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CONTINGENCY RESERVE AND SUPPLEMENTARY BUDGET IN SERBIA: CHALLENGES AND NECESSARY IMPROVEMENTS

Summary and main recommendations:

A government budget is the central document of public finances, and adequate citizen participation in its preparation and execution is essential. Figuratively, the budget is a contract between the state and society. It outlines how much and in what ways the state will collect funds from households and businesses, and conversely, how those funds will be allocated for public services and policies. The elected executive branch, or Government, holds the power to manage the budget, but it must do so with taxpayer participation and oversight. This occurs directly through public hearings and debates, and indirectly through citizen representatives in the National Assembly and independent state institutions. These fundamental principles of the budget process are enshrined in domestic legislation, including the Constitution, Budget System Law, Law on the National Assembly, and the Rules of Procedure for both the National Assembly and the Government.

The government is allowed a certain level of flexibility in the budget execution, but with clear restrictions. The budget adopted by the National Assembly can never be executed to the last dinar in keeping with the plan. It is not possible to fully predict all the circumstances in which public revenue will be collected and public expenditure executed, while (minor) technical deviations and errors are also inevitable when forecasting numerous individual budget appropriations. Consequently, certain in-year budget adjustments without the participation of the Parliament are permitted, and this is carried out in practice through the contingency reserve (*known in Serbia as the Current budget reserve*). This contingency reserve is basically replenished by transferring funds which the budget beneficiaries do not execute during the year in accordance with the initially planned budget. These funds are then reallocated by virtue of Government decisions to beneficiaries and projects for which, as it has turned out, the budget has not allocated enough funds. The legally permitted maximum amount of funds that can be reallocated through contingency reserves (without the Parliament's approval) currently stands at 4% of the republican budget revenue, amounting to about EUR 700 million in 2024. If a need arises in the course of the year for more significant amendments to the budget and changes in economic policies, the Government is required to submit a supplementary budget to the National Assembly for adoption.

Relying heavily on contingency reserves was a common practice in the previous years. The Fiscal Council has analyzed virement of public funds through contingency reserves in Serbia in the 2018 – 2023 period. This analysis has revealed the tendency of the Government to use contingency reserves systematically and on a large scale, i.e., close to the statutory cap

of 4% of budget revenue (while there are clear indications that in at least two years, 2020 and 2022, this statutory cap has even been exceeded). For all practical purposes, this implies that a total of at least EUR 2.6 billion of budget resources was reallocated through contingency reserves in the period from 2018 to 2023, meaning that they were not part of the standard procedures for planning and incorporation into the budget. In fact, the actual amount is even slightly higher, since a full set of data on the use of contingency reserve in 2023 is not yet available (it will be published in the second half of 2024), while a full set of data for 2019 has never been published.

Contingency reserve was also used for conducting ad hoc economic policies, which should not be its purpose. As mentioned before, one of the essential principles of well-regulated public finances is that they are managed with the participation of citizens, i.e., their representatives. Viewed from that angle, the use of contingency reserve is acceptable when it increases the flexibility of the budget at a technical level or when it is necessary to quickly respond to unforeseen circumstances - but it is not acceptable to use it for the implementation of new fiscal policies. Nonetheless, this is exactly what was going on in Serbia in previous years. Certain important and financially generous government policies were not part of the standard stages of planning and budgeting (the Fiscal Strategy, the Annual Budget Law), but were rather adopted outside of regular procedures and the Parliament. These policies were usually announced by top state officials at press conferences - and then contingency reserve was used as one of the sources for their financing. After analyzing the use of the contingency reserve in the 2018 – 2023 period, we recognized that it was used to finance about EUR 400 million of new unbudgeted economic policies. The most common and generous of those policies were related to ad hoc measures in the domain of social protection (non-targeted cash payments to households). Moreover, to a certain extent this method was also used to fund increases in incentives for agricultural production, new pro-natalist policy measures, and the like.

