

## **An Assessment of the Program of Measures to Maintain the Fiscal Deficit of the Republic of Serbia**

**Fiscal Council supports any effort by the government of RS to reduce the budget deficit, but we estimate that the planned Program of measures for stabilizing the fiscal deficit will not provide sufficient savings even if fully implemented; probably the effects of these measures will be smaller than anticipated.**

**The government of Serbia has adopted measures to reduce the deficit.** The government of RS has adopted at the session on March 29, 2012 a Program of measures for maintaining/stabilizing the fiscal deficit (hereafter: Program). In the Explanation of the Program, it is stated that the planned budget deficit in 2012 is difficult to achieve due to unfavorable trends in government revenues and that measures are necessary in order to make the deviations from the planned deficit as small as possible. The overall, planned effect of the Program amounts to 15.7 billion dinars and it consists of (i) an increase in budget revenues on the basis of a takeover of own-source government revenues of budget users in the amount of 10.9 billion dinars and (ii) a reduction of discretionary expenditures of 4.8 billion RSD. The Fiscal Council has a legal obligation (The budget system law, article 92e) to provide independent and credible assessments of economic policy measures of the Government proposes toward achievement of the quantitative targets of fiscal policy.

**Total predicted savings of 15.7 billion dinars are not sufficient even if measures are fully implemented.** The Fiscal Council warned that at the end of last year the planned (general government) fiscal deficit of 4.25% of the GDP (152 billion dinars) for 2012 will not likely be achieved, mostly because of optimistic planning of government revenues. The data on the execution of the consolidated budget for the first two months of 2012, in addition to preliminary data on revenues and expenditures of the Republican Budget in March, suggest even more unfavorable trends from those pointed out by the Fiscal Council in December. Early indicators suggest that the deficit of the general government in the first three months of 2012 could be about 55 billion dinars instead of the planned 26 billion dinars, which already represents a deviation from the target for the first quarter of about 30 billion dinars. Therefore, the planned Program of measures by which the government deficit was to be reduced by only 15.7 billion dinars would not be sufficient to return the fiscal flows within the needed frameworks.

**Actual effects of the planned measures as per the assessment of the Fiscal Council will be smaller than predicted and amount to approximately 13 billion dinars (rather than the predicted 15.7 billion dinars).**

The Government's Program envisages that on the basis of the takeover of own-source revenues of budget users, the government budget revenues would increase by 10.9 billion dinars from the moment of the adoption of the Program until the end of 2012; and the users whose funds are redirected are: Treasury (the planned amount which is transferred to the budgetary revenues amount to 920 million dinars), Ministry of Culture (420 million dinars), The Fund for the Protection of Environment (4.378 million dinars), The Budgetary Fund for Forests of the Republic of Serbia (1.390 million dinars), The Republican Agency for Land Surveys (3.570 million dinars), the Directorate for and Precious Metals (128 million dinars), and the Ministry of Infrastructure and Energy (52 million dinars). The Program did not

explain from which sources will these budgetary users finance their obligations when in 2012 they lose their own-source revenues. Some budget users included in this Program are paying salaries of their employees from these revenues (e.g, Republican agency for land surveys). Since the Program did not envisage layoffs of employees in the Republican agency for land surveys, it remains unclear how will the legal obligations to pay salaries of employees be fulfilled when its own revenues are transferred into the central budget (about 900 million dinars). If these obligations are taken over by the budget of the Republic, a positive fiscal effect of the transfer of own revenues of budgetary users to the budget revenues of the Republic will be reduced by that amount. In addition to salaries, some budget users, such as the Fund for the Protection of the Environment and Budgetary Fund for Forests, have projects under implementation (classified as specialized services and subsidies), and it is possible that there are other obligations of remaining budget users which must be fulfilled legally by the end of the year. Funds for this purpose will, therefore, probably be secured also from the RS budget. As a result, the Fiscal Council estimates that the net effect for the budget will most likely be smaller by about 3 billion dinars of the planned 10.9 billion dinars.

**The takeover by the budget of funding sources from a certain group of budget users represents a step in the right direction, but it is important to note that this decision of the Government is an *ad hoc*, emergency measure.** In its past reports, the Fiscal Council has warned about the problem of inadequate control of spending from own-source revenues of certain budget users as well as about the fact that the present way of reporting and spending of public funds (collected in this manner) is not a good practice in managing public finances<sup>1</sup>. It is necessary to regulate systemically all own-source revenues of budget users so that they can plan their spending and discharge efficiently their social functions.

**The Fiscal Council estimates that the second part of the measures envisaged by the Program – a reduction of discretionary expenditures by 4.8 billion RSD – is possible.** Expenditures mandated by law (salaries, pensions and social protection), capital expenditures and incentives for agricultural and industrial production will not be reduced relative to the plan. Savings measures are being planned almost across the board in other discretionary expenditures: costs of travel, services, current maintenance, materials, contributions to the NGOs, machines and nonmaterial goods. Savings in the aforementioned cases are planned in the range of 10%-15% relative to the planned expenditures and are estimated to total 4.8 billion dinars. The Fiscal Council still estimates that space for such consolidation is becoming even smaller. In the RS budget for 2012 already there are envisaged sizeable savings in the purchase of goods and services (about 10% in real terms in relation to 2011). As a result, the Fiscal Council estimates in its analysis of the budget for 2012 that there is a risk that some necessary expenditures are not executed and that budgetary arrears increase. Savings will be possible only if with better prioritization and rationalization rather than across-the-board reduction in a large number of discretionary expenditures.

**The Fiscal Council supports limiting issuance of guarantees and indebtedness related to projects.** State guarantees are envisaged for domestic commercial banks in 2012 up to 120 million euros (in the 2012 budget 432.5 million euros was planned) and limits on domestic project borrowing in the amount of 175 million euros ((in a) budget plan of 115 million euros). The goal of the aforementioned restrictions is the slowing down of the growth

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<sup>1</sup> Expenditures from own revenues of budget users have grown in recent years, from about 50 billion in 2010 to the planned 70 billion in 2012. In its analysis of the 2012 budget, Fiscal Council has estimated that, in parallel to the cuts in expenditures of the Republican budgets, expenditures from own-source revenues are envisaged to grow extremely fast, about 20 percent in real terms.

of public debt which at the end of 2011 surpassed the legal limit of 45% of the GDP and continues to grow in 2012 as well. In this way, simultaneously, one of the reasons that brought about the freezing of the arrangement with the IMF (International Monetary Fund) is being eliminated. However, the Fiscal Council believes that to avoid crisis of public debt in coming years even stricter control and issuance of guarantees is necessary.

**The Fiscal council estimates that other urgent measures are necessary.** Data from the first quarter 2012 indicate a high probability that the fiscal deficit by the end of the year would be significantly higher not only than that in the planned budget, but also higher than our initial assessment in December. Already in the first three months of 2012, it is possible that the deficit will deviate from the target of 30 billion dinars for the first quarter, and since there is no indication that unfavorable trends will be reversed during the year, that gap will most likely grow higher. Given the significantly larger funds that are not secured in this year, the Program's predicted savings of 15.7 billion dinars are not enough, and absent other measures, the fiscal policy would be undermined. Therefore, it is necessary to adopt and implement other measures in the direction of fiscal consolidation, which would include other budgetary units and other units of the general government and the public sector (at the level of local governments, and public companies/enterprises).

In Belgrade, March 30, 2012.