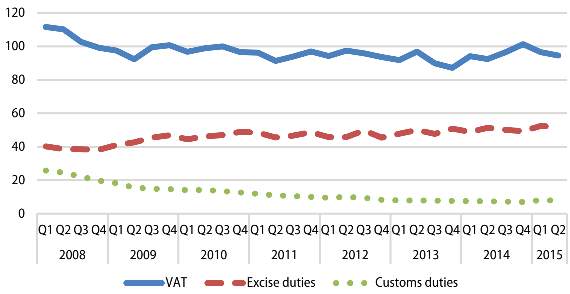
Non-tax revenues slowing down, the largest share collected at the beginning of 2015

Y-o-y increase in non-tax revenues came from an intensive dividend payout by public and state-owned enterprises. However, real drop in these revenues (by 8.3%) in the period April-July compared with the preceding four months suggests that they are slowing down. This increase was based on a high-pressure collection of the total annual dividend at the beginning of the year, which affected the intrannual dynamics of these revenues. However, it is considered to be temporary and unsustainable in the long run, because under such system companies are unable to finance their fixed assets. Furthermore, it will not be possible to permanently keep the system of paying the savings based on the wage reduction into the budget. Analyses of the trends in public finance should therefore be based on the dynamics of tax revenues.

Tax revenues slowing down, but still above the targeted level

Tax revenues suffered a real drop (by 1.4%) in the period April-July compared with the same period last year, which is in accordance with the drop in consumer spending. These revenues fell (by

Graph T6-5. Serbia: Seasonally adjusted revenues from consumption tax (RSD billion, in 2014 prices)



Source: *QM* calculations based on the MF data

0.5%) compared with preceding four-month period, as well.[3] Revenue collection slowed down because revenues from consumption tax slowed down due to reduction in the shadow economy and rise in exports, and revenues from the tax on factors of production decreased due to wage and pension reduction. However, in spite of this slowdown, revenues collected in the period April-July were above the targeted level, primarily due to increase in excise revenues and social security contributions.

Excise revenues stopped growing, but remained above the targeted level

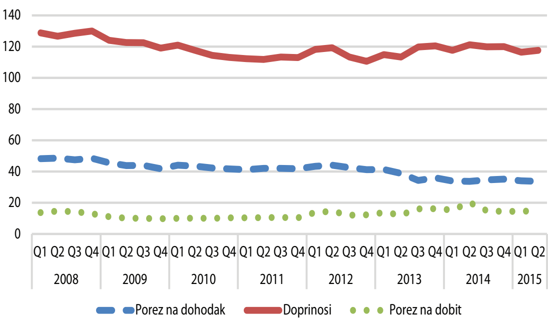
Strong upward trend in excise revenues detected in the first four months of 2015 was halted in the period April-July. Excise revenues collected in this period remained unchanged compared with the same period last year (although excise tax rates were increased), and fell slightly (by1.3%) compared with the preceding four months. Excise revenues stopped growing probably because the effectiveness of the first wave of actions against tobacco products smuggling were exhausted, and sales (legal) of petroleum products decreased (see: Graph T 6-6). In spite of that, excise revenues collected in the period April-July exceeded the targeted level by 4%. Similarly, excise revenues collected in the first seven months of 2015 rose above the targeted level by 5%. Revenues from excise on tobacco products were much lower than before 2013, when illegal sale of these products increased notably, which indicates that there is much room for further actions against the shadow economy in this area.

Revenues from VAT slowed down in the period April-July, but reached the targeted level

Revenues from VAT increased in the period April-July compared with the same period last year (by 0.7%). On the other hand, real seasonally adjusted revenues from VAT fell compared with the preceding four-month period (by 3.1%). Revenues from VAT slowed down in the period April-July due to a slowdown in revenues from gross domestic VAT (2.5% decrease compared with the preceding four-month period), and increase in VAT refund (by 6% compared with the preceding four months), which was probably caused by rise in exports as of May, and previous delays in VAT refund. This slowdown in revenues from gross domestic VAT could mean that the government loosened its efforts to curb the shadow economy. The Tax Administration initially achieved some very promising results, but to make these results permanent, and then further reduce the size of the shadow economy (and there is enough room to do this), it is necessary to maintain tight and systemic controls on tax payers, and to keep punishing defaulters. Otherwise, shadow economy could grow again. Accordingly, many tax offenders who have been punished during the preceding one year's period continue disobeying tax regulations. The government has to make it clear that these are not just temporary actions taken now and then, but that they demonstrate government's continuing commitment to reducing the shadow economy. Although the strong upward trend in revenues from VAT was halted, these revenues reached the targeted level in the period April-July. Revenues from VAT collected in the first seven months of 2015 exceeded the projected amount by 2.5%, mainly due to a large inflow at the beginning of the year. Increase in revenues from VAT, excise revenues and social security contributions, driven by reduction in the shadow economy, contributed much to the recovery in public finance. It is therefore necessary to intensify activities against the shadow economy and make them systemic to preserve the results that have been achieved so far.

