Trends

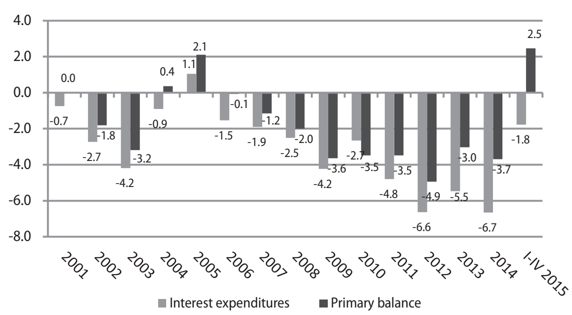
6. Fiscal flows and policy

Fiscal deficit in the first four months of 2015 totaled RSD 22 billion (1.8% of GDP), and was much smaller than in the previous year, and below the targeted amount for this period, as well. Y-o-y decrease in fiscal deficit was primarily caused by the wage and pension reduction, and reduction in state subsidies to loss-making public enterprises and banks. On the other hand, it shrank below the targeted level mainly under the influence of one-off and temporary factors – aggressive dividend payments made by public enterprises, one-off revenue payment by the Agency for Insurance of Deposits, extraordinary revenues from the license for 4G network, and low public investments. Additionally, further heightening of actions against shadow economy also contributed to reduction in fiscal deficit. Namely, revenues from VAT continued to grow, and contrary to the preceding quarters, this period saw a considerable rise in revenues from the excise on tobacco, so the overall tax revenues were by 2% higher than planned. As expected, public expenditures went down due to the wage and pension reduction, but also to extremely low public investments, which accounted for only 1.5% of GDP in the first four months of 2015. If the current trends continued, fiscal deficit in 2015 could run at 4.5-4.7% of GDP, and would be by 1.2-1.4% of GDP below the projected level. However, since these are mostly one-off or temporary improvements, structural deficit will more probably shrink below the projected amount by about 0.6% of GDP. Although it is a good result, considering that the initial plan implied substantial fiscal adjustment, this improvement is still quite small, given the total amount of fiscal deficit, and its sustainability is uncertain, because possible revision of the key measures for fiscal consolidation which actually led to deficit reduction has already been announced by Government representatives. These savings should be used to further reduce fiscal deficit and to scale up public investments, because they have much larger impact on economic activity than current consumption. Public debt (including the debt of local self-governments) totaled 76.6% of GDP at the end of April, and is expected to reach about 80% of GDP at the end of 2015.

General trends and macroeconomic implications

Fiscal deficit stands at RSD 22 billion (about 1.8% of GDP) in the first four months of 2015

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



Source: *QM* calculations

Consolidated fiscal deficit stood at RSD 22 billion in the period January-April 2015, which approximates 1.8% of the four-month GDP. Furthermore, Serbia had primary budget surplus of RSD 30 billion (2.5% of the four-month GDP) in this period.[1]

Fiscal deficit much below the targeted level…

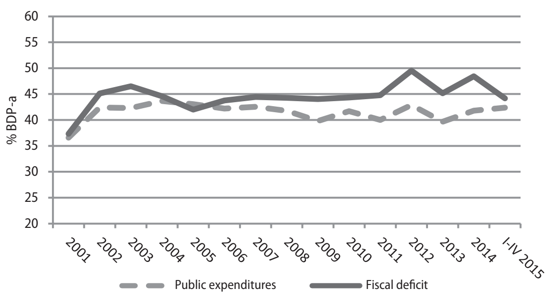
In the preceding years, fiscal deficit in the first four months of a year accounted for about 31% of the annual deficit, on average. With such dynamics, consolidated fiscal deficit would have totaled RSD 72 billion in the period January-April 2015, meaning that fiscal performance in this period considerably exceeded the expectations. However, this reduction in fiscal deficit was to a large extent caused by numerous one-off or temporary (unsustainable) factors, the most significant being the following: *i)* aggressive dividend payout by public and state-owned enterprises at the beginning of the year worth RSD 17 billion – if this amount was equally distributed over the entire year, revenues from dividend payments in the first four months would decrease by RSD 11 billion, *ii)* a number of large one-off revenues – license for 4G network was granted for RSD 2.5 billion,

1 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.