Pursuance of economic policies through contingency reserve increases the risk that the adopted measures will be inefficient. Important policies (including those previously mentioned in the domain of social protection, incentives for agriculture, pro-natalist policies) should be part of strategic, long-term and well-thought-out government decisions. If instead they are conducted without due consideration, through contingency reserve, there is a high risk that they will be inefficient. Thus, for example, the appropriateness of (undisputedly popular) non-targeted cash payments to households is more than questionable. The problems of social vulnerability and the unsatisfactory standard of living of a portion of Serbia's population are of a durable nature and cannot be solved by occasional one-off cash payments. All the more so since these payments were only linked to a certain age (or retirement status), and not to the objective social vulnerability of beneficiaries. Certain problems have also been identified in relation to the hastily adopted population policy measures. According to the most recent studies, birth grants to encourage childbirth led to an increase in the fertility rates among underage Roma women to an extent that puts their health at risk. Even a program that seemed rather simple at first glance (construction of apartments for members of the security forces), the launch of which underwent an urgent procedure, and the initial funding came from contingency reserves - was marred by numerous inefficiencies. The completion of works missed the original deadlines, and the Law governing this program was amended as many as four times since its initial adoption (following the urgent procedure) in 2018 due to the identified flaws. Its fifth amendment is currently pending in the Parliament (which, among other things, prohibits renting the apartments purchased on favorable terms during a ten-year period).

Contingency reserves are also used for systematic funding of individual budget beneficiaries - which is not in line with their basic purpose. The analysis of decisions on the use of contingency reserves shows that certain beneficiaries of these funds appear far more

often than others. As many as 249 out of a total of 1,305 analyzed decisions were related to just three groups of beneficiaries: 1) local self-governments, 2) religious organizations and 3) sports associations. The total funds paid for them through contingency reserves from 2018 to end-2023 amounted to about EUR 365 million (225 million to the local level, 75 million to religious organizations and 65 million to sports associations).

- *Local self-government financing should be arranged in an objective and sustainable manner.* Additional funding for local self-government units based on discretionary decisions of the Government (through contingency reserve) is problematic for several reasons. One of the main objections related to this practice refers to unspecified criteria used to determine the local self-government units that were to receive contingency funds from the republican budget, and the amounts for each of them. In most of the cases, the reasoning of the decision on contingency reserve allocation features only one sentence that is not informative: the funds are allocated "*for meeting the obligations that could not be projected in the process of preparing and adopting the budget, and which may give rise to liquidity risks of the local government*". Therefore, it remains unclear why, for instance, in the previous six years the municipality of Čajetina received 20 times more funds from the contingency reserves than Lajkovac and as many as 30 times more than Pećinci - even though all three municipalities have similar populations. Likewise, it remains unclear why the City of Belgrade received four times more funds (in per capita terms) from the contingency reserve than Niš. If the need for additional financing of local self-governments (as indicated by the widespread use of contingency reserve) really exists, then this has to be regulated in an objective and transparent manner, through the Law on Local Self-Government Financing – rather than by discretionary decisions of the Government.
- *Through the use of contingency reserves, initially budgeted funds for religious organizations were doubled.* Religious organizations are also frequent beneficiaries of funds from contingency reserves. In the 2018-2023 period, they received on average more than EUR 10 million of additional funds from this source on an annual basis (predominantly for the construction of the Temple of Saint Sava). It is interesting to compare this amount with the recurrent budget allocations that were initially planned for support to religious organizations. These recurrent budget expenditures also amounted to slightly more than EUR 10 million a year. This means that the initially budgeted funds for religious organizations were systematically doubled by using contingency reserves. Since the practice of providing supplementary funding for religious communities through contingency reserve was repeated year after year, this can hardly be classified as unforeseen events or minor planning errors. These amounts, if there is a need to allocate them, would have to be planned in advance and presented in the regular budget process.
- *The operation of sports associations was also continuously funded with additional resources from contingency reserves.* Similarly to the practice followed for religious organizations, additional funds from contingency reserves were also repeatedly allocated to sports associations. Through this channel, in the period from 2018 to 2023, they received a top-up for their operation in the average amount of around EUR 10 million a year - primarily the Football Association, the Basketball Federation, the Tennis Federation and the Olympic Committee. In fact, in a number of cases it is not even possible to precisely identify the beneficiaries of these funds, because in the decisions on the use of contingency reserves, only a brief explanation is provided that it was support for the regular operation of sports associations. Instead of additional funding pursuant to discretionary decisions of the Government, the expenditures for sports

associations should be objectively identified and planned in advance through regular budget procedures.

