From the Editor

The Government of the Republic of Serbia, within the budget rebalance, adopted a series of fiscal policy measures that result in an increase in state expenditures and revenues, as well as a fiscal deficit compared to what would have been achieved without the rebalance. On the expenditure side, pensions and salaries in part of the public sector were extraordinarily increased, subsidies for agriculture were increased, one-time assistance was approved for young people up to 16 years of age, public investments were increased, while on the revenue side, all excise taxes were increased, except for electricity. Immediately after the budget rebalance, a decision was made to provide additional one-time assistance to pensioners in the amount of 20,000 dinars per pensioner. One-time assistance to young people and pensioners, as well as an increase in public investments, have a temporary impact on public expenditures, while the extraordinary increase in salaries and pensions and subsidies for agriculture permanently increase the budget expenditures. The increase in excise taxes also permanently increases budget revenues, with the aim of providing funds to finance permanently increased expenditures. During September, the Government of Serbia launched a price reduction campaign, which in the first step covered 20, and in the second another 16 essential products. From the perspective of the labour market and the functioning of the economy, the Government's decision to increase the minimum wage by 17.8% from the beginning of the next year is important. In the field of monetary policy, the National Bank of Serbia (NBS) increased the mandatory reserve rate during September and made a decision on the administrative reduction of interest rates on housing loans with value less than 200,000 euros.

According to the interpretation of representatives of the Government and the NBS, the main goals of the mentioned measures are to improve the living standards of citizens and combat inflation. However, the adopted measures will affect fiscal sustainability, the labor market, the competitiveness of the Serbian economy, and its growth in the medium and long term. Although the adopted measures have important economic consequences, it is quite obvious that they have significant political implications, which boil down to a temporary increase in the living standards of citizens and strengthening the support for the ruling party ahead of the announced elections.

When it comes to the impact on the living standards of citizens, the adopted measures will certainly lead to its improvement in the short term. In the next few months, the increase in wages and pensions, the approval of one-time assistance to young people and pensioners, the reduction in prices of essential products, the reduction in credit costs, and the increase in the minimum wage will certainly improve the living standards of citizens, but this effect will be slightly reduced as these measures will slow down the decrease in inflation, which will reduce the real amount of the increase in living standards. However, the effect of these measures on the living standards of citizens in the medium term will probably be slightly negative or, at best, neutral compared to the standard that would have been achieved if these stimulative measures had not been applied. The reason for this is that the increase in disposable income of citizens will slow down the decrease in inflation and lead to a longer application of restrictive measures, such as high-interest rates, which will slow down the economic recovery in the coming years. The reduction in prices of essential products and the reduction in interest rates on housing loans are temporary measures, so after their application expires, prices and rates will rise again. Moreover, during their application, it is very likely that trading companies and banks will compensate for the lost revenue due to the reduction in prices of some products by increasing the prices of other products. The increase in the reserve requirement rate will temporarily reduce the profits of banks, but over time, banks will increase the prices of their services (interest rates, fees, commissions, etc.) to pass on the costs of this measure to users of banking services, which will negatively affect the living standards of citizens, in a similar way as the increase in interest rates. The increase in the minimum wage will increase the earnings of the lowest-paid workers next year, which will raise their standard. However, the high growth of labour costs in industries where minimum wages are paid, which are typically labour-intensive, will affect the rise in prices of their goods and services, which will lead to an increase in consumer prices, and thus a decrease in the living standards of citizens.

Although the second goal of the adopted measures is to curb inflation, a more detailed analysis shows that some of the adopted measures will stimulate inflation growth, while others will contribute to its reduction. Among the observed measures, the most important measure aimed at reducing inflation is the increase in the mandatory reserve rate, which directly affects the reduction of liquidity and aggregate demand. In addition, the reduction of prices of essential products will have a certain temporary impact on reducing inflation, but this impact will be modest both due to the small scope of products and because it will affect the rise in prices of other products. The most direct impact on accelerating inflation will be from the increase in excise taxes, which represents the cost for the permanent increase in pensions, salaries, and agricultural subsidies. Another important channel through which the adopted measures will affect the slowdown in the decline and prolongation of the period of high inflation is the increase in aggregate demand due to an increase in the fiscal deficit by over 1% of GDP, compared to the deficit that would have been achieved had there been no budget rebalance. If the one-time payment to pensioners of 20,000 dinars is added to this, the total increase in the fiscal deficit, as a measure of the expansiveness of fiscal policy, rises to close to 1.5% of GDP. As previously stated, measures that grant additional funds to citizens and the economy increase disposable incomes and aggregate demand, which will affect a slower decline in inflation. A relatively high increase in the minimum wage will have a certain impact on the rise in prices of goods and services in industries where a large number of workers with minimal wages work, such as security services, cleaning and maintenance of space, the textile industry, etc. In summary, it is estimated that inflation will continue to decline in the coming months because it is affected by falling prices on the world market, stagnation of the EU economy, and slow growth of the Serbian economy, high interest rates in Serbia and the world, etc. However, the decline in inflation will be slower, and the period of high inflation will be slightly longer due to the implementation of the package of expansive economic policy measures.