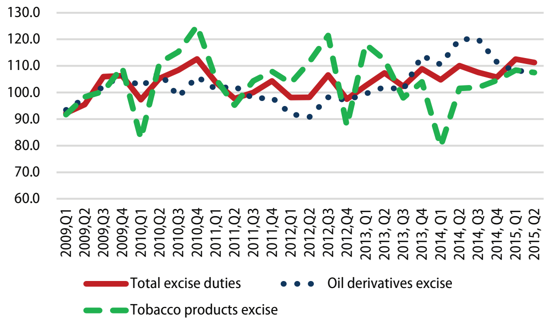
3 Y-o-y growth rates of public revenues and public expenditures were calculated on the basis of inflation-adjusted absolute amounts (real growth rates). Quarter-on-quarter (qoq) growth rates of public revenues and public expenditures were calculated on the basis of seasonally adjusted and inflation-adjusted absolute amounts.

Graph T6-6. Serbia: Seasonally adjusted excise revenues, by components (2010=100)



Source: *QM* calculations based on the MF data

Graph T6-7. Serbia: Seasonally adjusted revenues from VAT, by components (2010=100)



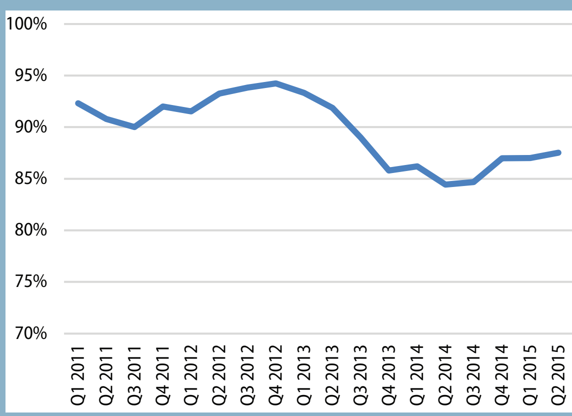
Source: *QM* calculations based on the MF data

Box 1. Collection efficiency of VAT measured by C-efficiency ratio

VAT performance can be roughly measured as a ratio between the collected VAT revenue and perfectly enforced VAT levied at the current effective VAT rate on all consumer consumption. Higher ratio indicates grater collection efficiency, i.e. smaller size of the shadow economy.

Graph T6-8 shows a strong downward trend in VAT performance (growing shadow economy) in 2013, which was reversed as of Q2 2014, so the collection efficiency improved considerably by the end of the year, and continued improving in 2015, but at a much slower pace. However, in spite of these improvements, collection efficiency of VAT, measured by C-efficiency ratio, is far below the level it was at before the sharp decrease in 2013 occurred. This suggests that there is much room to increase collection efficiency. The data also indicate that along with the measures that have been taken so far, some new measures need to be introduced to achieve further improvements, because the effectiveness of the current measures have probably been exhausted.

Graph T6-8. Serbia: Annualized C-efficiency ratio

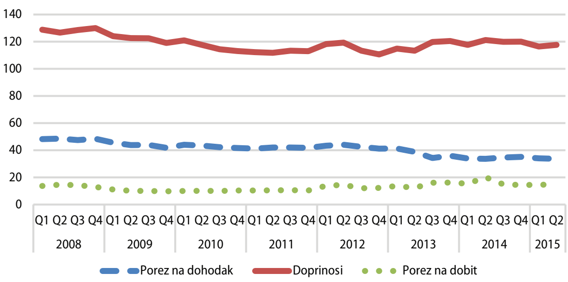


Source: *QM* calculations based on the MF data

Social security contributions exceed the targeted level

Revenues from personal income tax fell (by 1.5%) in the period April-July compared with the preceding four-month period, but went up compared with the same period last year (by 0.5%). This y-o-y increase might have been caused by a more notable reduction in informal employment at the end of 2014 and at the beginning of 2015 (because public sector wage cuts push down the total mass of wages), but the local trend indicates that it was halted in the period April-July. On the other hand, contributions for mandatory social security insurance went up slightly in the period April-July compared with the preceding four-month period (by 0.5%), but suffered a y-o-y decrease (by 2.6%) due to the public sector wage reduction. Real y-o-y decrease in revenues from personal income tax and social security contributions does not match the official data showing 2% drop in average wage, and 10% increase in formal employment, because with such trends in labor market, without changing tax and contribution rates, these revenues should have grown by 8%. However, a reliable method is used to record public revenues (cash principle), meaning that this discrepancy is another indicator of inconsistency between the official data on trends in labor market and other macroeconomic trends. On the basis of intraannual dynamics of revenues from social security contributions in 2015 and in the preceding years, it is estimated that social security contributions collected in the period April-July, and in the period January-July 2015, exceeded the projected level by 5%, mainly because reduction in the shadow economy narrowed the room for wage payments outside the legal flows.

