Republic of Serbia

FISCAL COUNCIL

ASSESSMENT OF THE SUPPLEMENTARY BUDGET LAW FOR 2019

Summary

Supplementary Budget prescribes the usage of the entire surplus made in the 2019 budget by the end of the year. For the first time since 2014, the Government proposed that the National Parliament adopt a supplementary budget that additionally increases public expenditure. Public revenue collection was better than expected in 2019, which (if no supplementary budget was adopted) would result in a modest fiscal surplus instead of the planned deficit. Bearing this in mind, the Government proposed a supplementary budget that increases the budget expenditures in such a way that the year would end exactly as originally planned - with a small deficit of 0.5% of GDP. This is an important change in fiscal policy compared to the previous four years, when better fiscal results were mostly preserved and used for repayment and additional decrease of the excessive public debt and not for expenditures - which meant that all years, from 2015 to 2018, ended in a surplus (or with a lower deficit than planned) and with a public debt decrease that was better than planned.

In its Assessment of the proposed Supplementary Budget, the Fiscal Council answers two questions. *First*, is it justified to additionally increase public expenditure in the supplementary budget and thus give up on a fiscal surplus (which would have happened without the new expenditures) in favour of a small deficit? *Secondly*, have these new funds been put toward economically justified purposes? Our analyses show that, under certain conditions, it is acceptable to use this year's budget surplus. Public debt has decreased to just over 50% of GDP and the country is no longer in direct danger of a public debt crisis – however, the economic growth is lagging behind in 2019. It would thus be fine if the available budget funds were used primarily on growth enhancing measures. The main issue with the proposed supplementary budget, however, is the fact that only a quarter of the new funds are allocated to such measures, e.g. infrastructure development (and the question is if they will even be used for this purpose), whereas most of the funds are directed to non-productive (in terms of growth) purposes. Excessive growth of salaries in the general government, which will - on average – amount to about 9.5% and far exceed the achieved economic growth, is fiscally and economically the most irresponsible of the proposed measures.

Supplementary Budget calls for expenditure increase of 50 bn dinars. Current fiscal trends show that, in 2019, the budget execution would be in line with the initial Budget Law (although with a somewhat different expenditure structure). On the other hand, budget revenue collection shall exceed the plan by about 50 bn dinars. About 60% of this increase is permanent and structural, while the remaining part came from certain one-time payments into the budget (tax from the concession fee for the Nikola Tesla Airport etc). Supplementary Budget proposes that the larger budget revenues be completely used to finance the increase of public expenditure, driving the budget execution result from a possible surplus of about 25 bn dinars to the deficit of 23 bn dinars. The most significant new policies and measures that increase expenditures are the following:

A) 9 bn in expenditures for the resolution of loans indexed in Swiss Francs;
B) 9 bn dinars for a one-time assistance to the pensioners in the amount of 5,000 dinars;
C) 10 bn dinars for additional equipment in the security sector (Military and Police);
D) 13 bn dinars of additional investments for the construction of Pojate-Preljina highway;
E) 7 bn dinars of additional expenditures for interest payments due to early loan repayment,
F) 2 bn dinars for the increase of public sector salaries.

The Supplementary Budget provides for an acceptable budget deficit of approximately 0.5% of GDP, but the measures that increase budget expenditures are mostly problematic. The proposed deficit of 23 bn dinars was, actually, planned in the original Budget Law as well. As we assessed when the budget was adopted, this is a suitable target for Serbia - as a deficit of about 0.5% of GDP provides for a drop in public debt to GDP ratio of about 2 p.p. per year, (from about 54% of GDP at the end of 2018 to about 52% of GDP at the end of 2019). An alternative to this Supplementary budget was to end 2019 with a surplus of about 0.5% of GDP and decrease the public debt by about 3 p.p. of GDP. The Fiscal Council believes that the most important thing for Serbia is that its public debt is on a downward path relative to GDP of about 2 p.p. per year; additional acceleration of this trend by creating a budget surplus, although undoubtedly helps, is no longer critical (unlike when the public debt was over 70% of GDP). Hence, it is acceptable in general, to have the Government increase its expenditures in the supplementary budget, if they are “earmarked” for justified purposes. Serbia has many structural issues in the budget, a poor and underdeveloped infrastructure, and, in addition, the economic growth in 2019 is coming under the forecast (in the first half of the year, GDP growth was only 2.8%). With all this in mind, it is our position that an economic priority should be to direct the available funds towards an improvement of budget structure and incentivize economic growth; this, however, is only minimally reflected in the proposed supplementary budget.

