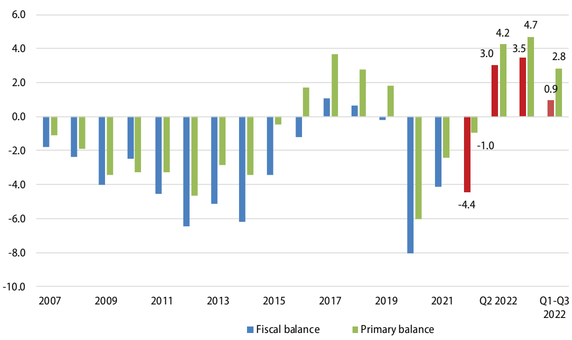
6. Fiscal Trends and Policy

In Q3 2022, there was a slowdown in the growth of public revenues, with year-on-year real growth of only 1%, while seasonally adjusted, compared to the previous quarter, they fell by around 4.5%. Due to the slowdown in economic activity and the real devaluation of incomes due to high inflation, the growth of the relevant tax bases has slowed down, so the positive effect of inflation on state revenues was exhausted in the second part of the current year. On the other hand, high inflation had a strong impact on the real decline in public spending, which deepened in Q3 (and amounted to around 11.2%), and similar trends continued in October. However, it should be borne in mind that about EUR 1.1 billion of state aid to EPS and Srbijagas was not reported as an expense in the budget until the end of October, which is expected to be done by the end of the year. If those expenses had also been included, current spending in the first three quarters of 2022 would have been 3% higher in real terms compared to the same period last year. After a long time, there was a noticeable drop in capital spending in Q3, which may have been a consequence of the slowdown in implementation, postponement of some projects or delays in the fulfilment of some obligations. After the budget rebalancing, it is estimated that the consolidated fiscal deficit in 2022 will be 0.9 pp. higher than originally planned and that it will amount to about 3.9% of GDP, although current developments indicate that the deficit could be somewhat smaller than that. The increase in the deficit compared to the initial plan was the result of large spending to cover the losses of EPS and Srbijagas, but also the activation of other public spending programmes, as well as the reduction of some taxes (e.g. excise duty). The revised fiscal strategy foresees that in 2023 the fiscal deficit will amount to about 3.3% of GDP, of which more than half will be the result of covering the losses of EPS and Srbijagas. Amendments to the law on the budget system have revised the fiscal rules. While the direction of the reform of special fiscal rules is assessed as correct, the way of defining general fiscal rules reduces the chances of conducting a countercyclical fiscal policy. At the end of Q3, public debt amounted to EUR 32.4 billion (55.5% of GDP), which was EUR 2.3 billion more than at the end of 2021 - primarily due to direct borrowing by the state to finance future obligations, but also to finance assistance to public companies from the energy sector. In addition, the depreciation of the dinar against the dollar affected the growth of the public debt by over half a billion euros. Nevertheless, the relative level of debt (as a % of GDP) is almost stagnant, due to the effects of inflation on nominal GDP growth. The announced conclusion of the arrangement with the IMF is economically justified, as it increases the chances of conducting a sustainable fiscal policy, and in addition, it provides credit funds for financing the budget under more favourable conditions.

General Fiscal Trends

In Q3, there was a strong real slowdown in income growth and a large drop in public spending

Graph T6-1 Serbia: Consolidated Fiscal Balance and Primary Balance (% GDP)



Source: QM calculations using MFIN data

In Q3 2022, the year-on-year growth of public revenues slowed down significantly, and they were only 1% higher in real terms compared to the same period last year, while in the previous two quarters the year-on-year growth was approximately 5%. The slowdown on the revenue side is also indicated by the fact that, compared to the previous quarter, seasonally adjusted public revenues fell significantly in real terms (by 4.5%).

In Q3, public spending continued the year-on-year real decline that began in the

Officially declared surplus in Q3 was RSD 63.8 billion (3.5% GDP)…

previous quarter, with the real decline in spending in Q3 amounting to 11.2%, which is twice the rate of decline in Q2. The fact that seasonally adjusted public spending in Q3 also recorded a significant real drop compared to Q2 of the current year (by 6.4%) also indicates a strong decline in public spending.

In the period January-September, the fiscal surplus of RSD 48.3 billion was officially declared (0.9% of GDP)…

Due to a strong drop in spending and a slight increase in income, a consolidated fiscal surplus of RSD 63.8 billion was realised in Q3, i.e. 3.5% of the quarterly GDP, and a primary surplus of about RSD 86.6 billion was achieved or 4.7% of the quarterly GDP.

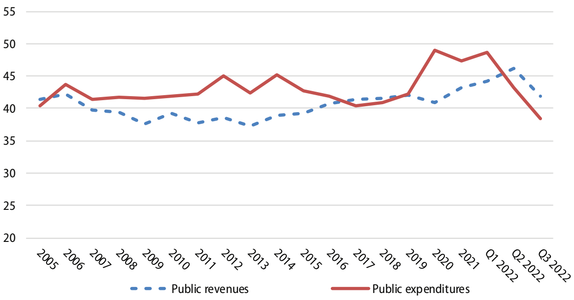
Observed at the level of the first three quarters of 2022, public revenues achieved moderate real growth (by 3.2%), while public spending decreased in real terms (by about 2.4%). Consequently, in the period Q1-Q3 2022, a consolidated surplus of RSD 48.3 billion was reported or around 0.9% of the nine-month GDP, while the primary surplus amounted to 2.8% of GDP.