Graph T6-9. Serbia: Seasonally adjusted revenues from tax on factors of production (RSD billion, in 2014 prices)



Source: *QM* calculations based on the MF data

Revenues from corporate income tax went up slightly in the period April-July compared with the preceding period (by 0.5%). On the other hand, these revenues suffered a sharp real y-o-y drop of 18%, which could be a consequence of a notable decline in profitability in 2014.

Considerable decrease in public expenditures…

There was a real y-o-y decrease in public expenditures in the period April-July 2015 (by 2.3%). These expenditures were much lower than in the preceding four-month period (by 7.1%), as well. This decrease was driven by reduction in wages, pensions and subsidies.

…due to wage and pension cut…

Public expenditures fell mainly due to wage and pension reduction. There was a real y-o-y decrease in expenditures on wages of 11.3% in the period April-July. These expenditures fell compared with the preceding four-month period (by around 3%), as well, probably because the number of public sector employees declined and controls on payment of different bonuses and allowances were tightened. There was a y-o-y decrease in expenditures on pensions in the period April-July (by 4.5%). These expenditures went down in this period compared with the preceding four-month period, as well (by 1.3%). In the first seven months of 2015 savings from gross wages amounted to RSD 33 billion, and savings from gross pensions totaled RSD 13 billion.[4] Reduction in wages and pensions is expected to bring annual savings of RSD 70 billion, and its *net effect* on fiscal deficit (taking into account the consequential decrease in revenues from taxes on wages and pensions and social security contributions) is estimated at RSD 55-60 billion. Accordingly, if this measure is abolished, fiscal deficit might widen considerably in 2016.

…and reduction in subsidies

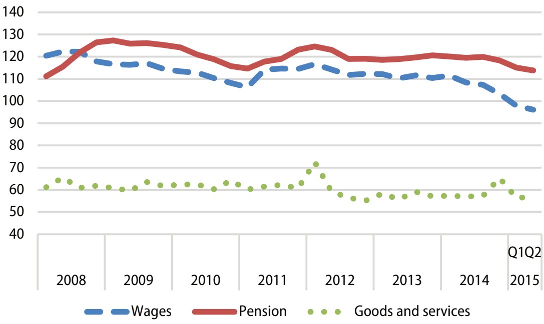
There was a real y-o-y drop in expenditures on subsidies in the period April-July (by 8%). These expenditures fell notably in this period compared with the preceding four-month period (by 15.7%). Expenditures on subsidies in Serbia are much above the sustainable level and above average of comparable countries, so this reduction is welcome. Besides that, their purpose and granting procedure need to be changed to increase their efficiency.

Public investments rise steeply, but fail to reach the target

Extremely slow pace of public investment at the beginning of 2015 was quickened in the period April-July. Namely, public investments (especially in traffic infrastructure) grew notably (by 29.1%) in this period compared with the preceding four-month period. There was a slight y-o-y rise in these investments, as well (by 2.7%). However, public investments accounted for only 2.7% of GDP in this period, which is 15% below the targeted level, and in the first seven months of 2015 only 2.4% of GDP was spent on public investment, i.e. about 25% less than planned. Most probably, only investments in traffic infrastructure will reach the annual target. Public investments are strong stimulus to economic activity, both in the short term (rise in demand) and in the long term (increase in supply), and therefore need to be scaled up, as close as possible to the annual target for 2015. This target should be lifted in 2016 (to at least 3.5% of GDP) and all the necessary preparations for achieving it should be made. After the potential partners abandoned the concession for Corridor XI from Belgrade to Čačak, the remaining sections of the highway, that have not been contracted yet, could be financed from the budget.

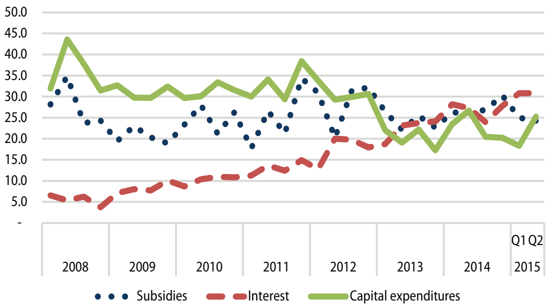
4 Net effect of wage and pension reduction on fiscal deficit is weaker because this reduction pushes down revenues from taxes and contributions deductible from public sector wages.

