Republic of Serbia
FISCAL COUNCIL
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ASSESSMENT OF THE PROPOSED SUPPLEMENTARY BUDGET FOR 2021

Summary:

The proposed supplementary budget brings a U-turn in fiscal policy – a stark increase of the budget deficit, leading to public debt growth. After the record-breaking general government deficit in the 2020 crisis, amounting to 8.1% of GDP (about 3.7 bn Euros), it was planned that the 2021 budget would lead Serbian finances to a somewhat smoother sailing. Hence, the initial 2021 budget envisaged a decrease in the fiscal deficit down to 3% of GDP, which would then (according to the Government's forecasts) lead to the stabilization of public debt compared to GDP. However, only a few months into this year, this fiscal plan was completely abandoned. The proposed supplementary budget envisages the general government deficit of 6.9% (about 3.5 bn Euros) instead of 2.9% of GDP (about 1.5 bn Euros). A more than two-fold increase of the fiscal deficit, exceeding the original plan by 2 bn Euros, shall be financed by new loans, which will postpone the stabilization of the public debt trajectory. Namely, with a deficit at the planned level, the ratio of public debt to GDP will continue growing in 2021 – from 58.2% of GDP to 61-62% of GDP at the end of the year – which is an excessive level of debt for a country like Serbia.

The deficit was increased due to a new package of anti-crisis measures, additional expenditures in the healthcare system, but also a strong increase of expenditures of individual budget beneficiaries. Increased expenditures foreseen in the supplementary budget actually amount to about 2.2 bn Euros, but the deficit has not increased quite to that level; it has increased to about 2 bn Euros because the public revenue has also increased by about 200 m Euros at the same time (primarily through better collection of the contributions).[1] A little over a half of the planned deficit increase, i.e., about 1.2 bn Euros, pertains to budget expenditures for the implementation of a new (third) anti-crisis package. The additional 200 m Euros pertain to increased expenditures of the healthcare system (purchase of vaccines, construction and equipping of new hospitals and vaccine factory, additional expenditures for medical staff). About 330 m Euros of the budget expenditure increase are allocated to increased infrastructure development

[1] Improved collection of the contributions is not accounted for directly in the supplementary budget, as it increases the revenues of the mandatory social insurance funds, and not the national budget. Increased collection of contributions is therefore visible in the supplementary budget indirectly, through decreased transfers from the national budget to these funds, by the same amount.

(railway, environment protection), while about 370 m Euros are to go towards increased expenditures of the Ministry of Defence (procurement of arms, but also increased wage bill).

Approximately one half of the fiscal deficit increase of 4 p.p. of GDP (from 3% to 7% of GDP) could be seen as economically well-founded, or indisputable. New expenditures from the supplementary budget, that form the basis of the deficit decrease, can qualitatively be classified into three groups: *The first*, economically justified, comprises increased expenditures for infrastructure and healthcare. *The second*, only partly economically justified, comprises the new package of mostly non-targeted anti-crisis measures. *The third*, which we see as questionable, especially at a time of a healthcare crisis, primarily relates to the large increase of expenditures for arms procurement. Taking all this into consideration, the summary assessment of the Fiscal Council is that approximately one half of the fiscal deficit increase in the supplementary budget is economically well-founded (or indisputable), while the second half would have to be planned more rationally, or rather, avoided.

1) The best aspect of the proposed supplementary budget is the strong increase of government investment into infrastructure. This is a good fiscal policy, especially at a time of crisis, as it has an efficient growth-stimulating effect; also, there is a clear need for such an investment as the state of basic infrastructure in Serbia is deplorable. What is especially good about this increase is that over one third of the new investments relate to environment protection (sewerage construction, wastewater treatment plants, landfills). The proposed supplementary budget could finally be the turning point towards a resolution of the excessive pollution that the Fiscal Council has been warning about for years. Increased expenditures on healthcare are also an undisputed priority during the epidemic, and are thus justified.
2) In principle, it is good that the Government is adopting a new anti-crisis package to support the economy and the population, as the epidemic is still raging and a significant number of enterprises and citizens in Serbia are still at risk. However, the proposed anti-crisis package has not been designed in an economically sound and rational manner. The main shortcoming of this package is that the vast majority of funds are distributed to the economy and the population completely non-selectively, i.e., including to those who do not need these funds.
3) The supplementary budget also, for an undisclosed reason, almost doubles the investments in the defence sector, mainly for the purchase of arms. These investments were several times higher in Serbia than in the comparable CEE countries even before this supplementary budget, but now, they are additionally inflated. The Government should explain why it is taking such a vast loan for these purposes, in the middle of a healthcare crisis, and only a few months after the budget had been adopted.

The planned Serbian fiscal deficit of 7% of GDP is higher than the average for the comparable countries. The comparative data also shows that the proposed supplementary budget envisages a far higher deficit growth than was necessary. Namely, other Central and Eastern European (CEE) countries are also facing prolonged epidemic and are increasing their fiscal deficits. However, the fiscal deficit decrease in CEE mostly ranges from 1 to 2% of GDP, compared to 4% of GDP in Serbia. At that, before the supplementary budget, Serbia had planned for a deficit lower than CEE average (which is appropriate, since it suffered less of an impact from the crisis) – and it has now become a country with a fiscal deficit exceeding CEE average.