* 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.

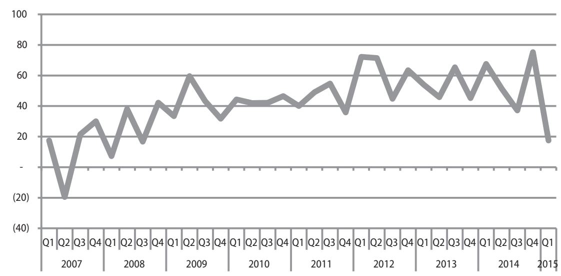
the Agency for Insurance of Deposits paid RSD 7 billion to the budget, *iii)* low public investments – if pubic investments made in the first four months of 2015 equaled the annual average for the preceding years, capital expenditures in this period would be by RSD 8-10 billion higher (Savings based on reduction in capital expenditures have negative impact on economic growth. Therefore, keeping them at this low level is unsustainable.). Accordingly, if we exclude the influence of the foregoing one-off or temporary/unsustainable factors, fiscal deficit totals more than RSD 50 billion in the first four months of 2015, which is still below the targeted amount. This to a large extent can be attributed to reduction in shadow economy, and to a certain extent to reduction in other expenditures (on goods and services, subsidies etc.).

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



Source: *QM* calculations based on the MF data

Graph T 6-3. Serbia: Seasonally adjusted fiscal deficit (RSD billion, in 2013 prices)



Source: *QM* calculations based on the MF data

…due to reduction in the shadow economy and the influence of one-off and temporary factors

Trends in tax revenues show that the government's increased efforts to curb the shadow economy continued in the first four months of 2015. Consequently, revenues from VAT kept growing notably in this period and the upward trend continued in May, as well. Contrary to the preceding quarter, activities against excise goods smuggling (primarily tobacco products) were heightened in this period, which caused a steep rise in excise revenues. Furthermore, reduction in illegal sale of these goods caused decrease in under the table wage payments, and consequential rise in revenues from social security contributions.

Central government budget deficit smaller than expected, stands at RSD 5.2 billion in May

Data show that the central government had budget deficit of RSD 5.2 billion in May 2015, which is much below the projected level and the deficit recorded in May 2014. This reduction came from further rise in revenues and cut in expenditures. Revenues from VAT and non-tax revenues went up considerably in this period. Namely, non-tax revenues grew by RSD 2.4 million y-o-y. This suggests that the aggressive collection of dividend revenue and other non-tax revenues continued, which is considered unsustainable in the long term. On the other hand, some payments were postponed for the beginning of June, which pushed down the central government expenditures. Thus expenditures on wages and transfers to other government levels, expenditures on interest payments, and capital expenditures in this period were much lower than in the same period last year. If capital investments in May had been executed in accordance with the plan, central government would have run RSD 3 billion larger fiscal deficit. We can, therefore, conclude that moderate improvements in fiscal performance continued in May, but that they were partly caused by one-off and temporary factors.

FY 2015 deficit could narrow to 4.5-4.7% of GDP, which is by 1.2-1.4% of GDP below the forecast, and 2% smaller than in 2014

The aforementioned and some additional factors are expected to push down the deficit below the annual target. If the trends in tax revenues detected in the first four months continue throughout the year, these revenues might exceed the forecasts by 2%, or RSD 25 billion (0.6% of GDP) in 2015. Since capital expenditures in the first four months were much below the projections, and May saw continuation of this trend, real annual rise in capital expenditures is expected to be much below the targeted 20%. With real rise in capital expenditures of 5-10% in 2015, which seems quite ambitious at the moment, overall annual capital expenditures would be by 0.3% of GDP below the projection. Furthermore, the aforementioned extraordinary/one-off revenues and intensified dividend payout by public enterprises will push 2015 revenues above the projected level by 0.3-0.4% of GDP. Accordingly, if the current trends continued and if no extraordinary events occurred and if no large changes were made in economic policy, 2015 fiscal deficit would outperform the plan by 1.2-1.4% of GDP and shrink to 4.5-4.7% of GDP.