Graph T6-10. Serbia: Seasonally adjusted expenditures on wages, pensions and goods and services (RSD billion, in 2014 prices)



Source: *QM* calculations based on the MF data

Graph T6-11. Serbia: Seasonally adjusted expenditures on interest payments, subsidies and capital expenditures (RSD billion, in 2014 prices)



Source: *QM* calculations based on the MF data

Expenditures on interest payments going up due to growing indebtedness

Expenditures on interest payments went up considerably in the period April-July 2015 compared with the same period last year (by 16.6%), and were higher than in the preceding four-month period, as well (by 1.9%). Growing indebtedness of the country is the key driver of this increase. However, under the ECB and Fed's expansive monetary policy, borrowing conditions improved, which has favorable impact on expenditures on interest payments, meaning that without the influence of these temporary external factors, rise in these expenditures would be even larger.

Analysis of fiscal trends by government level

Central government and Health Insurance Fund running deficit, other government levels running surplus in Q2

In Q2 2015 the central government and the Health Insurance Fund ran budget deficit (RSD 17.2 billion and RSD 1.8 billion respectively). On the other hand, the Pension and Disability Insurance Fund, AP Vojvodina and local self-governments ran budget surplus (RSD 0.3 billion, RSD 0.9 billion and RSD 1.8 billion respectively).

Revenues of local self-governments went up because revenues from property tax continued to grow

Both central government and local self-governments collected more revenue in Q2. Revenues from VAT, excise revenues and non-tax revenues pushed up the central government revenues. On the other hand, the upward trend in revenues from property tax continued in Q2 (16.3% y-o-y), and pushed up the revenues of local self-governments. This indicates that local self-governments continued with their efforts to increase revenue impact of property tax and thus make up for the loss of revenue from construction land usage fee. Revenues from property tax grew by 75% in 2014, and if they keep growing at the pace detected in Q2 2015, total revenues from property tax in 2015 will equal the sum of revenues from property tax and construction land usage fee collected in 2013, which is justifiable.

Graph T6-12. Serbia: Fiscal surplus (deficit) at different levels of government (bn. RSD, current prices)

Year	*Budget of Republic*	*Pension fund*	*National Employment Service*	*Health fund*	*Vojvodina budget*	*Local self-governments*
2010	-108.0	-1.0	-0.1	1.9	-9.6	-11.5
2011	-144.3	0.2	1.3	2.1	-0.7	-15.6
2012	-213.0	-0.4	0.8	4.0	1.1	-0.3
2013	-194.4	-1.2	-0.5	8.7	1.3	6.3
2014	-204.1	3.6	2.0	0.2	1.0	8.5
Q1 2015	-24.9	-4.2	0.0	2.0	1.6	4.3
Q2 2015	-17.2	0.3	0.1	-1.8	0.9	1.8

Source: *QM* calculations based on the MF data

Local self-governments spend more because they have excessive available funds

Different government levels showed some quite divergent y-o-y trends in expenditures in Q2 – central government (budget of the Republic, Pension and Disability Insurance Fund and Health

Insurance Fund) spent less, and expenditures of local self-governments went up. This reduction in expenditures of the Republic budget was achieved through fiscal consolidation, and consequential reduction in expenditures on wages and transfers to Pension and Disability Insurance Fund, and slow pace of capital expenditures. On the other hand, y-o-y increase in expenditures of local self-governments (by 8.3%) was caused by a steep rise in expenditures on subsidies and welfare, and to a certain extent, by rise in expenditures on goods and services and capital expenditures (see: *Appendix 3*). Rise in expenditures on subsidies and goods and services is justifiable only to the amount used to pay off arrears. Moderate real rise in local public investment (by 15.9%) is economically justifiable and welcome. Total expenditures of local self-governments went up because the funds delegated to local self-governments exceed their competences.

A balance between the assigned competences and revenues should be established

Sub-central government levels have been running large and growing surplus – the budget of AP Vojvodina showed surplus of RSD 1 billion in 2013 and RSD 1.6 billion in 2014, and in the first half of 2015 it totaled RSD 2.5 billion. Similarly, budgets of local self-governments showed surplus of RSD 6.3 billion in 2013 and RSD 8.5 billion in 2014, and in the first half of 2015 it totaled RSD 6.1 billion. On the other hand, the central government runs a quite large deficit. This all leads to conclusion that there is a systemic imbalance in distribution of competences and revenues among different government levels, so that the sub-central government levels have been given more revenue than competences. To improve the management of public finance, it is necessary to correct this imbalance. This can be achieved through a systemic reform in the system for funding sub-central government levels and by bringing distribution of available funds in line with delegated competencies.