… but when spending for public companies is added, the de facto deficit was RSD 83.4 billion (1.5% of GDP)

However, it should be emphasised that in this period the state issued aid to public companies from the energy sector in the amount of about RSD 132 billion (i.e. EUR 1.1 billion), which was not declared as the cost of subsidies and was not included in the fiscal deficit, but was recorded as an expenditure "below the line" - for the acquisition of financial assets. Therefore, realistically, taking into account this cost of subsidies, which should be officially declared after the budget rebalancing adopted at the beginning of November, in the first three quarters of 2022 a consolidated fiscal deficit of about RSD 83 billion was realised, i.e. about 1, 5% of the nine-month GDP.

The slowdown in revenues and the decline in spending continued in October as well

Graph T6-2 Serbia: Consolidated Public Revenue and Public Spending (% GDP)

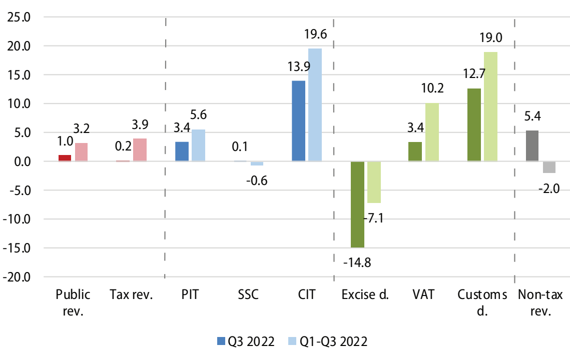


Source: *QM* calculations using MFIN data

After a long time, a real year-on-year decrease in public revenues (by 2%) was recorded in October, and a large real year-on-year decrease in spending continued (by 10%). Primarily due to the sharp drop in spending, a consolidated fiscal surplus of RSD 17.1 billion was achieved in October.

Although public revenues in July recorded a slight real drop (by 2%) compared to the same month last year, a real drop (by 1.8%) was also recorded on the side of public spending.

Graph T6-3 Serbia: Interannual Real Growth Rates of Public Revenues in 2022 (%)



Source: *QM* calculations using MFIN data

Public Revenue Dynamic

The growth of public revenues in Q3 was the result of a slight real increase in tax revenues and a slightly higher growth in non-tax revenues.

Tax Revenue

The growth of tax revenue has slowed down

In Q3 2022, tax revenues recorded a very slight year-on-year growth in real terms (by 0.2%), which represents significantly slower growth than in previous quarters. Compared to Q2 2022, seasonally adjusted tax revenues decreased in real terms (by 3.9%).

Due to the increase in the prices of imported goods, revenues from VAT and customs duties continue to grow moderately, but much more slowly than before

The growth of tax revenues in Q3 was primarily driven by strong growth in income from corporate income tax and customs duties, as well as moderate growth in income from VAT and personal income tax, while revenues from excise taxes fell sharply, and revenues from social contributions were virtually unchanged in real terms compared to Q3 last year.

The positive effect of inflation on tax revenues has been depleted

The growth of customs and VAT revenues in Q3 was predominantly due to the increase in the prices of imported goods, which was higher than the overall inflation rate. Nevertheless, it can be seen that the real growth of VAT and customs revenues in Q3 was significantly lower than the growth achieved in previous quarters, which was a consequence of the slowdown in economic activity and the real devaluation of incomes. This, together with the rising inflation rate, has affected the real reduction of consumption. i.e. tax bases. From this, it can be concluded that the positive effect of inflation on tax revenues is running out, which confirms the claim, presented in the previous issue of the Quarterly Monitor, that the fiscal benefits (on the revenue side) of inflation are temporary.

Revenues from excise duties are falling due to the reduction in excise duty rates, inflation and falling demand

Revenues from excise duties recorded a strong year-on-year decline in Q3, which represents a continuation or acceleration of the decline that began in Q1 of the current year. The decline in excise revenue was particularly pronounced in the segment of excise duties on oil derivatives, which can be explained by the temporary reduction of excise duties by the Government in order to mitigate price shocks, and possibly also by a reduction in the consumption of petroleum derivatives due to rising prices, as well as by the devaluation of specific excise rates due to high inflation.

Revenues from income tax are growing, while those from social contributions are stagnating

Income tax revenues continued year-on-year growth, although this growth in Q3 was lower than in previous quarters, which is a consequence of developments in real incomes and employment. On the other hand, income from social contributions was almost unchanged in real terms compared to Q3 last year. The difference in the dynamics of revenue from income tax and contributions can only be partly explained by the reduction of the social insurance contribution rate at the beginning of the year and the introduction of tax breaks, while the rest can be attributed to the change in the income structure or the opening of new opportunities for avoiding the payment of social contributions. Revenues from corporate income tax continue strong year-on-year growth, although somewhat slower than in previous quarters, primarily due to the dynamics of economic profitability.

In Q1-Q3, tax revenues increased moderately, primarily due to price growth, i.e. tax bases

Observed at the level of the first three quarters of 2022, tax revenues achieved year-on-year real growth (by 3.9%), whereby the growth of revenues was widely spread across all forms of taxation, except for revenues from social contributions and excise taxes. The general assessment is that the growth of income in the first nine months of 2022 was a consequence of the strong rise in prices (especially imported goods), as well as the dynamics of earnings and employment. In contrast to the first two quarters, when the growth of seasonally adjusted tax revenues was also recorded compared to the previous quarter, there was a decline in Q3, which indicates that the slowdown in economic activity and the devaluation of real incomes and consumption have begun to be reflected in state revenues as well.