Structural deficit is expected to narrow below the projected amount by 0.6% of GDP

However, since this discrepancy between the actual deficit and the fiscal projections is to a large extent a result of the influence of one-off or temporary factors, lasting (structural) improvement in Serbia's fiscal performance (relative to the projections) will be much smaller, i.e. structural deficit is expected to narrow below the projected amount by 0.6% of GDP. Reduction in shadow economy is expected to push down structural deficit by RSD 20-25 billion (about 0.5% of GDP) relative to the projected level, which would be a good result, because the initial plan also implied relatively strong fiscal adjustment. However, this structural improvement in Serbia's fiscal performance is still uncertain and relatively small given the amount of fiscal deficit (fiscal deficit of 5% of GDP would remain among the largest in Europe). We therefore think that, in spite of the current fiscal trends, there is no room for revision of fiscal consolidation measures (revision of wage and pension reduction etc.) in 2015, especially because there is a risk that some of the adopted measures will not be implemented (excise on electricity, restructuring and privatization of public and state-owned enterprises etc.), which could impair Serbia's fiscal performance in the second half of the year, and in 2016. Additionally, even if the reduction in structural deficit is larger than expected, these savings should be used to further reduce the deficit (fiscal deficit of 4.5% of GDP in 2015 would still be among the largest in Europe) and to finance public investments, because they have more favorable impact on economic activity than current consumption. On the other hand, illusion created in the media that the country's fiscal performance improved considerably in the first few months of 2015 raises people's expectations. Consequently, this puts the government under great pressure to increase expenditures and/or to give up on some of the measures for fiscal consolidation, and lessens the chances of carrying out some of the key structural reforms (employee rightsizing, restructuring and privatization of public and state-owned enterprises etc.).

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

There was a real y-o-y rise in public revenues of 6.7% in the first four months of 2015. It was mainly driven by a considerable increase in non-tax revenues, and somewhat smaller y-o-y increase in tax revenues, caused by notable rise in excise revenues and revenues from VAT.

Public revenues going up due to a steep rise in non-tax revenues…

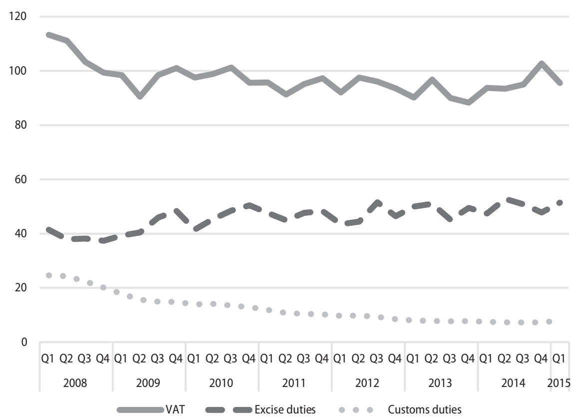
Real y-o-y rise in non-tax revenues of 65.4% in the period January-April contributed most to increase in public revenues in this period. It was driven by the following: *i)* public and state-owned enterprises paid dividends worth RSD 17 billion (in the preceding years dividend payout was usually made in the last quarter of the year), *ii)* one-off payment of about RSD 2.5 billion for the license for 4G network and *iii)* the Agency for Insurance of Deposits (AID) made a one-off payment of RSD 7 billion to the budget, on the basis of a refund received from EPS for settlement of EPS's debts to the Paris and London Club of Creditors in previous years. Since this rise in non -tax revenues is mainly caused by one-off factors, and the foregoing amount of paid dividend is above the long-term sustainable level (the one which would leave the companies sufficient funds to invest in rehabilitation of fixed assets), evaluation of the dynamics in public finance should be based on the dynamics in tax revenues.

…and a much slower rise in tax revenues (0.4%), driven by increase in excise revenues and revenues from VAT

There was a slight real y-o-y rise in tax revenues in the period January-April 2015 (by 0.4%). These revenues, however, suffered a real drop (by 2.1%) compared with the last four months of 2014.[2] Reduction in shadow economy (which led to rise in revenues from consumption tax) and the wage and pension cut (and consequential reduction in the base for personal income tax and social security contributions) had divergent effect on the dynamics of tax revenues. Tax revenues were by 2% above the projected level in the first four months of the year, primarily because the

2 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 T 6-4. Serbia: Seasonally adjusted revenues from consumption taxes (RSD billion, in 2014 prices)



Source: *QM* calculations based on the MF data

Excise revenues going up due to reduction in tobacco smuggling…

government continued and expanded its actions against the shadow economy, especially in the domain of excise goods.