The Supplementary budget plans for an increase of investments into road infrastructure by 13 bn dinars, but we cannot positively say that these expenditures will be executed as planned. As we mentioned, the best measure in the Supplementary budget - in economic terms - is the increase of infrastructure investments. In this case, the investment goes towards the construction of the Pojate-Preljina motorway (the Morava corridor), and the increase is by about 13 bn dinars (from the original 2 bn to 15 bn dinars). It is questionable, however, whether the works will be completed, in the value prescribed by the supplementary budget for 2019. The works on this section of the motorway have not yet begun (of the initially budgeted 2 bn dinars, less than 150 million have been used in the first 6 months), so it would be difficult to expect that seven times higher funds be used up (in only 3 months), all the more so since the end of the construction season is at hand. If the works are not completed, the fiscal deficit in 2019 will be smaller than the planned 0.5% of GDP and could amount to 0.2-0.3% of GDP.

Financial assistance to pensioners in the amount of 5.000 dinars is not a good social policy measure. Within the social welfare measures, the supplementary budget envisages a payment of 5.000 dinars to all pensioners. The issue with this measure is that the social position of the citizens cannot - and must not - be determined by their status. It is estimated that about 100,000 elderly people in Serbia have no pension and are classified as socially most vulnerable Serbian citizens - and now, they don't even qualify for the planned welfare measure. On the other hand, there are pensioners whose income level is such that they don't need this kind of assistance. The bad practices of populist social policy, embodied in the treatment of pensions in Serbia for quite a long time (e.g. the previous payment of the 13th pension for all groups of pensioners) should finally be abandoned. Since its very foundation, the Fiscal Council has been emphasizing that the purpose of welfare and social system is to direct the limited budget funds to assist those in most dire material need, whereas pensions should be determined based on clear economic parameters (years of service, quantity of contributions paid, expected duration of pension etc).

An additional increase (by 10 bn dinars) of the already unusually high expenditures for military and police is expected. We already entered 2019 with record-breaking investments into the security sector (defence and police), which the Fiscal Council had pointed out as it occurred. As a reminder, the budget for overall expenditures for these purposes was originally planned in the amount of 46 bn dinars (0.9% of GDP), which was almost three times higher than the average of such investments in Central and Eastern European countries (amounting to about 0.3% of GDP). These are investments that, although formally presented as capital investments and included in overall public investments, do not increase the economy's productive capacity (unlike investments into roads, railroads, water supplies, sewers) and have a negligible effect on economic growth. It was expected that, after a significant growth in the two previous years, these expenditures would start dropping - opening a budget space for other important capital investments (environment protection, healthcare, education). However, the Supplementary budget plans for additional purchase of equipment for the military and the police and does not even hint at an expected change in direction in the future.

Adoption of the law on conversion of loans indexed in Swiss Francs in April 2019 brought about a large - and, in our opinion, unjustified - budget expenditure of 9 bn dinars. In April 2019, the Fiscal Council, in line with its legal obligations, analysed and assessed the Draft Law on the conversion of housing loans indexed in Swiss Francs, submitted by the Government to the National Parliament for adoption. The conclusion of the analysis was that the proposed Law represented an unjustified and too large extensive cost for all Serbian citizens for the purposes of resolving a litigation case between two private parties (banks and debtors). However, despite the Fiscal Council's assessment, the Draft was adopted and the Supplementary budget now formalizes the public cost derived from its adoption. With these expenditures now visible in the Supplementary budget, one should also keep in mind that the budget will be another 2 bn dinar short in the upcoming years because of the unpaid corporate income tax (the banks were given tax credit to resolve these loans).