Due to inflation, tax revenues are still significantly higher than planned

Starting from the usual intra-year dynamics of revenue realisation and plans for 2022, it is estimated that tax revenues in the first three quarters of 2022 were collected in an amount significantly higher than planned - probably by over one and a half billion euros, of which about half was owed to better VAT collection - primarily in the first half of the year. The better collection of tax revenues than planned was mainly the result of higher inflation than was taken into account when creating the initial plan in the second half of last year.

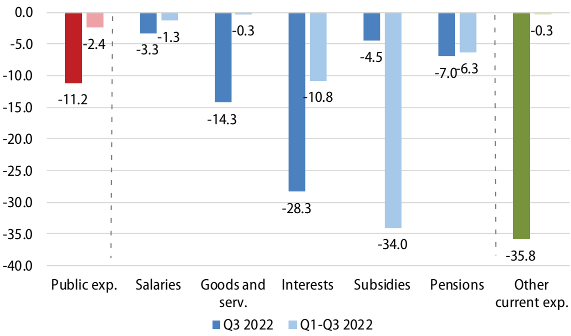
In October, tax revenues fell in real terms

In October, tax revenues decreased in real terms (by 3.5%) compared to October 2021, primarily due to a strong drop in revenues from excise taxes, VAT, and social contributions for mandatory social insurance, which indicates the continuation of the trend of slowing down the dynamic of revenues from the third quarter.

Non-Tax Revenue

In Q3, non-tax revenues recorded a moderate year-on-year growth in real terms, while in the first three quarters, the total amount of non-tax revenues was lower in real terms by about 2% compared to the same period last year, which represents a smaller reduction of this type of public

Graph T6-4 Serbia: Interannual Real Growth Rates of Public Spending in 2022 (%)



Source: *QM* calculations using MFIN data

revenue compared to initial projections given in the Fiscal Strategy for 2022.

Public Spending Dynamic

In Q3, the real decline in public spending, both current and capital, deepened, while spending on activated guarantees and budget loans strongly increased.

Current Spending

Current spending fell significantly in Q3 in real terms, primarily due to inflation

In Q3 2022, the current public spending experienced a strong year-on-year decline in real terms (by 8.2%), and a seasonally adjusted real decrease was also achieved compared to the previous quarter. The decline in current spending was widespread and included all types of current spending. It is estimated that the real decline in current spending was mainly influenced by rising inflation and the fact that most current spending categories are limited by budgets and financial plans in nominal amounts.

Despite the significant increase in public sector wages since January of the current year, spending on wages has continued to drop year-on-year in real terms, which is a consequence of accelerated inflation.

Spending on wages is declining in real terms due to the acceleration of inflation

Public spending on pensions, which already recorded a noticeable year-on-year increase in real terms in Q1 and Q2, fell even more in real terms in Q3 (by 7%) compared to the same period last year, which is a consequence of the real devaluation of pensions due to inflation, as well as the decrease in the number of pensioners.

Spending on pensions is dropping in real terms, due to inflation and the decline in the number of pensioners

Spending on goods and services also recorded a strong year-on-year decline in Q3 in real terms, which can also be predominantly attributed to high inflation. The total budgets of various segments of the public sector for these purposes are nominally limited, so even with procurement fully implemented according to the plan, this affects the real decrease of spending for these purposes, i.e. the reduction in the amount of goods and services that the public sector purchases with the budget. Since the labour technology is unchanged, it will affect a strong nominal increase in this category of spending in the coming period, in order to enable the normal functioning of the public sector.

High inflation also affects a strong real decline in spending on goods and services, as well as subsidies and interest

Spending on subsidies also decreased in real terms in Q3 compared to last year, which may be a consequence of the dynamics of the implementation of certain subsidy programmes (some subsidy payments were made earlier in the pre-election period), as well as the fact that many subsidy programmes are defined in a fixed nominal amount, making them susceptible to real depreciation due to high inflation.

In Q3, spending on interest also declined sharply in real terms (by 28.3% compared to Q3 2021), which was a consequence of the dynamic of maturities for existing debts, and the fact that over 80% of Serbia's public debt is indexed in euros and dinars which, in the conditions of an unchanged dinar exchange rate against the euro and high inflation, affects a strong real drop in interest costs.

Spending on activated guarantees is also growing strongly

In Q3, the trend started in Q2, which refers to the growth of spending based on activated budget guarantees continued. Activated guarantees increased again (by 234.4%) compared to the same period last year, which may be a consequence of the dynamic of maturing obligations under guarantees issued in the previous years, as well as the activation of guarantees for recent loans to the public and state enterprises.

In the period Q1-Q3 current spending was reported in a smaller amount than last year…

As a result of growth in Q1, a moderate decline in Q2 and a strong real decline in Q3, current spending decreased in real terms year-on-year in the first three quarters (by 3.7%), primarily due to the real devaluation of public sector wages and pensions, the decline in the number pensioners (by about 25,000, i.e. by 1.5%), a real decrease in spending on goods and services, subsidies and interests - primarily due to inflation.

… but when unrecorded subsidies are included, current spending would be realistically higher by about 3% compared to last year

It should be noted that the conclusions regarding the dynamic of current spending would be significantly different if the payment of state aid to public enterprises in the energy sector in the amount of EUR 1.1 billion was expressed as the cost of subsidies in this period. In that case, current spending in the first three quarters of 2022 would be realistically higher by about 3% compared to the same period last year.

Similar trends in current spending continued in October. Thus, current public spending in October 2022 recorded a real year-on-year decrease of about 15%, with all categories of current spending recording a year-on-year decrease.