The use of contingency reserve is not presented transparently enough, so taxpayers are often deprived of information concerning the purpose of these funds. The specific feature of contingency reserve is that they are used to finance substantial confidential expenditures of the state - which is why the purpose of these funds is unknown. In the 2018-2022 period, we counted about EUR 700 million used in this way, while in fact the actual amount is even higher than that because the data set is not complete. There are many dilemmas surrounding the widespread confidential use of contingency reserve. To begin with, one glaring question can be posed: is it really possible that Serbia's security-related and other sensitive needs depend on whether sufficient space will be created for them in the budget in the course of a year (since that is what contingency reserve is in essence)? The peculiarity of the use of contingency reserve for confidential purposes also lies in the fact that a mere third of those funds is earmarked for the security sector (the Ministry of Defense, the Ministry of the Interior and the Security Information Agency). The other 65% or so of confidential expenditures from contingency reserves was spent by other beneficiaries, including even the Ministry of Youth and Sports. For instance, the data indicates that the Ministry of Defense and the Ministry of Finance executed equal amounts of expenditure under confidential decisions, while by far the largest number of individual confidential decisions (in lower amounts) concerned the Government General Secretariat. Quite often, even the decisions that are not classified as confidential lack transparency. The reasonings of decisions on the use of contingency reserves often contain only generic sentences (funding for regular operation, or support for the operation of a particular beneficiary). Such reasonings provide no information about the real reason and purpose of the reallocation of funds through contingency reserves.

International practice reveals at least three issues with the use of contingency reserve in Serbia. *First*, the Government's discretionary spending power outside basic budgetary control mechanisms is excessive. The current 4% of budget revenue cap is high, especially considering that the Government's discretionary spending is significantly smaller than the total budget due to legally or contractually pre-defined expenditures (e.g., wages, pensions, debt interest). This means that through contingency reserve, the Government practically has at its disposal a new "mini-budget" that it can manage without the approval of the Parliament. Comparable European countries with similar quantitative restrictions usually have smaller reserve (e.g., North Macedonia's is almost half the size). *Second*, Serbia lacks any restrictions on how contingency reserve is used, allowing them to reallocate funds between fundamentally different policies or even for entirely new fiscal measures. This undermines the budget's credibility as a public finance management tool and the legislature's role in the budget process. *Third*, transparency and reporting are inadequate. International recommendations (IMF, 2016) call for regular, meaningful, and standardized reporting to the legislature and taxpayers on budget modifications—a practice currently absent in Serbia.

Important channel through which the Government conducts fiscal policy without sufficient citizen participation is the adoption of fast-tracked supplementary budgets. From 2019 to 2023, Serbia adopted seven supplementary budgets. The fiscal policy modifications introduced by these budgets were extensive, even excluding the exceptional year of 2020. On average, these supplementary budgets (excluding 2020) reallocated at least EUR 1.9 billion across various economic classifications (investments, transfers to social security funds, subsidies, net lending, etc.), fundamentally altering the size and composition of the initially adopted budgets. Moreover, not only did these supplementary budgets significantly modify the country's fiscal policy, but they were also typically adopted through fast-track procedures, limiting time for thorough analysis and meaningful parliamentary debate. Of the

seven supplementary budgets adopted in the past five years, only the 2019 budget avoided this expedited process.

On average, fast-tracked supplementary budgets received only four days for analysis and less than two days for parliamentary debate. We have analyzed the amounts of time allotted to conduct the procedure for adopting the supplementary budgets in the 2019–2023 period. The analysis has revealed that the practice of adopting supplementary budgets in the fast-track procedure cut the time for scrutinizing this document from the statutorily defined 15 days (in the regular procedure) to a mere four days, while the time for debate was curtailed to less than two days. A striking example occurred in 2023. The Government approved the supplementary budget bill on Saturday, September 2, and the parliamentary debate began on Tuesday, September 5, with adoption following swiftly on Wednesday, September 6. The problem of insufficient involvement of the Parliament and the general public in the adoption of budget documents was clearly pointed out by the European Commission. The 2023 progress report explicitly noted that the minimum deadline between submitting the supplementary budget bill to Parliament and its subsequent debate and adoption was not respected. The Commission concluded that Serbia must enhance public participation and bolster legislative oversight in the budget process.