Trends in public debt

Serbia's public debt totaled EUR 24 billion at the end of July (74.1% GDP)...

At the end of July 2015 Serbia's public debt totaled EUR 24 billion (74.1% of GDP), and with the debt of local self-governments included it accounted for 75.3% of GDP.

...and with the debt of local self-governments included – 75.3% of GDP

From the end of March to the end of July 2015 public debt remained almost unchanged in nominal terms, because fiscal deficit in this period was small (EUR 150 million), and was mainly financed from previously accumulated government deposits. Additionally, trends in dinar exchange rate had favorable impact on public debt dynamics, i.e. dinar appreciated against dollar by 1.3%, and dinar to euro exchange rate remained unchanged. Although nominal public debt remained unchanged in the period April-July, public debt to GDP ratio fell slightly (by 1.2%), because dinar appreciated against dollar and GDP grew slightly.

Table T6-13. Serbia: Public debt dynamics 2000-2015

	Amount at the end of period, in billions EUR												
	2000	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Q1 2015	July 2015
I. Total direct debt	14.17	9.62	8.58	8.03	7.85	8.46	10.46	12.36	15.07	17.3	20.2	21.6	21.5
Domestic debt	4.11	4.26	3.84	3.41	3.16	4.05	4.57	5.12	6.5	7.0	8.2	8.7	8.5
Foreign debt	10.06	5.36	4.75	4.62	4.69	4.41	5.89	7.24	8.6	10.2	12.0	12.9	13.0
II. Indirect debt	-	0.66	0.80	0.85	0.93	1.39	1.71	2.11	2.60	2.81	2.5	2.6	2.5
III. Total debt (I+II)	**14.2**	**10.3**	**9.4**	**8.9**	**8.8**	**9.8**	**12.2**	**14.5**	**17.7**	**20.1**	**22.8**	**24.2**	**24.0**
Public debt / GDP[2]	**169.3%**	**50.2%**	**36.2%**	**29.4%**	**25.6%**	**31.3%**	**41.5%**	**45.1%**	**59.3%**	**63.8%**	**70.9%**	**73.3%**	**72.3%**
Public debt / GDP (QM)[3]	**169.3%**	**52.1%**	**36.1%**	**29.9%**	**28.3%**	**32.8%**	**41.9%**	**44.4%**	**56.1%**	**59.4%**	**71.0%**	**75.3%**	**74.1%**

1) According to the Public Debt Law, public debt includes debt of the Republic related to the contracts concluded by the Republic, debt from issuance of the t-bills and bonds, debt arising from the agreement on reprogramming of liabilities undertaken by the Republic under previously concluded contracts, as well as the debt arising from securities issued under separate laws, debt arising from warranties issued by the Republic or counterwarranties as well as the debt of the local governments, guaranteed by the Republic.
2) Estimate of the Ministry of Finance of the Republic of Serbia
3) QM estimate (Estimated GDP equals the sum of nominal GDP in the current quarter and three previous quarters)
Source: QM calculations based on the MF data

Indirect debt stagnates in 2015, but it could start growing

Public debt structure did not change much in the period April-July. Direct debt shrank by EUR 150 million due to old foreign currency savings payout and payment of other internal and external debts (EUR 270 million and EUR 120 million respectively). On the other hand, indirect debt remained almost unchanged because the government continued its policy of not granting implicit subsidies to state-owned and public enterprises. Favorable trends in the market (low

Trends

gas prices and favorable ratio between the price of raw materials and products in steel industry) allowed this, but the factors that could push up the debt in the following period have not been eliminated, i.e. in spite of the announcements that restructuring and privatization of large public and state-owned enterprises, as major users of state guarantees (Srbijagas, Azotara, Petrohemija etc.), would be finished in the first half of 2015, not much progress has been made.

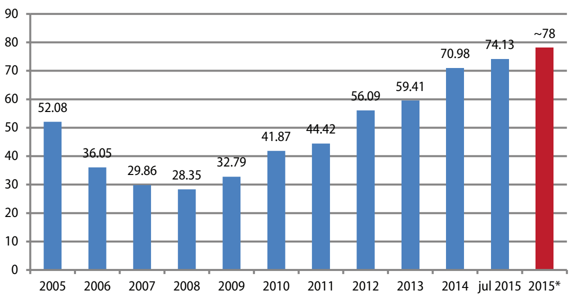
Refinancing of expensive loans by cheaper ones is recommendable under the current trends in the world market