There was a notable real y-o-y rise in excise revenues in the first four months of 2015 (by 7.6%). These revenues were higher than in the last four months of 2014, as well (by 2.4%). This is the result of the governments more decisive actions against illegal distribution of tobacco products, while excise revenues from petroleum products suffered a slight decrease. However, to make a reliable judgment about whether the downward trend in excise revenues on tobacco products has been reversed and a lasting reduction in illegal distribution of tobacco products achieved, it is necessary to observe the trends in these revenues in the months to come. Excise revenues slowed down in May compared with the preceding months partly under the influence of seasonal and temporary factors (due date for excise duty payment for the second half of May fell at weekend, and therefore these payments were made on June 1). Slight real y-o-y rise in these revenues of 0.4% speaks in favor of this conclusion.

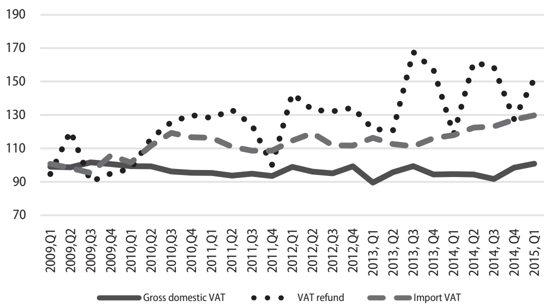
…but illegal sales of tobacco products are still above the level recorded before 2013

Although seasonally adjusted and inflation-adjusted excise revenues from tobacco products reached the level they were at before 2013, this increase is not as large as it should be considering that in the meanwhile specific excise duty on tobacco products was raised on three occasions. This could mean that illegal sales of these products are still higher than before 2013, though, the number of smokers decreased in the meanwhile, as well. Additionally, somewhat slower y-o-y rise in excise revenues in May, compared with the preceding months, may suggest that a sustainable recovery in these revenues is still uncertain.

Revenues from VAT still going up due to reduction in shadow economy

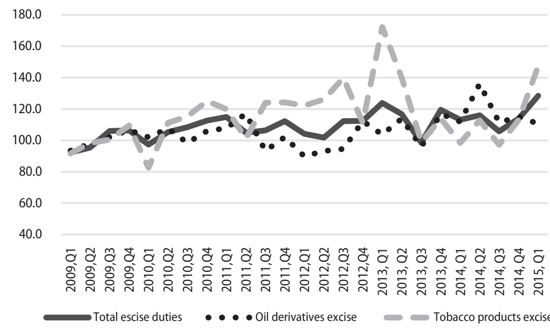
There was a real y-o-y rise in revenues from VAT in the period January-April (by 0.6%). On the other hand, real seasonally adjusted revenues from VAT in this period decreased compared with the preceding quarter (by 5.9%). Revenues from VAT slowed down in the period January-April 2015 because unpaid VAT refunds from the preceding months, which were subject to delay due to the newly adopted practice by the Tax Administration of investigating almost every VAT refund claim, were paid in this period. This is, however, economically unjustifiable. On the other hand, the upward trend in gross domestic VAT and VAT on imports, first detected in the middle of 2014, continued in the first four months of 2015. This suggests that the government continued its actions against the shadow economy successfully, given that there was no notable recovery in economic activity, and employment, wages, exchange rate and prices remained almost unchanged. Moreover, the ratio between the revenues from VAT collected in the first four months of 2015 and the annual target for 2015 was higher than in the previous years. Revenues from VAT continued growing in May and were 22% (RSD 7.2 billion) higher y-o-y.