The Fiscal Council recommends that the Government immediately reduce the permitted use of contingency reserve to 3% of budget revenue and to 2% in the medium term. The analysis carried out by the Fiscal Council indicates that contingency reserve in Serbia is overused, for purposes that are inconsistent with the spirit of this instrument. A statutory reduction in the allowable reallocation amount is the first step towards resolving this issue. In the short term, reducing the contingency reserve from the current 4% of budget revenue to 3% is feasible and easily implementable. In the medium term, after establishing a sustainable system-wide solution for financing certain standard beneficiaries of contingency reserve (e.g., local governments, religious organizations, sports associations), further reducing the reserve to 2% of budget revenue would be prudent. In fact, this 2% of budget revenue cap would not be unprecedented for Serbia, as it was the arrangement in place prior to the 2015 and 2016 amendments to the Budget System Law, which increased the allowed reallocation through contingency reserve first to 2.5% and then to the current 4%.

The permitted uses of contingency reserve should be clearly defined and restricted. The basic rule governing the use of contingency reserve, which is often applied in international practice, refers to prohibiting or strictly limiting the virements within or between different public policy areas (or ministries), as well as the financing of new policies that were not planned in the budget. For example, the first restriction would prevent transferring funds originally allocated for education to other areas like transportation or healthcare. Reallocations between ministries are typically prohibited or allowed only in specific cases where ministries implement complementary policies. Even more rigorous are the restrictions for the Government when it comes to using the contingency reserve to implement new policies not approved by the Parliament. In many countries, this is explicitly prohibited by law, preventing the Government from launching and funding new programs during the year without prior parliamentary approval. By limiting reallocations and prohibiting the financing of new policies from contingency reserve, significant alterations to the budget's composition, as approved by Parliament for financing the Government's policies and objectives, are effectively prevented. Implementing similar restrictions in Serbia is essential.

The law must define the use of contingency reserve more precisely, and the reports on its use should be transparent and published regularly. The permitted virement through contingency reserve in Serbia currently amounts to: *"up to 4% of total revenue and receipts from sale of non-financial assets for the budget year"*. However, the law does not clearly define

the exact budget revenue to which this refers – the revenue that was initially planned in the budget, the revenue that was projected in the subsequent supplementary budget, or the actually collected revenue in the year in question. Furthermore, reporting on contingency reserve usage is inadequately regulated. Real-time monitoring through the Official Gazette is limited, as confidential decisions are not published, and formal justifications are often vague and lack meaningful content. Therefore, the Government should regularly inform taxpayers, in a standardized manner (e.g., via the Ministry of Finance website), about public spending through contingency reserve on a monthly or quarterly basis. Lastly, the final reporting on contingency reserve usage in annual budget financial statements needs improvements. This includes establishing a direct link between the funds used and the permitted cap, clearly indicating what is and is not included in the statutory limit, and, in the case of confidential decisions, disclosing whether funds are replenished or reallocated through the reserve, etc.

The practice of adopting supplementary budgets in the fast-track procedure must be discontinued. In recent years, supplementary budgets have introduced such extensive fiscal policy changes that they have effectively held the same weight as regular budgets. Consequently, the current fast-track adoption practice is highly detrimental, as it significantly reduces the time available for scrutiny, debate, high-quality amendments, and recommendations from both representatives of citizens and independent institutions. The rationale often offered to the public—that fast-tracking is necessary because the budget is "locked," preventing regular Government payments during the parliamentary process—is only partially accurate. It cannot justify expediting the fundamentally important procedures of the budget process. Moreover, well-established mechanisms exist to ensure the state's operational functionality in such situations. In the past, supplementary budgets have been adopted through regular parliamentary procedures without jeopardizing the state's functioning (e.g., in 2011 and 2019).