In addition to the impact on the standard of living and inflation, the adopted and announced measures (one-time assistance to pensioners) will result in an increased fiscal deficit of about 1.5% of GDP, compared to the deficit that would have been achieved without these measures. Given that the deficit is financed by borrowing, this means that due to the implementation of the mentioned measures, the state will additionally borrow 1.5% of GDP. Although this additional borrowing is not alarming and will not jeopardize the solvency of the state, it is assessed that it would have been better if it had been omitted or implemented to a lesser extent. The increase in excise duties, which will have a one-time impact on inflation growth and slow down the standard of living, has a positive impact on fiscal sustainability as the state will generate additional revenues in the amount of 0.4% of GDP in the coming years due to this measure. By increasing excise duties, an increase in the structural fiscal deficit has been prevented, due to the permanent increase in expenditures for pensions, salaries, and agricultural subsidies, which would have resulted in the state's permanent borrowing on that basis. The adopted and announced measures, viewed collectively, do not significantly worsen Serbia's fiscal sustainability in the coming years, but that does not mean that fiscal sustainability cannot be jeopardized by the implementation of other measures in the coming years. Government representatives have announced large investments in the construction of the Expo centre, the national stadium, new roads and railways, municipal infrastructure, etc., which will be financed by state borrowing. If other state expenditures are not reduced or taxes are not increased, public debt, as well as interest rates for its financing, will continue to grow rapidly, so in that case, problems with its financing are not excluded.

The adopted fiscal and monetary measures will have a certain impact on economic activity in this and the coming years. The increase in aggregate demand through the increase in the fiscal deficit will have a relatively modest positive impact on economic activity in the next few months. Increased incomes of citizens will lead to higher demand, which will be transferred to a relatively modest percentage increase in production in Serbia. The increase in public investments has a greater impact on economic growth, but its absolute amount is not large, and it is uncertain to what extent it will be realized, due to the usual delays in investment implementation. The increase in aggregate demand, mostly through the growth of current consumption, by about 1.5% of GDP could increase GDP by 0.2-0.3 percentage points in the next few months.

The impact of the adopted and announced measures on economic growth in the medium term will be predominantly negative, and it will be felt through an extended period of high inflation and high interest rates used to curb inflation. In addition, the increase in excise taxes raises the overall tax burden, which was already high in Serbia for its level of development. It was previously mentioned that the relatively high increase in the minimum wage will negatively affect the functioning and growth of low-productivity sectors. In Serbia, before the last increase, the ratio of the minimum to the average wage was about 47%, while in the CEE countries it averaged about 40%, and in OECD members about 43%. It is estimated that after an increase of 17.8% next year, the minimum wage in Serbia will account for over 50% of the average wage, which is a relatively high amount.

Economic growth in Serbia in the coming years will depend on numerous other factors, not just the economic policy measures that have been implemented or announced over the past few months. The Serbian economy is strongly influenced by global economic trends, especially in Europe, which, according to current forecasts, will be relatively unfavorable over the next two to three years. Additionally, Serbia's economic growth will be affected by fiscal and monetary policy measures that will be adopted in the coming years, the content and effects of which are currently difficult to predict. Ultimately, Serbia's medium and long-term economic growth will crucially depend on fundamental factors, such as the quality of institutions. According to several international studies, the quality of institutions in Serbia has been deteriorating for several years, noting that even before this decline, the quality of institutions was low. This low and declining quality of institutions will pose a significant obstacle to achieving rapid economic growth in Serbia, which is essential to catch up with Central and Western European countries. The low quality of institutions was also evident in the adoption of fiscal and monetary measures over the past few months: pension increases were made contrary to the legal rules on their indexation, the decision on the minimum wage was made without the consent of employers and unions, decisions on launching public projects are made without prior public and expert discussions, the decision to reduce interest rates on housing loans was made by the NBS without prior agreement of the contracting parties, and the campaign to reduce the prices of essential products is being conducted in a non-transparent manner, etc.

One of the important characteristics of the economic policy measures adopted over the past few months is that their expected effects in the short term are moderately positive, while their effects in the medium and long term are negative or neutral. This temporal distribution of the effects of economic policy measures is characteristic of political economic cycles, where authorities implement expansionary fiscal policies before elections to temporarily improve the living standards of citizens, thereby increasing the chances of the current government in the elections. Although such measures are not immune even in developed democracies, they are particularly characteristic of weak democracies and electoral autocracies where the ruling party uses state policies and resources to enhance its own electoral prospects. However, large variations in fiscal policy reduce the stability and predictability of the business environment and slow down economic growth in the long run.