In October, a significant real drop in current spending was recorded

Capital Spending

Capital spending in Q3 has decreased by over a third in real terms

After several years of almost continuous growth, capital spending decreased significantly in Q3 2022 - it was over a third lower in real terms than in Q2 2021. Despite this, capital spending in that period was relatively high and amounted to about 5.1% of GDP. The real drop in capital spending was a consequence of inflation, but probably also the delays in the settlement of obligations to suppliers due to worsening financing conditions, and possibly also delays or slowing down of the implementation of some investment projects.

In the first three quarters, capital spending amounted to about 5.7% of GDP

At the level of the first three quarters of 2022, capital spending, primarily due to a large drop in Q3, recorded a year-on-year real decline of 0.3%. Nevertheless, at the level of the first nine months, total capital spending amounted to about 5.7% of GDP, which is significantly below the planned 7.5% of GDP this year. In the conditions of recessionary pressures, maintaining capital spending at a high level, which would be used for the construction of public infrastructure facilities for which there are methodologically based assessments of economic profitability, would represent an economically correct fiscal policy response to the crisis.

General Fiscal Framework

The fiscal deficit in 2022 could be slightly lower than the planned 3.9% of GDP

Although in the first ten months of 2022, a consolidated surplus of around RSD 65 billion was reported, when the cost of covering the losses of Srbijagas and EPS is shown as a budget expenditure, and the increase in pension costs due to their increase since November taken into account, as well as the trend of slowing down of revenue dynamics, it is estimated that at the level of the entire 2022, the deficit of the consolidated state sector should still be realised, but that it could be somewhat smaller than predicted after the adoption of the rebalance (3.9% of GDP).

Box 1. Assessment of the Budget Rebalance for 2022

In November 2022, the rebalancing of the Republic's budget was adopted, which implies an increase in the consolidated fiscal deficit from 3% to close to 4% of GDP, which would mean that Serbia would realise a large level of deficit for the third year in a row. The rebalancing foresees an increase in public revenues compared to the initial plan by about RSD 200 billion, primarily due to the effects of inflation on the growth of nominal tax bases. The rebalance foresees an increase in public spending - based on new permanent or one-time programmes (increase in parental allowance, three cycles of non-selective aid payments to young people, increase in pensions in November by 9%, increase in subsidies to agriculture, etc.) in the amount of about RSD 65 billion, increase in investment in commodity reserves by about RSD 40 billion, as well as a subsidy for covering the losses of public companies (EPS and Srbijagas) by about RSD 150 billion. It is considered a positive that the rebalancing foresees capital spending remaining at the initially planned high level (of about 7.5% of GDP at the level of the consolidated state sector), although, considering the implementation dynamic in the first three quarters, there are considerable risks that this goal might not be achieved. On the other hand, large spending on indiscriminate aid to young people (of around RSD 30 billion this year), along with large subsidies to cover the losses of public companies and an insufficient level of budget transparency, especially in the subsidy segment, represent its shortcomings.

In addition to the fact that in the previous three years, Serbia has achieved high fiscal deficits, which were partly caused by external and objective reasons (pandemic, energy crisis), but also by internal problems and inefficiencies (primarily in the segment of the work of public enterprises), an important shortcoming of Serbia's fiscal policy refers to the significant indiscriminate spending of funds for purposes that cannot be justified by the argument of fairness or efficiency (e.g. programmes to help young people or some high-value investment projects for which there are no studies of economic profitability) and insufficient transparency of the budget, both of the Republic and of local governments.

A fiscal deficit of 3.3% of GDP is planned for 2023

The revised fiscal strategy, which includes the budget of the Republic for 2022, adopted at the beginning of December, foresees that a consolidated fiscal deficit of 3.3% of GDP will be achieved in 2023.

More than half of the deficit refers to covering the losses of EPS and Srbijagas

Although such a deficit in 2023 would be somewhat smaller than the deficit that will probably be realised in 2022, which is considered a step in the right direction, the planned deficit for 2023 is still relatively high.

The rest of the budget is generally assessed as adequate

Nevertheless, bearing in mind that more than half of the deficit is owed to cover the losses of EPS and Srbijagas, the rest of the deficit (of about 1.5% of GDP) is assessed as economically adequate, considering the state of the economy and external circumstances.

The enormous spending on aid to EPS and Srbijagas, which is planned for next year in the amount of 1.7-1.8% of GDP, is to a lesser extent the consequence of the general energy crisis, and to a greater extent of the inefficient management of public enterprises. The announced increase in electricity prices will partially reduce EPS' losses, but structural problems and risks related to its operations remain open.

The fact that capital spending is expected to remain at a high level of around 7% of GDP in the next year is also assessed as positive, while it should be noted that a large part of this spending will relate to the implementation of projects for which there is no evidence of economic profitability (e.g. the National Stadium). The predicted indexation of wages and pensions in 2023 is mostly in accordance with the limits introduced by the new fiscal rules, although a higher indexation of pensions than the rate of inflation may contribute to fuelling inflationary pressures.

In the tax policy segment for 2023, the main change refers to the reduction of the social security contribution rate by one percentage point and a moderate increase in the non-taxable part of wages, which will moderately reduce the fiscal burden of labour. Such a direction of reform is evaluated as correct because it has a positive effect on the international competitiveness of the economy, but also on the progressiveness of the tax system. On the other hand, the introduction of new specific rules for the taxation of income from self-employment further complicates the tax system and violates its horizontal fairness. Therefore, instead of partial interventions in the income taxation system, the possibilities for its fundamental reform should be considered, which would respect the requirements regarding both equity and economic efficiency.