Graph T 6-5. Serbia: Seasonally adjusted revenues from VAT, by components (2010=100)



Source: *QM* calculations based on the MF data

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



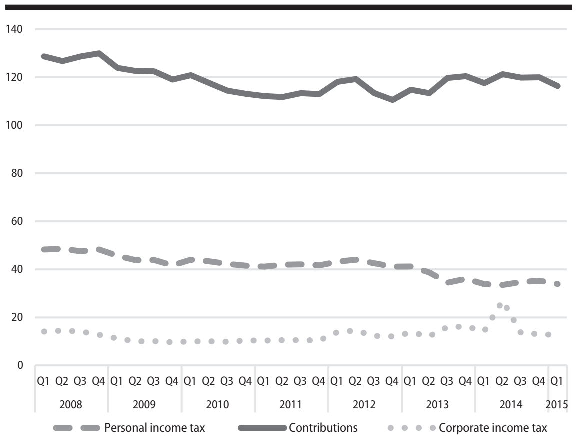
Source: *QM* calculations based on the MF data

Revenues from personal income tax and social security contributions going down, though at a slower pace than expected

Revenues from personal income tax and contributions for mandatory social security insurance went down in the period January-April 2015 compared with the preceding four-month period (real drop of 1.0% and 1.9% respectively). Revenues collected in the first four months of 2015 were lower because the cut to public sector wages (and pensions - from which health care insurance contributions are deducted), which came into effect as of November 2014, affected only the last two months of 2014, while the first four months of 2015 were all hit by this reduction. This reduction in revenues from personal income tax and social security contributions was expected, though somewhat smaller than planned. Namely, the ratio between these revenues collected in the first four months of 2015 and the annual target was higher than in the same period 2014. This could also be a result of reduction in shadow economy, because reduced amount of money circulating in the black market lessens the ability to pay wages outside the legal flows. There was a real drop in revenues from personal income tax in the period January-April 2015 compared with the preceding four-month period and the same period last year, which could be a sign of a decline in profitability of companies.

Steep drop in public expenditures…

Graph T 6-7. Serbia: Seasonally adjusted revenues from taxes on factors of production (RSD billion, in 2014 prices)



Source: *QM* calculations based on the MF data

There was a real y-o-y decrease in public expenditures in the first four months of 2015 (by 5.8%). They went down considerably compared with the preceding four-month period (by 10.9%), too. This drop in expenditures was caused by the wage and pension reduction and a considerable decrease in public investments. Furthermore, large one-off net budget borrowings were declared at the end of 2014 (assumed debt of Air Serbia, financial rehabilitation of banks etc.).

…due to wage and pension reduction…

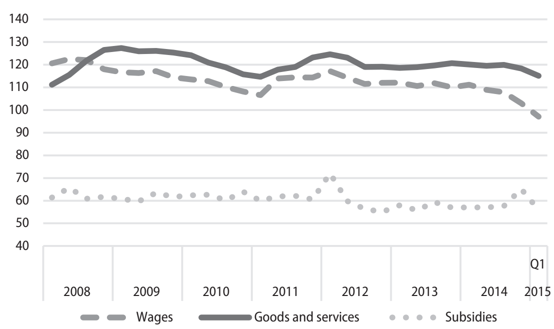
In absolute terms, the wage and pension cut, which produced its full effect in the first four months of 2015, contributed most to the reduction in public expenditures. Namely, real expenditures on wages fell by 12.9% (approximately RSD 17 billion) y-o-y in this period, and real y-o-y decrease in expenditures on pensions was somewhat smaller, but still significant (by 4.3%, or RSD 5.4 billion). Accordingly, reduction in expenditures on wages and pensions brought savings of about RSD 22 billion in the first four months of the year, and the expected annual target is RSD 70 million. This decrease in expenditures on wages considerably exceeds the effects of the 10% wage cut, probably because the number of public sector employees decreased, tighter controls on payment of different bonuses and allowances (for overtime work etc.) were imposed, but also because increased earnings for years of service are no longer calculated for the full years of service but only for the time spent with the last employer.

…and inefficient execution of public investments, which accounted for only 1.5% of GDP

Public investments suffered a real y-o-y decrease in the first four months of 2015 (of 12.3%), and fell compared with the preceding four-month period, as well (by 3.4%). Accordingly, public investments accounted for only 1.5% of GDP in the period January-April 2015. Taking into account the intra-annual dynamics in capital expenditures in previous years and in 2015, and the projected annual rise in capital investments of 20% in 2015, we estimate that in the first four months of 2015 the government spent RSD 8 billion less on public investments than they planned. Inefficient execution of public investments is economically unfavorable because public investments are one of few antirecession measures available to the Government, and should be used especially in times of recession, which is the case of Serbia now.