The most harmful of all the measures proposed by the Supplementary budget, in economic terms, is the excessive increase of salaries in the general government, in the range from 8 to 15%. The majority of planned expenditures that are included in the Supplementary budget are one-offs, meaning that once they are executed in 2019, they will not be a burden on the 2020 Budget (payment of 5.000 dinars to all pensioners, majority of the resolution for loans indexed in Swiss francs etc). However, this is not true for the proposed increase of salaries in the general government. The effect of this measure in 2019 is actually minimal - as the increased salaries will be paid only once in the current year (December); but it will cost the country 12 times more in the future and represent an enormous and permanent fiscal burden. Increase of salaries in the general government is justified, but only proportionally to economic growth, which is something that the Government is not adhering to for the second year in a row now. The 2019 budget had planned for salaries to be increased, on average, by 9%, although the nominal economic growth in 2019 in Serbia shall amount to 5.5% (real GDP growth of about 3% and around 2% inflation. Instead of correcting the mistake it had made in the 2019 Budget when the time came, i.e. lowering the salary increase in the 2020 Budget – the Government thorugh the Supplementary budget decided to increase general government salaries by an even higher percentage than in the 2019, by over 9.5% on average (although the GDP growth is slowing down). This increase of the salaries in general government is not supported by economic growth and is thus both fiscally and economically unsustainable and irresponsible.

The structure of salaries in the general government is deteriorating, as their increase by line ministries is once again implemented without objective parameters. Since 2015, the Government has been announcing the introduction of a pay grades system that would permanently and objectively bring the general government wage system to order. On several occasions, the Fiscal Council analysed and provided concrete recommendations to bring this process to an efficient and appropriate completion. However, despite the announcements, and despite the legally prescribed deadlines, from year to year the government has been avoiding the introduction of this system. Instead, in the proposed Supplementary budget, the salaries are increased in different ministries (and other budget beneficiaries) for the fifth time, arbitrarily, with no analysis or explanation as to why, for example, the Ministry of Interior is getting a higher raise than the Ministry of Finance. Several years of arbitrary salary increases in different ministries have now worsened wage parities between different parts of the public sector to such an extent that the question is whether the pay grade system, in the form in which it was designed, has any chance to take root in the future.

Table 1 Central government revenue and expenditure: 2019 Budget, estimated execution and rebalance

In bn dinars	2019 Budget	Estimated 2019 execution before the rebalance	2019 Budget rebalance
I Budget revenues	**1,246.2**	**1,294.5**	**1,292.6**
1. Tax revenue	1,059.9	1,095.6	1,092.8
Income tax	61.5	69.0	68.1
Profit tax	108.5	118.0	117.8
VAT	539.1	542.0	545.2
Excise	291.4	306.0	301.2
Oil derivatives excise	*156*	*164*	164.2
Tobacco excise	*102.1*	*105*	102.5
Customs	47.1	47.1	47.2
Other tax revenue	12.3	13.5	13.3
2. Non-tax revenue	172.4	185.0	185.0
3. Donations	13.9	13.9	14.8
II Budget expenditures	**1,269.1**	**1,268.5**	**1,316.2**
I. Current expenditures	1,084.0	1,091.5	1,116.7
Wage bill	294.4	294.2	296.3
Expenditures for the use of goods and services	128.0	131.8	131.7
Expenditures on interests	103.1	103.0	110.6
Subsidies	100.3	103.5	114.5
Donations to international organizations	4.2	5.0	5.4
Other donations and transfers	5.0	5.5	5.5
Transfers to other levels of governments	86.7	90.0	89.7
Transfers of OOSO	222.0	203.0	208.9
Social protection from the budget	113.3	120.0	120.0
Other current expenditures	27.0	35.5	34.2
2. Capital investments	165.5	160.7	182.3
3. Activated guarantees	13.0	11.3	11.5
4. Budget loans	6.6	5.0	5.7
FISCAL RESULT	**-22.9**	**26.0**	**-23.6**