The announced conclusion of the arrangement with the IMF is economically justified

In the last quarter of 2022, the issue of concluding a binding precautionary arrangement with the IMF was brought up to date. In addition to the fact that the conclusion of such an arrangement increases the chances of leading a responsible and sustainable fiscal policy, it was announced that the arrangement could include the option of taking out loans to support the budget. Given that financing conditions on the world financial markets are increasingly unfavourable, securing part of the financing through more favourable credit arrangements with international financial institutions, such as the IMF, is considered economically justified. In addition, the existence of a firm arrangement with the IMF can represent a positive signal to potential investors in Serbian government securities.

Public Debt

Public debt at the end of Q3 2022 amounted to EUR 32.4 billion (55.5% of GDP)

At the end of Q3 2022, Serbia's public debt amounted to EUR 32.4 billion (55.5% of GDP), which is about EUR 1.1 billion more than at the end of Q2, and almost EUR 2.3 billion more than at the beginning of the current year. During October, the public debt was almost stationary, so that at the end of that month it was almost equal to the debt level at the end of Q3.

In Q3, the public debt increased by EUR 1.1 billion, and since the beginning of the year by almost EUR 2.3 billion

Most of the increase in public debt in the first three quarters of 2022 was the result of an increase in the level of direct state debt (by more than EUR 2 billion), while indirect debt, based on the provision of state guarantees for borrowing by public and state enterprises, increased by about EUR 230 million. This was a consequence of the state providing assistance to these companies directly, through payments from the budget, and to a lesser extent indirectly, through guarantees for their borrowing - probably due to legal restrictions regarding the issuance of guarantees, without changes to the Budget Law.

About 90% of the increase in public debt refers to direct government borrowing

The large increase in the absolute amount of public debt in the first three quarters of 2022, despite the fact that a consolidated fiscal surplus of over EUR 400 million was achieved in that period, is the result of two groups of factors.

The debt is growing strongly even though the state achieved a fiscal surplus...

First, in the previous period, the state borrowed in advance, in order to finance obligations (debts) that are due for repayment in the following period, which can be considered economically justified, since a further increase in interest rates and a worsening of borrowing conditions are expected.

... due to extra-budgetary aid payments to public enterprises and state borrowing in advance

Secondly, the growth of the absolute amount of public debt in the first three quarters of 2022 can be attributed to a greater extent to the borrowing of the state to finance aid to public enterprises primarily in the energy sector (EPS and Srbijagas) in the amount of about EUR 1.1 billion, which have not yet been shown as subsidy costs in the consolidated balance sheet.[1]

Table T6-5 Serbia: Public Debt[1] 2000-2022 (billions of euros)[1]

	2000	2008	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Q1 2022	Q2 2022	Q3 2022
I. Total direct debt	**14.2**	**7.9**	**15.1**	**17.3**	**20.2**	**22.4**	**22.7**	**21.4**	**21.5**	**22.5**	**25.2**	**28.8**	**29.0**	**29.6**	**30.8**
Domestic debt	4.1	3.2	6.5	7.0	8.2	9.1	8.8	9.1	9.4	9.8	11.2	11.3	10.7	10.8	11.2
Foreign debt	10.1	4.7	8.6	10.2	12.0	13.4	13.9	12.4	12.1	12.6	14.0	17.4	18.2	18.8	19.6
II. Indirect debt	-	**0.9**	**2.6**	**2.8**	**2.5**	**2.4**	**2.1**	**1.8**	**1.5**	**1.5**	**1.4**	**1.4**	**1.6**	**1.7**	**1.6**
III. Total debt (I+II)	**14.2**	**8.8**	**17.7**	**20.1**	**22.8**	**24.8**	**24.8**	**23.2**	**23.0**	**23.9**	**26.7**	**30.1**	**30.6**	**31.3**	**32.4**
Public debt / GDP (QM)[3]	**169.3%**	**28.3%**	**56.1%**	**55.9%**	**66.2%**	**70.0%**	**68.0%**	**57.8%**	**53.7%**	**52.0%**	**57.0%**	**56.5%**	**56.0%**	**55.3%**	**55.5%**

Source: *QM* calculations using MFIN data

The relative level of debt is falling, primarily due to inflation

Despite the strong growth of the absolute level of public debt in Q3, its relative level, expressed as a ratio to GDP, increased by only 0.13% of GDP, while compared to the beginning of the year, it decreased by 1.1% of GDP. This was primarily the result of relatively high inflation. Since more than 4/5 of Serbia's public debt is denominated in euros and dinars, and the exchange rate of the dinar against the euro was stagnant, and due to the increase in prices, the nominal amount of GDP increased strongly, which affected the decline in the ratio of the level of public debt to GDP. The real devaluation of the public debt through relatively high inflation had a direct positive impact on the level of state indebtedness, while the long-term impact is probably unfavourable, bearing in mind the negative impact of inflation on the factors on which real economic growth depends.

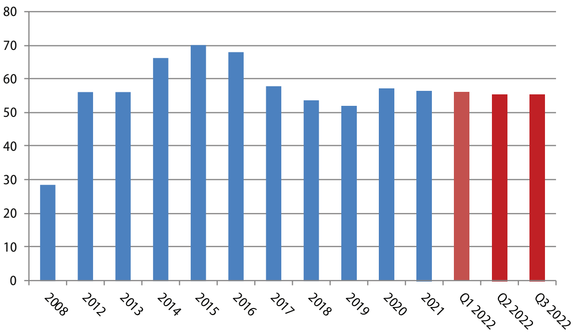
1 According to the Law on Public Debt, public debt includes the debt of the Republic arising from contracts concluded by the Republic on securities, on contracts, i.e. agreements reprogramming the obligations assumed by the Republic under previously concluded contracts, as well as issued securities according to special laws, the debt of the Republic that arises from the guarantee given by the Republic or from the direct assumption of the obligation in the capacity of the debtor to pay the debt on the basis of the given guarantee, i.e. on the basis of the counter-guarantee given by the Republic, the debt of the local government for which the Republic has given a guarantee.