The supplementary budget will have a permanent effect on GDP growth, which could exceed 5% in 2021 – however, the same effect could have come with a far lower deficit.

Forecasting economic growth in 2021 is still quite uncertain, since it is unclear how long the pandemic will last, or how fast the economies in the EU and the region, with which Serbia is tightly entwined, will recover. Preliminary statistics for the first two months of 2021 show that the Serbian economy continues with gradual recovery (although, since it is compared to a relatively high base, the year-on-year GDP growth in the first quarter will most likely be 0%). Such trends hint at a GDP growth of about 4% in 2021 in Serbia, which is currently the best estimate of GDP growth in 2021 that would have taken place without the adoption of the supplementary budget. However, since the supplementary budget envisages measures that will also have a significant impact on accelerating economic activity – primarily the increased investment into infrastructure, with a part of the third anti-crisis package (which is properly targeted) – Serbia's GDP will most likely grow more than the aforementioned 4% in 2021. We estimate that the supplementary budget will have a positive impact on GDP growth of about 1.5 p.p. compared to the current trend, so the overall GDP growth in 2021 could amount to 5.5% if these assumptions are correct. It is important to emphasize that the supplementary budget would have an approximately same impact on GDP growth acceleration had the Government been less generous during its elaboration and chosen a more selective approach in the implementation of anti-crisis measures. We estimate that the same impact on acceleration of economic activity would have been achieved had the supplementary budget called for half as large a deficit increase (resulting in a deficit of 5% of GDP, instead of 7% of GDP).

Majority of the planned increased deficit (about 1.2 out of 2.2 bn Euros) comes from the new anti-crisis package, which had not been planned for in the budget at all. Although it was already clear at the end of 2020 that the health crisis will continue, and that a part of the economy and population will suffer economic consequences in 2021 as well, the original 2021 budget completely failed to envisage any kind of funds for anti-crisis measures. It would be understandable and justifiable to say that the Government was unable to accurately predict the scope of measures in 2021 at the end of 2020, but the fact that they set aside no funds for crisis interventions, is neither understandable nor justifiable. These interventions are now the main reason why, only few months after the budget was adopted, a supplementary budget is being proposed. This supplementary budget plans to have the new, third anti-crisis package cost approximately 1.2 bn Euros; a little under 700 m Euros have been allocated to businesses and about 500 m Euros for the population. The majority of *assistance to the economy* goes towards a non-selective payment of a half of minimum wage in the private sector for three months, which will cost the budget about 600 m Euros. The remaining amount allocated to the economy, of about 70 m Euros, is selective and aimed at the sectors at risk, such as hotels, catering, bus transport and independent artists. The majority of *assistance to citizens* relates to the payment of 60 euros to all citizens of age (two times 30 Euros, in May and November), and an additional 50 Euros to all pensioners; this will cost the budget approximately 450 m Euros. In addition, funds have been planned to pay an additional 60 Euros solely to the unemployed and 100 Euros for all Serbian citizens in Kosovo and Metohija (including children), i.e. 200 Euros if the person is also unemployed. Beside these measures, which are undisputed budget expenditures, the Government has also included the issue of guarantees for the private sector loans in the amount of 1 bn Euros in 2021; this does not require any funds to be allocated from the budget in 2021.

It is irrational to incur additional debt to the taxpayers to pay money to the businesses that have not been hit by the crisis. One (smaller) part of the package of assistance to businesses, of about 70 m Euros, pertains to sector-specific support to activities at risk (hotels, catering, bus transporters etc); the Fiscal Council has no objection to this part of the assistance package, in principle. However, the second part of the package in the amount of 600 m Euros is quite problematic; this will serve to pay one half of the minimum wage, per employee, for three months – and almost all private enterprises can apply. The payment of the minimum wage (or a part of the minimum wage) per employee is one of the most common types of assistance that the European countries use to support their economies, and Serbia is no exception. But, most of the countries, even in their first support packages, applied a selective approach in defining the eligibility criteria for their businesses. This means that only those enterprises, which were objectively hit by the crisis, would be eligible – and not pharmacies, courier services, call centres and other activities and businesses that may even be doing better than before the crisis. If there were any examples in 2020 of countries that had paid minimum wages non-selectively, in 2021 we have identified no comparable European country that continued with non-selective payments, like Serbia. At that, there are no operational limitations that would prevent the process of selecting eligible enterprises in Serbia, since financial reports for 2020 have been elaborated and could easily be used to see which enterprises were impacted by the crisis, and which were not. Had Serbia defined objective eligibility criteria for enterprises to apply for assistance, it could have saved, i.e., lowered the amount of the new debt by, 300 m Euros.