Expenditures on interest payments for 2015 are estimated at around EUR 1.1 billion (3.5% of GDP), y-o-y increase of 0.5% of GDP. This rise is expected to continue in 2016, as well, but at a slower pace. Expenditures on interest payments depend on the amount of debt and the level of interest rates, and the letter are determined by the level of public debt and sustainability of public finance of a country and trends in the global financial market. Persistent implementation of the fiscal consolidation program will slow down the debt in the following period. However, increase in debt-to-GDP ratio is not expected to be halted until 2017 (if the program is implemented consistently). Therefore, expenditures on interest payments can be reduced in the following period through refinancing of some expensive loans, though this option is quite limited because loans that can be refinanced make a relatively small share of the total debt. Borrowing conditions in the global financial market have improved, under the Fed and ECB's expansive monetary policy, and initially good results of fiscal consolidation in Serbia slightly decreased the country risk. Therefore, some of the expensive loans (with interest rates of 4-6%) should be refinanced by cheaper ones. Furthermore, the initiative to use a half of the revenue from privatization of Telekom for early repayment of expensive loans is considered welcome. The foregoing could slightly slow down the overall expenditures on interest payments in the following period (by around EUR 50-100 million annually). Although these savings would not have a notable impact on the health of public finance, this measure should be applied anyway, because it requires relatively small administrative efforts.

Public debt will amount to around 78% of GDP at the end of 2015

Debt-to-GDP ratio will continue to rise in 2015, because fiscal deficit is expected to widen in the second half of the year, and some other factors could also push up the debt (exchange rate, issuance of government guarantees etc.). If real dinar exchange rate remains unchanged, and if borrowing in advance of need remains within the expected level, and without new issuance of government guarantees, public debt will probably reach 77% of GDP, and with the non-guaranteed debt of local self-governments included, it will total 78% of GDP, which is unsustainable in the long term and suggests that the extraordinary fiscal results achieved in 2015 should be used to further reduce fiscal deficit in the following period, instead of increasing current spending.

Graph T6-14. Trends in public debt in Serbia (% of GDP



Source: *QM* calculations

Appendices

Annex 1. Serbia: Consolidated General Government Fiscal Operations[1]), 2008-2015 (nominal amounts, bn RSD)

	2008	2009	2010	2011	2012	2013	2014					2015		