Due to the depreciation of the dinar against the dollar, the public debt increased by about EUR 240 million in Q3

The dinar exchange rate against the euro was stable in Q3, while the dinar against the US dollar depreciated by 6.5% in that period. Considering that about 11% of Serbia's public debt is expressed in dollars, the depreciation of the dinar against the dollar affected the growth of public debt in Q3 by about EUR 240 million. At the level of the first three quarters, the dinar depreciated against the dollar by about 15%, which affected the increase of the public debt by about EUR 560 million.

By the end of the year, the public debt could remain at a level below 57% of GDP, although there are risks that it will be slightly higher

Graph T6-6 Serbia: Public Debt Dynamic (% GDP)



Source: *QM* calculations using MFIN data

The revised fiscal strategy predicts that the public debt will amount to around 59.9% of GDP at the end of 2022. Considering the current fiscal trends and the fact that part of the aid to public companies in the energy sector is already included in the public debt, and bearing in mind the high nominal GDP growth due to high inflation, it is estimated that the public debt of Serbia could remain at the end of 2022 within the planned framework. And if the state carries out significant additional borrowing in advance or extraordinary borrowing is necessary to help the energy sector, the public debt could be slightly higher.

Box 2. Assessment of the Proposed Changes to Fiscal Rules

Amendments to the Law on the Budget System provide for a fundamental revision of fiscal rules. In the part related to general fiscal rules, the limit for the state's public debt was raised from 45% of GDP to 60% of GDP, and the target medium-term deficit was reduced from 1% of GDP to 0.5% of GDP, whereby the targeted fiscal balance would be 0% of GDP, if the public debt exceeds 60% of GDP, while in case the public debt is from 45% to 55% of GDP or below 45% of GDP, the target deficit would be 1.5% or 3% of GDP respectively. In the part related to special fiscal rules, it is stipulated that the total spending on wages of public sector employees cannot exceed 10% of GDP, and the same limit is foreseen for pensions and related monetary increases. In particular, the fiscal rules in the wage segment are operationalised through the wage indexation policy, which is established every year by the Budget Law, while the pension indexation policy is linked to the level of pension spending. Thus, in the event that the total mass of pensions is below the mentioned limit, pensions are indexed according to the growth rate of net wages in Serbia, while in the case that the mass of pensions amounts to 10-10.5% of GDP, pensions are indexed according to the Swiss formula (average growth rate of wages and inflation), and in the event that the mass of pensions exceeds 10.5% of GDP, indexation is done only according to the inflation rate.

Bearing in mind the country's level of development and borrowing conditions, as well as numerous empirical studies that show that in less developed countries, public debt begins to negatively affect economic growth already at a debt level of about 50% of GDP, it is estimated that the general fiscal rule in the public debt segment is relatively widely set, and from the perspective of the sustainability of public finances and their contribution to the development of the country, it would be more correct if that limit were set at a lower level (up to 50% of GDP). On the other hand, the decision to include the state's obligations based on restitution in the mentioned public debt limit is considered correct, since these financial obligations are now known. The general fiscal rule in the deficit segment is, on the one hand, more restrictive than before, since the target medium-term deficit has been reduced from 1% of GDP to 0.5% of GDP. On the other hand, the corrective elements that allow the target deficit to be higher if the public debt is lower, are set so that the expansion of fiscal policy is exclusively linked to the level of public debt, without taking into account the state of the economy, which is economically sub-optimal. For example, according to the new fiscal rule, the state can conduct an expansive fiscal policy if the public debt is relatively low even in a situation when the economy is expanding, while in recession conditions the state would be forced to conduct a restrictive fiscal policy if the public debt is higher. In this way, the space for conducting a countercyclical fiscal policy is reduced. Special fiscal rules are generally assessed as well set, taking into account the level of development of the country, the existing structure of the public sector, and good European practice.

It is assessed as positive that the amendments to the Law on the Budget System specify the way the state reacts in case of exceeding the limits given by the fiscal rules, in terms of preparing and adopting a programme of measures to restore the fiscal policy within the framework defined by the rules. On the other hand, the amended fiscal rules will be applied only from 2025, which is justified by the necessity of implementing anti-crisis measures in 2023 and 2024, which can also be considered inadequate. Instead, it would be more expedient if the fiscal rules provided for a way of correcting the limit in extraordinary conditions caused by crises, so that the new fiscal rules could be applied as early as 2023.

Appendices

Annex 1. Serbia: Consolidated General Government Fiscal Operations, 2010-2022 (bn RSD)