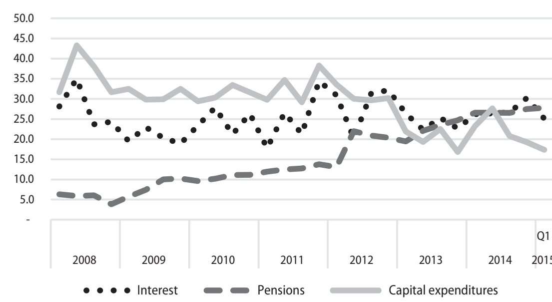
There was a real y-o-y decrease in expenditures on goods and services and expenditures on subsidies (by 4.4% and 4.5% respectively). These expenditures went down compared with the preceding quarter, as well. Reduction in expenditures on goods and services is good so long as it does not jeopardize the proper functioning of the country. On the other hand, the reduction in subsidies is justified, but to some extent, it is a consequence of a high base for comparison.

Graph T 6-8. 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 T 6-9. 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 public debt and dinar (to dollar) depreciation

Expenditures on interest payments went up considerably in the first four months of 2015 compared with the same period last year (by 13.5%), and were higher than in the preceding four-month period, too (by 1.9%). This increase was caused by growing public debt and dinar depreciation (especially against dollar). However, borrowing conditions for Serbia improved because the ECB and Fed loosened their monetary policy, which had 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.

Fiscal trends by government level

Central government and Pension and Disability Insurance Fund running budget deficit, other government levels running budget surplus in Q1

In Q1 2015 the central government and Pension and Disability Insurance Fund ran budget deficit (RSD 24.9 billion and RSD 4.2 billion respectively). On the other hand, AP Vojvodina, local self-governments and the Health Insurance Fund of the Republic of Serbia had budget surplus (RSD 1.6 billion, RSD 4.1 billion and RSD 1.95 billion respectively).

Republic budget revenues going up – due to increase in non-tax and tax revenues…

The aforementioned rise in consolidated public revenues in Q1was relatively homogeneous across different government levels, i.e. both the republic budget revenues and revenues collected by local self-governments grew. The first were pushed up by increase in excise revenues and revenues from VAT, and considerable rise in non-tax revenues, and the letter went up due to a strong real y-o-y increase in revenues from property tax in Q1 (by 40.5%).

Revenues from property tax grew in Q1 because local self-governments increased their efforts to scale up property tax collection and thus make up for the loss of revenue from construction land usage fee, which was abolished in 2014 (see *Highlight 2*). Revenues of the Health Insurance

…revenues of local self-governments growing – due to increase in revenues from property tax

Fund of the Republic of Serbia suffered a sharp real y-o-y drop in Q1 (by 13.3%), because the contribution rate for health insurance was decreased in the middle of 2014, and the wage and pension cut reduced the contribution assessment basis.

Expenditures of central government and Health Insurance Fund going down, while local self-governments spend more

There was a real y-o-y decline in expenditures of the central government and the Health Insurance Fund in Q1 (by 10.7% and 6% respectively), while local self-governments increased their expenses (by 1.2%). Public sector wage cut and reduced capital investments pushed down the republic budget expenditures. On the other hand, local self-government expenditures on subsidies, welfare and public investments went up y-o-y (by 16.3%, 11.2% and 4.5% respectively), while expenditures on employees and other expenditures declined.

Local self-governments stretch the rules on public sector wage cut

However, real y-o-y decrease in expenditures on employees is more than twice smaller at the local level (7.1%) than at the central level (15.2%). This suggests that the local self-governments have found the ways to stretch the rules regarding the public sector wage limits and cuts, by giving extraordinary pay raise.