							Q1	Q2	Q3	Q4	Q1-Q4	Q1	Q2	jan-jul
I PUBLIC REVENUES	**1,193.5**	**1,200.8**	**1,278.4**	**1,362.6**	**1,472.1**	**1,538.1**	**352.9**	**403.3**	**407.6**	**457.0**	**1,620.8**	**365.6**	**424.7**	**954.5**
1. Current revenues	1,143.1	1,139.2	1,215.7	1,297.9	1,393.8	1,461.3	334.9	383.7	385.4	436.8	1,540.8	364.3	422.7	951.0
Tax revenue	1,000.4	1,000.3	1,056.5	1,131.0	1,225.9	1,296.4	301.3	348.7	344.8	375.1	1,369.9	309.9	368.7	826.0
Personal income taxes	136.5	133.5	139.1	150.8	35.3	156.1	32.2	35.1	36.9	42.2	146.5	32.5	35.6	81.3
Corporate income taxes	39.0	31.2	32.6	37.8	54.8	60.7	15.5	29.8	14.2	13.2	72.7	13.0	25.9	42.9
VAT and retail sales tax	301.7	296.9	319.4	342.4	367.5	380.6	93.6	97.0	101.7	117.3	409.6	96.2	100.1	235.9
Excises	110.1	134.8	152.4	170.9	181.1	204.8	42.9	55.2	58.4	56.0	212.5	46.3	57.2	128.2
Custom duties	25.8	48.0	44.3	38.8	35.8	32.5	7.3	7.5	7.8	8.6	31.2	7.9	7.9	18.6
Social contributions	312.7	318.8	323.0	346.6	378.9	418.3	99.3	109.8	110.7	120.6	440.3	100.6	125.9	284.8
Other taxes	35.6	37.1	46.0	43.5	42.6	43.5	10.7	14.3	15.1	17.2	57.3	13.4	16.0	34.3
Non-tax revenue	0.0	138.8	159.2	36.9	37.9	34.9	33.7	35.0	40.5	61.7	170.9	54.3	54.1	125.0
2. Capital revenues	1.4	0.9	0.3	2.0	8.7	3.5	0.4	0.6	0.4	0.6	2.0	0.3		3.5
	0.0													
II TOTAL EXPENDITURE	**-1,265.5**	**-1,328**	**-1,419.5**	**-1,526.1**	**-1,717.3**	**-1,750.2**	**-421.0**	**-448.3**	**-447.4**	**-562.2**	**-1,878.9**	**-379.3**	**-438.9**	**-993.9**
1. Current expenditures	-1,089.6	-1,155	-1,224.8	-1,324.8	-1,479.9	-1,549.8	-381.7	-393.6	-398.0	-454.7	-1,628.0	-368.9	-406.0	-926.2
Wages and salaries	-293.2	-302.0	-308.1	-342.5	-374.7	-392.7	-95.7	-97.9	-96.4	-98.6	-388.6	-83.8	-104.3	-236.6
Expenditure on goods and services	-181.4	-187.4	-202.5	-23.3	-235.7	-236.9	-50.9	-58.3	-60.2	-87.4	-256.8	-50.9	-58.8	-132.7
Interest payment	-17.2	-187.4	-34.2	-44.8	-68.2	-94.5	-35.5	-28.6	-26.8	-24.2	-115.2	-40.6	-32.7	-79.3
Subsidies	-77.8	-22.4	-77.9	-80.5	-111.5	-101.2	-19.4	-23.7	-27.9	-46.1	-117.0	-18.7	-23.8	-51.5
Social transfers	-496.8	-63.1	-579.2	-609.0	-652.5	-687.6	-170.7	-172.4	-172.8	-181.0	-696.8	-166.7	-173.8	-401.4
o/w: pensions5)	*-331.0*	-556.4	*-394.0*	*-422.8*	-473.7	-498.0	-125.0	-126.9	-128.0	-128.1	-508.1	-121.0	-122.8	-285.0
Other current expenditures	-23.5	-387.3	-22.9	-31.7	-37.4	-36.9	-9.6	-12.6	-14.0	-17.5	-53.7	-8.1	-12.5	-24.7
2. Capital expenditures	-106.0	-24.0	-105.1	-111.1	-126.3	-84.0	-13.9	-25.3	-23.7	-33.7	-96.7	-10.5	-23.8	-46.7
3. Called guarantees	-1.6	-2.2	-2.7	-3.3	-3.7	-7.9	-3.4	-5.9	-8.2	-12.1	-29.7	-6.9	-8.2	-19.4
4. Buget lendng	-19.3	-24.0	-30.0	-25.0	-38.2	-35.6	-5.2	-5.8	-0.3	-44.1	-55.4	-0.5	-0.9	-1.6
III CONSOLIDATED BALANCE	**-72.0**	**-127.1**	**-141.0**	**-163.5**	**-245.2**	**-212.1**	**-68.1**	**-45.0**	**-39.8**	**-105.2**	**-258.1**	**-21.1**	**-14.2**	**-39.4**