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021					2022			
										Q1	Q2	Q3	Q4	*Q1-Q4*	Q1	Q2	Q3	Q1-Q3
I PUBLIC REVENUES	**1,472.1**	**1,538.1**	**1,620.8**	**1,694.8**	***1,842.7***	**1,973.4**	**2,105.3**	**2,278.6**	**2,255.0**	**594.5**	**691.4**	**683.4**	**742.7**	**2,711.9**	**678.6**	**802.8**	**771.8**	**2,253.2**
1. Current revenues	1,393.8	1,461.3	1,540.8	1687.6	*1833.3*	1964.9	2090.6	2263.7	2243.8	588.7	688.2	680.4	735.3	2692.6	676.5	799.9	766.9	2243.4
Tax revenue	1,225.9	1,296.4	1,369.9	1463.6	*1585.8*	1717.9	1822.2	1993.7	1990.8	531.2	624.6	608.8	655.6	2420.1	616.9	734.2	682.5	2033.6
Personal income taxes	35.3	156.1	146.5	146.8	*155.1*	167.9	179.4	203.7	204.2	55.6	70.2	61.5	68.7	255.9	63.5	84.8	71.2	219.4
Corporate income taxes	54.8	60.7	72.7	62.7	*80.4*	111.8	112.5	126.7	122.9	28.5	63.0	34.2	33.7	159.5	35.7	87.6	43.5	166.8
VAT and retail sales tax	367.5	380.6	409.6	416.1	*453.5*	479.3	499.8	550.6	549.3	139.2	165.0	169.7	185.0	658.9	181.4	201.3	196.4	579.1
Excises	181.1	204.8	212.5	235.8	*265.6*	279.9	290.0	306.5	306.0	78.9	73.8	91.1	86.3	330.0	84.3	80.0	86.8	251.2
Custom duties	35.8	32.5	31.2	33.3	*36.4*	39.7	43.6	48.1	51.9	13.3	14.4	15.8	18.5	62.0	18.4	19.0	19.9	57.4
Other taxes	42.6	43.5	57.3	63.3	*67.3*	567.4	77.1	82.1	82.7	20.9	23.1	22.5	25.4	91.8	22.7	24.4	24.9	72.0
Social contributions	378.9	418.3	440.3	505.7	*527.5*	71.9	619.7	675.9	673.7	194.8	215.2	214.0	238.0	862.0	211.0	237.1	239.8	687.9
Non-tax revenue	37.9	34.9	170.9	224.0	*247.5*	247.0	268.4	270.0	253.0	57.6	63.7	71.6	79.6	272.5	59.6	65.7	84.4	209.7
II TOTAL EXPENDITURE	**-1,717.3**	**-1,750.2**	**-1,878.9**	**-1,844.0**	***-1,899.7***	**-1,921.1**	**-2,073.0**	**-2,289.7**	**-2,697.7**	**-607.2**	**-717.5**	**-712.6**	**-934.0**	**-2,971.3**	**-746.7**	**-750.3**	**-708.1**	**-2,204.9**
1. Current expenditures	-1,479.9	-1,549.8	-1,628.0	-1696.6	*-1,717.9*	-1745.3	-1847.2	-2001.7	-2352.9	-541.9	-636.0	-577.9	-689.7	-2445.5	-661.7	-619.6	-593.5	-1874.7
Wages and salaries	-374.7	-392.7	-388.6	-419.2	*-417.7*	-426.3	-468.8	-516.3	-578.9	-153.1	-158.0	-155.2	-162.6	-629.0	-168.9	-173.5	-168.0	-510.4
Expenditure on goods and services	-235.7	-236.9	-256.8	-257.6	*-283.6*	-301.6	-343.4	-379.3	-441.0	-96.8	-105.1	-123.8	-164.6	-490.3	-109.8	-131.8	-118.7	-360.3
Interest payment	-68.2	-94.5	-115.2	-129.9	*-131.6*	-121.2	-108.6	-108.9	-110.2	-48.2	-21.5	-28.4	-10.7	-108.7	-53.2	-21.0	-22.8	-97.0
Subsidies	-111.5	-101.2	-117.0	-134.7	*-112.7*	-113.3	-109.7	-121.2	-251.5	-25.5	-84.8	-31.9	-64.0	-206.3	-38.5	-31.5	-34.1	-104.2
Social transfers	-652.5	-687.6	-696.8	-710.0	*-716.8*	-720.1	-746.0	-782.9	-806.3	-202.4	-214.0	-217.1	-216.6	-850.0	-249.6	-222.6	-220.8	-692.8
o/w: pensions	-473.7	-498.0	-508.1	-490.2	*-494.2*	-497.8	-525.2	-559.3	-583.5	-151.1	-153.2	-152.4	-152.0	-608.7	-156.8	-159.0	-158.5	-474.4
2. Capital expenditures	-126.3	-84.0	-96.7	-114.5	*-139.3*	-133.9	-199.3	-266.3	-293.2	-62.5	-70.7	-131.3	-202.1	-466.6	-76.4	-122.0	-94.3	-292.6
3. Called guarantees	-3.7	-7.9	-29.7	-30.1	*-39.1*	-28.8	-19.7	-10.8	-7.5	-1.8	-1.8	-1.8	-2.3	-7.7	-1.5	-3.1	-6.9	-11.5
4. Buget lendng	-38.2	-35.6	-55.4	-2.7	*-3.3*	-13.2	-6.8	-10.9	-44.2	-1.0	-9.1	-1.5	-39.9	-51.5	-7.1	-5.6	-13.4	-26.1
CONSOLIDATED BALANCE	**-245.2**	**-212.1**	**-258.1**	**-149.1**	***-57.1***	**52.3**	**32.2**	**-11.1**	**-442.8**	**-12.7**	**-26.1**	**-29.3**	**-191.4**	**-259.4**	**-68.1**	**52.5**	**63.8**	**48.3**

Source: *QM* calculations based on the MoF data

Annex 2. Serbia: Consolidated General Government Fiscal Operations, 2012-2022 (real growth rates, %)