Table T6-10. Serbia: Fiscal surplus (deficit) at different levels of government (bn. RSD, current prices)

Year	*Budget of Republic*	*Pension fund*	*National Employment*	*Health fund*	*Vojvodina budget*	*Localself-government*
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	-0.1	2.0	1.6	4.1

Source: *QM* calculations based on the MF data

Budgets of sub-central government levels remain in surplus…

Fiscal trends in the last few years, including 2015, show that there is a notable imbalance between the competence and revenue distributed to different government levels, i.e. sub-central government levels are assigned more revenue than competence. Accordingly, the AP Vojvodina has been running budget surplus of more than RSD 1 billion annually since 2012 (and showed surplus of RSD 1.6 billion in Q1 2015), and the budgets of local self-governments have been in surplus since 2013 (the sum of the budget surpluses in 2013 and 2014 totalled RSD 14.8 billion, and reached as much as RSD 4.1 billion in Q1 2015 alone). On the other hand, there are some indications that local self-governments often fall behind with payments to other government levels and to private sector, which suggests that the economic management at this level is inefficient.

…indicating vertical imbalance in distribution of competence and revenue

All this leads to conclusion that the system of vertical financial equalization needs to be reformed, to achieve vertical balance between revenues and competencies. Thus, the burden of fiscal consolidation would fall equally on all government levels.

Trends in public debt

Serbia's public debt totaled EUR 24 billion at the end of April (74.6% GDP)...

At the end of April 2015 Serbia's public debt totaled EUR 24 billion (74.6% of GDP), and with the debt of local self-governments included it accounted for 76.6% of GDP.

...and with the debt of local self-governments included – 76.6% of GDP-a

From the end of 2014 to the end of April 2015 public debt grew by EUR 1.3 billion, which is several times larger than fiscal deficit in that period (totaling less than EUR 200 million). This was to a large extent caused by a strong dollar to euro appreciation (which pushed up the debt by EUR 700 billion) and borrowing in advance of need, for financing future deficits and for principal repayments on the current debt.

Table T6-11 Serbia: Public debt dynamics 2000-2015

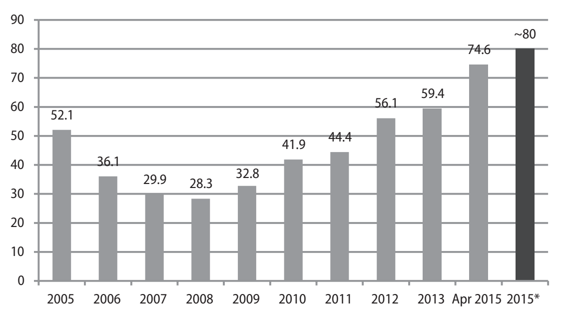
	Amount at the end of period, in billions EUR											
	2000	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	apr 2015
I. Total direct debt	14.17	9.62	8.58	8.03	7.85	8.46	10.46	12.36	15.07	17.3	20.2	21.5
Domestic debt	4.11	4.26	3.84	3.41	3.16	4.05	4.57	5.12	6.5	7.0	8.2	8.7
Foreign debt	10.06	5.36	4.75	4.62	4.69	4.41	5.89	7.24	8.6	10.2	12.0	12.8
II. Indirect debt	-	0.66	0.80	0.85	0.93	1.39	1.71	2.11	2.60	2.81	2.5	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**	**24.0**
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%**	**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%**	**74.6%**

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 causes of its earlier growth have not been removed

After the period of strong growth in 2013, and steady decrease in 2014, indirect debt stagnated in the first four months of 2015. However, this stabilization of indirect debt does not mean that its key drivers have been removed but is a consequence of new funding mechanisms and external and temporary factors. State guarantees on loans to public and state-owned enterprises (Srbijagas, EPS, Železara etc.) have been key generator of indirect debt. The key cause of insolvency and illiquidity of Srbijagas, i.e. unpaid receivables for the gas supplied to large customers (Petrohemija, Azotara etc.), has not been removed. However, sharp drop in oil prices in the world market alleviated this problem, but only temporarily. EPS is facing similar problems, which are caused by inefficient organization and management, high losses in electricity transmission, poor collection of receivables, and low price of electricity. Liquidity is maintained through borrowing, but this is just a temporary solution, which brings new problems and challenges. Inefficient organization of the company is the only issue that has been addressed so far. The company has neither taken any actions against other critical issues, nor adopted a binding plan for their implementation. Similarly, working capital for Železara was provided in 2014 so there was no need for additional borrowing in 2015. However, the problem of financing future operations, after the existing funds are spent, remains unsolved.