Payment of identical, non-selective assistance to citizens is indisputably a very poor fiscal policy measure. Another extremely expensive and irrational measure, specific to Serbia, is the non-targeted payment of (identical) assistance to all citizens of age, of 60 Euros (with an additional 50 Euros for pensioners). The first problem with this measure is that there are no available funds for it in the budget. That means that all taxpayers must first take out a loan (with interest) to have these envisaged funds paid to them. At that, this measure is not economically efficient, either. To pay out this non-selective assistance to the population in 2021, 0.9% of GDP will have to be spent (about 450 m Euros), while its potential effect on the economic growth amounts to 0.1 to 0.2 p.p. at best. The funds used will not return to the budget through a higher collection of taxes. We estimate that only about 10% of the funds used in this way will return to the budget. Specifically, only about 45 m Euros out of the 450 m Euros will return to the budget through the increase of VAT and excise. Finally, this measure is not valid even from the social policy viewpoint. Single payments cannot resolve the issues of inequality or poverty, not in any lasting way, as these are structural (lasting) problems; at that, the assistance is poorly designed as there is no justified social policy measure in which the same amounts are given to both impoverished and well-situated citizens.

Increased expenditures for infrastructure development, primarily directed at railways and environment protection, are a measure we see as very good. Out of about 330 m Euros of increased expenditures for infrastructure development (new healthcare facilities excluded), almost 150 m Euros are planned for railway structure; within this amount, the largest share shall go to the express railway Belgrade-Novi Sad. Although it is somewhat lower – about 130 m Euros, we see the stark increase in investments into communal infrastructure and environment protection as the most positive aspect of the supplementary budget. In environmental terms, Serbia is one of the most polluted European countries, putting its population's health at risk; the Fiscal Council has been persistently recommending that the Government start investing significantly in this field. The largest share of the funds, about 100 m Euros, have been allocated to the construction of sewers and regional landfills in municipalities and towns, while the remaining funds will mostly be used for the construction of several wastewater treatment plants. Finally, in the supplementary budget, for the first time we see funds allocated to the construction of the subway in Belgrade, amounting to a little over 25 m Euros.

It is now clear that the excessive increase of salaries in the public sector was a mistake of the 2021 budget. High fiscal deficit and public debt growth planned for 2021 are not solely due to the proposed supplementary budget, but also partly due to some earlier mistakes. One such mistake is the excessive increase of salaries in the public sector in the original budget. Immediately before the crisis, salaries in the public sector were already steeply (and economically unjustifiably) increased by about 10%, so they should have been frozen in 2021, or, at most, subjected to minimal indexation (as was done in other CEE countries). Instead, however, the budget for 2021 increases the salaries in the public sector by about 4.5% on average, which was already an excessive increase at the time. The supplementary budget now additionally increases these salaries to almost 7%, with the increase of salaries in the Ministry of Defence, and the growth of expenditures for salaries in healthcare (paid through the transfers to the NHIF), which is likely temporary and justified. In mid-2020, the Fiscal Council warned the Government to be particularly careful with increasing the salaries, as the healthcare crisis could demand unforeseen measures and expenditures, leading to new debt. In other words, if potential special measures and expenditures were to be added in 2021 to a budget that already planned for an excessive growth of salaries in the public sector, we could easily end up with a very high fiscal deficit and public debt growth – which is what just happened, in simplest terms. An additional problem with the excessive increase of salaries in the public sector is that this is a permanent increase. When the health crisis ends, a large part of public expenditures will automatically decrease (anti-crisis measures, special payments to the healthcare etc.), but the budget will not automatically return to a balanced state that it occupied before the crisis, as the salaries in the public sector were increased in 2020 and 2021 significantly more than would have been economically justified.

There is an opportunity (and a need) to make significant savings during the year and decrease the fiscal deficit from 7% of GDP to less than 6% of GDP. In the previous years, it was not rare to see the fiscal deficit coming under the forecast figure at the end of the year. The reason was usually found in somewhat better collection of public revenues than planned, or poorer implementation of some of the projects planned for the year. In 2021, there is a high probability of something similar taking place. Namely, we can already see potential savings of about 200 m Euros, since far fewer enterprises have applied for anti-crisis assistance package (payment of the minimum wage) than was expected. At that, it is possible that not all planned investments into the railway infrastructure will be implemented (they were increased three-fold compared to 2020), while some projects, that do not appear to be of priority, especially at a time of a health crisis (for example, the construction of the airport in Trebinje) could (and should) be postponed. It is important to note, however, that the Government treated the savings made in previous years in different ways. Some years, this led to a lower general government deficit than planned, while in other cases, the funds were used during the year through the budget reserve (for local governments, help to the church, sports clubs etc.) or in December for special payments to pensioners, employees in the public sector or subsidies to public and state-owned enterprises experiencing problems in operation. Since the supplementary budget for 2021 plans for a very high general government deficit of 7% of GDP, the Fiscal Council recommends that the Government direct all potential savings, that can be made during the year, solely at lowering the fiscal deficit (if possible, to less than 6% of GDP), which would also mean lower loans (the public debt would thus be stopped at about 60% of GDP).