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021					2022			
										Q1	*Q2*	*Q3*	*Q4*	*Q1-Q4*	*Q1*	*Q2*	*Q3*	*Q1-Q3*
I PUBLIC REVENUES	**0.6**	**-2.2**	**3.2**	***3.1***	***7.5***	***4.0***	**4.6**	**6.2**	**-2.6**	**9.2**	**40.8**	**11.5**	**5.7**	**15.5**	**5.0**	**4.9**	**1.0**	**3.2**
1. Current revenues	0.1	-2.6	3.3	*3.3*	*7.4*	*4.1*	*4.3*	*6.3*	*-2.4*	*8.7*	*41.0*	*11.4*	*5.2*	*15.3*	*5.7*	*5.1*	*0.7*	*3.3*
Tax revenue	1.0	-1.7	3.5	*0.3*	*7.2*	*5.2*	4.0	7.4	-1.7	8.8	43.7	13.0	6.9	16.8	6.8	6.3	0.2	3.9
Personal income taxes	2.1	-12.2	-8.1	*-1.2*	*4.5*	*5.1*	4.8	11.4	-1.4	11.3	50.0	19.5	6.3	20.4	5.1	9.2	3.4	5.6
Corporate income taxes	35.1	2.9	17.4	*-15.0*	*26.9*	*35.0*	-1.3	10.6	-4.5	16.1	162.0	-32.1	16.1	24.7	15.1	25.6	13.9	19.6
VAT and retail sales tax	0.0	-3.8	5.4	*0.2*	*7.8*	*2.6*	2.2	8.1	-1.8	2.4	30.1	14.7	14.6	15.3	19.9	10.3	3.4	10.2
Excises	-1.2	5.1	1.6	*9.4*	*11.4*	*2.3*	1.6	3.7	-1.7	1.8	2.8	15.2	-4.5	3.6	-1.7	-1.9	-14.8	-7.1
Custom duties	-14.0	-15.6	-6.5	*5.9*	*8.1*	*5.8*	7.8	8.1	6.3	10.1	18.5	11.0	18.1	14.7	27.4	19.7	12.7	19.0
Other taxes	-8.8	-5.2	29.2	*8.9*	*5.1*	*4.4*	5.2	4.5	-0.9	13.1	25.9	-3.2	-3.4	6.6	0.1	-4.5	-0.9	-2.2
Social contributions	1.9	2.6	3.1	*-2.1*	*3.2*	*3.8*	7.1	7.0	-1.9	14.7	59.7	24.3	5.4	22.9	-0.4	-0.4	0.1	-0.6
Non-tax revenue	-6.2	-8.7	1.5	*27.9*	*9.3*	*-3.1*	6.5	-1.3	-7.8	8.7	18.9	-0.5	-7.1	3.5	-4.8	-6.7	5.4	-2.0
II TOTAL EXPENDITURE	**4.3**	**-0.3**	**5.2**	***-3.2***	***1.9***	***-1.7***	***5.8***	***8.4***	***16.0***	***1.7***	***-5.3***	***7.1***	***18.2***	***5.8***	***13.1***	***-5.5***	***-11.2***	***-2.4***
1. Current expenditures	4.1	-2.7	2.9	*-1.4*	*0.2*	*-1.2*	*3.8*	*6.3*	*15.7*	*0.7*	*-6.1*	*-3.0*	*8.1*	*-0.1*	*12.3*	*-11.9*	*-8.2*	*-3.7*
Wages and salaries	2.0	-2.6	-3.1	*-9.7*	*-1.4*	*-0.9*	*7.8*	*8.1*	*10.4*	*7.9*	*7.1*	*3.8*	*-0.8*	*4.4*	*1.5*	*-0.8*	*-3.3*	*-1.3*
Expenditure on goods and services	1.5	-6.6	6.2	*-1.1*	*8.9*	*3.3*	*11.6*	*8.4*	*14.5*	*-0.7*	*-9.2*	*22.8*	*12.8*	*6.8*	*4.3*	*13.4*	*-14.3*	*-0.3*
Interest payment	41.9	28.8	19.3	*11.2*	*0.2*	*-10.6*	*-12.1*	*-1.6*	*-0.4*	*0.5*	*29.8*	*14.8*	*-57.1*	*-5.2*	*1.6*	*-11.6*	*-28.3*	*-10.8*
Subsidies	29.1	-15.6	13.2	*13.6*	*-17.3*	*-2.3*	*-5.1*	*8.4*	*104.3*	*-2.9*	*-10.6*	*-66.5*	*41.0*	*-21.2*	*39.2*	*-66.4*	*-4.5*	*-34.0*
Social transfers	-0.1	-2.1	-0.7	*0.5*	*-0.1*	*-2.1*	*1.6*	*3.0*	*1.4*	*2.6*	*2.3*	*5.9*	*-5.0*	*1.3*	*13.4*	*-6.0*	*-9.1*	*-1.4*
o/w: pensions	*4.4*	*-2.3*	*-0.1*	*-4.8*	*-0.3*	*-2.2*	*3.4*	*4.5*	*2.7*	*2.9*	*1.4*	*0.0*	*-3.1*	*0.2*	*-4.5*	*-6.2*	*-7.0*	*-6.3*
2. Capital expenditures	6.0	-38.2	12.7	*16.8*	*20.3*	*-6.7*	*45.9*	*31.1*	*8.4*	*12.3*	*12.7*	*112.9*	*59.1*	*52.9*	*12.3*	*56.0*	*-35.8*	*-0.3*
3. Called guarantees	-3.7	248.7	267.8	0.1	28.5	-28.5	-32.9	-46.3	-31.8	6.4	6.4	-27.2	17.9	-1.6	-19.5	58.2	234.4	93.4
4. Buget lending	-38.2	44.2	52.2	-95.1	20.8	283.9	-49.3	57.0	299.3	-51.2	-40.7	-74.1	71.5	12.0	571.6	-44.3	681.5	102.9

Source: *QM* calculations based on the MoF data