Graph T6-12: Trends in public debt (% of GDP)



Source: *QM* calculations

Serbia's public debt will account for 80% GDP at the end of 2015

Debt-to-GDP ratio will continue to rise in 2015 due to poor health of public finance, expected decrease in or stagnation of real GDP, and depreciation of dinar against euro and dollar. Possible issuance of government guarantees on project loans to public companies would contribute to this increase. Accordingly, assuming that dinar depreciates slightly against euro and dollar, and that borrowing in advance of need remains within the expected level, 2015 public debt might reach 78% of GDP, and with the debt of local self-governments included, this figure goes up to 80% of GDP, which is extremely high and unsustainable in the long term.

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	jan-apr
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**	**524.8**
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	523.2
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	445.9
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	44.7
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	18.6
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	131.0
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	65.3
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	10.6
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	159.0
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	16.7
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	77.4
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	
	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**	**546.8**
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	518.2
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	132.6
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	71.4
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	52.4
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	24.7
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	225.3
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	162.2
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	11.6
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	18.7
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	9.3
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	0.7
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**	**-22.0**

Source: *QM*

Annex 2. Serbia: Consolidated General Government Fiscal Operations[1)], 2008-2015 (real growth rates)

	2008	2009	2010	2011	2012	2013	2014					2015	
							Q1	Q2	Q3	Q4	Q1-Q4	Q1	Jan-Apr
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**	**6.7**
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	6.6
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	0.4
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	-1.0
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	-12.9
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	0.6
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	7.6
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	6.4
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	-1.9
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	13.8
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	65.4
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	
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**	**-5.8**
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	-5.0
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	-12.9
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	-4.4
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	13.5
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	-4.5
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	-2.6
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*	*-4.3*
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	-22.7
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	-12.3
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	82.6
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	-91.6

Source: *QM*

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

	Q1 2015/Q1 2014			
	Consolidated budget	Budget of Republic	Health Fund	Local self-governments
A Total public revenues (I)+(II)+(III)+(IV)	***7.6***	**13.3**	**-13.3**	**0.9**
I Current revenues (1)+(2)	*7.6*	13.2	-16.1	2.3
1. Tax revenues	*1.8*	2.2	-17.1	7.1
1.1. Customs	*8.9*	9.1	-	-
1.2. Personal income tax	*-0.1*	2.8	-	-1.2
1.3. Corporate income tax	*-17.2*	-16.3	-	-
1.4. VAT	*1.8*	1.9	-	-
1.5. Excise duties	*6.9*	7.1	-	-
1.6. Property taxes	-	-	-	40.5
1.9.Other taxes	*23.9*	6.8	-	-2.8
1.10. Social security contributions	*0.3*	-	-17.1	-
2. Non-tax revenues	*15.1*	104.8	59.6	-18.1
II Capital revenues	*59.8*	-	-18.0	-21.1
III Transfers from the other levels of government	-	-	-6.9	-4.2
IV Donations	*25.3*	36.9	-	7.4
B Total public expenditures (I)+(II)+(III)+(IV)	***-5.1***	**-10.7**	**-6.0**	**1.2**
I Current expenditures	*-4.4*	-10.8	-5.9	0.6
1.1 Wages	*-13.3*	-15.2	-11.2	-7.1
1.2. Goods and services	*-1.1*	-6.3	-1.4	-3.1
1.3 Interest payments	*13.0*	14.7	557.9	-13.6
1.4 Subsidies	*-4.2*	-10.5	0.0	16.3
1.5 Social insurance and social assistance	*-3.3*	-4.0	18.3	11.2
1.6 Transfers to the other levels of government	-	-18.1	-	-
1.7 Other current expenditures	*-15.9*	-48.9	71.8	6.1
II Capital expenditures	*-25.5*	-38.4	-84.1	4.5
III Strategic reserves		509.6	-	49.9
IV Net lending	*-90.9*	41.5	-	-36.7

Source: *QM*