Source: *QM* calculations based on the MF data

Annex 2.

	2008	2009	2010	2011	2012	2013	2014					2015		
							Q1	Q2	Q3	Q4	Q1-Q4	Q1	Q2	jan-jul
I PUBLIC REVENUES	**3.3**	**-8.9**	**-1.5**	**-4.6**	**0.6**	**-2.2**	**-0.8**	**4.3**	**3.5**	**5.4**	**3.2**	**7.6**	**4.2**	**4.2**
1. Current revenues	3.5	-9.1	-1.5	-4.4	0.1	-2.6	-0.3	4.3	2.8	5.7	3.3	7.6	4.1	4.1
Tax revenue	3.7	-8.8	-2.5	-4.1	1.0	-1.7	-1.0	6.4	3.8	4.3	3.5	1.8	-0.6	-0.3
Personal income taxes	6.3	-10.8	-3.9	-2.9	2.1	-12.2	-17.8	-13.5	0.8	-1.7	-8.1	-0.1	-0.4	0.3
Corporate income taxes	18.5	-27.0	-3.6	3.9	35.1	2.9	-18.0	165.3	-9.5	-18.1	17.4	-17.2	-14.5	-17.7
VAT and retail sales tax	2.5	-10.2	-0.7	-4.0	0.0	-3.8	4.3	-3.6	5.4	15.1	5.4	1.8	1.5	1.2
Excises	0.7	11.6	4.2	0.6	-1.2	5.1	-1.7	0.8	9.5	-2.4	1.6	6.9	1.9	2.5
Custom duties	1.8	-32.4	-14.9	-21.5	-14.0	-15.6	-4.4	-7.0	-6.9	-7.3	-6.5	8.9	4.0	7.2
Social contributions	4.3	-7.0	-6.5	-3.9	1.9	2.6	3.6	29.1	28.1	0.5	3.1	0.3	-1.6	-2.0
Other taxes	-2.3	-4.9	14.5	-15.2	-8.8	-5.2	12.1	8.2	0.8	44.1	29.2	23.9	9.9	17.0
Non-tax revenue	2.6	-11.3	5.8	-6.1	-6.2	-8.7	6.0	-13.1	-5.1	15.1	1.5	59.8	50.2	47.3
2. Capital revenues	-76.8	-41.4	-66.8	468.2	304.5	-63.0	-79.6	17.6	-27.7	6.0	-33.3	-19.5	22.9	
II TOTAL EXPENDITURE	**5.0**	**-4.8**	**-1.7**	**3.3**	**4.3**	**-0.3**	**4.4**	**3.7**	**-3.0**	**14.8**	**5.2**	**-5.1**	**-2.9**	**-3.6**
1. Current expenditures	6.9	-3.3	-2.2	3.1	4.1	-2.7	6.0	0.4	-1.2	6.5	2.9	-4.4	-2.6	-3.4
Wages and salaries	10.9	-6.0	-5.9	0.4	2.0	-2.6	-0.6	-2.0	-3.0	-6.5	-3.1	-13.3	-11.3	-12.3
Expenditure on goods and services		-5.7	-0.3	4.3	1.5	-6.6	-0.1	3.4	-1.6	19.1	6.2	-1.1	-0.8	1.4
Interest payment	-2.8	-5.7	-0.3	17.4	41.9	28.8	82.9	2.2	-3.4	13.6	19.3	13.0	12.2	14.8
Subsidies	-13.3	19.0	40.6	7.4	29.1	-15.6	-0.8	6.0	-3.8	41.9	13.2	-4.2	-26.1	-6.6
Social transfers	10.1	-26.0	13.9	5.8	-0.1	-2.1	2.4	-2.2	-1.8	-1.2	-0.7	-3.3	-0.9	-1.3
o/w: pensions5)	*9.5*	2.2	-3.9	3.9	*4.4*	*-2.3*	*1.5*	*0.0*	*0.2*	*-2.0*	*-0.1*	*-4.3*	*-4.7*	*-4.5*
Other current expenditures	14.9	6.7	-6.1	23.9	9.9	-8.4	31.1	36.2	43.1	55.0	42.6	-15.9	-2.4	-8.8
2. Capital expenditures	-4.3	-6.7	-11.8	5.3	6.0	-38.2	1.4	41.5	-12.8	25.2	12.7	-25.5	-7.5	-5.2
3. Called guarantees	283.5	-2.2	-2.7	-3.3	-3.7	248.7	40.7	439.8	417.0	310.5	267.8	98.8	34.8	69.4
4. Buget lendng	13.3	-24.0	-30.0	-25.0	-38.2	44.2	-36.1	45.5	-97.4	237.4	52.2	-90.9	-85.2	-86.3

Source: *QM* calculations based on the MF data

Annex 3. Serbia: Real annual rates of growth in public revenues and public expenditures, by the levels of government

	Q2 2015/Q2 2014			
	Consolidated budget	Budget of Republic	Health Fund	Local self-government
A Total public revenues (I)+(II)+(III)+(IV)	***3.5***	**7.3**	**-15.9**	**4.6**
I Current revenues (1)+(2)	*3.3*	7.0	-17.5	4.5
1. Tax revenues	*-1.1*	-0.1	-18.9	4.2
1.1. Customs	*4.0*	4.0	-	-
1.2. Personal income tax	*-0.3*	-0.8	-	0.0
1.3. Corporate income tax	*-14.5*	-11.2	-	-
1.4. VAT	*1.5*	1.5	-	-
1.5. Excise duties	*1.9*	1.9	-	-
1.6. Property taxes	-	-	-	16.3
1.9.Other taxes	*9.9*	-1.3	-	2.6
1.10. Social security contributions	*-3.0*	-	-18.9	-
2. Non-tax revenues	*49.0*	75.7	63.8	6.3
II Capital revenues	*59.8*	-	-71.7	23.4
III Transfers from the other levels of government	-	-	-12.2	4.2
IV Donations	*51.3*	168.8	-	-4.6
B Total public expenditures (I)+(II)+(III)+(IV)	***-3.8***	**-7.2**	**-8.0**	**8.3**
I Current expenditures	*-3.0*	-8.4	-8.1	8.1
1.1 Wages	*-11.3*	-11.1	-13.0	-8.8
1.2. Goods and services	*-0.8*	-11.2	-2.8	11.0
1.3 Interest payments	*12.2*	12.7	230.1	5.2
1.4 Subsidies	*-1.4*	-13.1	0.0	30.5
1.5 Social insurance and social assistance	*-0.9*	9.3	10.3	25.2
1.6 Transfers to the other levels of government	-	-16.0	-	-
1.7 Other current expenditures	*-2.4*	-17.3	-13.0	5.6
II Capital expenditures	*-7.4*	-11.0	155.2	15.9
III Strategic reserves		-22.8	-	-51.6
IV Net lending	*-85.2*	57.4	-	18.2

Source: *QM* calculations based on the MF data