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Review Paper

CHANGES IN FISCAL DEFICIT AND PUBLIC DEBT OF THE REPUBLIC OF SERBIA DURING THE COVID-19 PANDEMIC PERIOD

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Goran Milovanović[1], Goran Radisavljević[2], Sandra Milanović[3]

[1]University of Niš, Faculty of Economics, Republic of Serbia
[2]Municipality of Sokobanja, Republic of Serbia
[3]University of Niš, Innovation Centre, Republic of Serbia

ORCID iD:	Goran Milovanović	https://orcid.org/0000-0003-0091-2774
	Goran Radisavljević	https://orcid.org/0000-0002-6328-750X
	Sandra Milanović	https://orcid.org/0000-0002-0582-045X

Abstract. *The aim of this paper is to consider the nature of changes in the fiscal deficit and public debt of the Republic of Serbia and propose measures to reduce them, based on the analysis of selected statistical and academic sources. The fiscal deficit and the public debt of the Republic of Serbia constitute the subject determination of the paper. After presenting certain effects of the COVID-19 pandemic, the authors investigate: the causes of the change in the fiscal deficit and public debt of the Republic of Serbia; the impact of the COVID-19 crisis on the fiscal deficit and public debt of the Republic of Serbia; and the activity of the government in terms of reducing the fiscal deficit and public debt of the Republic of Serbia. The knowledge that is the result of this research should: contribute to the improvement of fiscal discipline; enable the determination of factors that make public debt and GDP growth sustainable taking into account fiscal constraints and risks.*

Key words: *GDP, fiscal deficit, public debt, COVID-19 pandemic, fiscal consolidation.*

JEL Classification: H61, H62, H63

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Corresponding author: Sandra Milanović
University of Niš, Innovation Centre, Univerzitetski trg 2, 18000 Niš, Republic of Serbia
| E-mail: sandramilanovic89@yahoo.com

INTRODUCTION

From the global economic crisis to the COVID-19 pandemic, weak fiscal sustainability has been demonstrated by both the European Union (EU) and the Western Balkans. Problems such as an increase in the fiscal deficit and public debt, which were generated by the COVID-19 pandemic, have not been completely solved by these countries. During the COVID-19 pandemic, the EU member states did not manage to comply with the rules of the Maastricht Agreement regarding public finances within their national framework, and these rules were constantly revised. In addition, this pandemic has reduced the ability of the Government of the Republic of Serbia to maintain the required level of fiscal deficit and public debt.

In order to reduce the fiscal deficit and the public debt caused by the deficit, it is necessary to identify the causes of its increase and adjust the conduct of fiscal policy accordingly. In addition to internal factors, the impact of external shocks is also important. For example, the COVID-19 pandemic affected all aspects of economic activity, both at the level of individual countries and globally. According to the COVID-19 Index of Economic Vulnerability, the Republic of Serbia belongs to the group of countries with medium risk exposure, due to its high dependence on remittances, but also its inability to respond to shocks due to the reduced potential of the fiscal and banking sectors (Davradakis et al., 2020). Therefore, this pandemic also affected the budget of the Republic of Serbia. The trend of a surplus was interrupted by the COVID-19 pandemic in 2020. A strong fiscal stimulus, along with an expansive monetary policy, mitigated the decline in GDP in 2020 due to the COVID-19 pandemic and declining revenues associated with lower economic activity.

The aim of this research is to provide a deeper insight into: the global effects of the COVID-19 pandemic; the movement of the fiscal deficit and public debt of the Republic of Serbia, before and during the COVID-19 pandemic; measures that have affected their reduction. Getting to know the extent of the impact of this pandemic will be based on showing the dynamics of the fiscal deficit and public debt, both in the Republic of Serbia and in the EU and eurozone countries. The research questions posed in this paper are:

R1. What are the global effects of the COVID-19 pandemic?

R2. What are the causes of the change in the volume of fiscal deficit and public debt of the Republic of Serbia?

R3. How does the COVID-19 pandemic affect the volume of fiscal deficit and public debt of the Republic of Serbia?

R4. What measures contribute to reducing the values of fiscal deficit and public debt of the Republic of Serbia?

The structure of the paper consists of three parts, in addition to the introduction and conclusion. The introduction is a brief overview of the content of the paper. The first part of the paper presents some of the global effects of the COVID-19 pandemic. The second part discusses the causes and changes in the fiscal deficit and public debt of the Republic of Serbia, as well as the impact of the COVID-19 pandemic on their change. The third part analyses some of the measures taken to reduce the deficit and public debt. At the end of the paper, conclusions based on previously analysed quantitative data and academic sources are presented.

1. COVID-19 PANDEMIC – ECONOMIC EFFECTS

By the end of the first week of December 2021, COVID-19 had caused the deaths of nearly 5.3 million people (Wordlometer, 2021a) and the emergence of hundreds of millions of poor people. About 813,000 people died in the United States alone, and about 1.44 million in Europe (Wordlometer, 2021b). Due to this disease, in 2020 the decline of the global economy was 4.3%. The return of global GDP to the level before the COVID-19 crisis is not expected before 2022 (Radisavljević, Milovanović & Đukić, 2021).

Highly developed countries are the most financially capable of enduring the COVID-19 crisis. However, due to the high share of services in the structure of GDP, the economies of these countries showed a relatively low level of resistance to the COVID-19 crisis in 2020. For example, US GDP fell by 3.5% in 2020, its biggest drop since 1946, when it reached 11.6%. The consequences of the spread of this disease in 2020 were especially pronounced in the EU and Eurozone countries. This year, the GDP of EU countries fell by 6.2% while the GDP of Eurozone countries fell by 6.6% (Eurostat, 2021a).

The COVID-19 crisis has not bypassed China, the world's second-largest economy. The closure of this country in the first quarter of 2020, due to the spread of COVID-19 disease, led to a historic decline in its economy of 8.7%. In the second quarter of 2020, China's GDP growth rate had a positive sign of 10% compared to the previous year. However, a significant increase in China's GDP occurred in the second half of 2020. In the third quarter of 2020, China's GDP growth was 2.8%, while in the fourth it was 3%. China is the only major world economy to grow in 2020 by 2.8% (Congressional Research Service, 2021). In 2021, China will successfully prove to the world that it has enough knowledge, money, resilience, and self-confidence to overcome the global consequences of the COVID-19 pandemic.

Despite the measures of national governments, the COVID-19 pandemic spread rapidly not only in 2020 but also in 2021. The end of the first year of the COVID-19 crisis was met by the Republic of Serbia with a 1.1% drop in GDP (Government of the Republic of Serbia, 2021). Only four countries (Ireland, Turkey, Norway and Lithuania) achieved better results in Europe (European Commission. 2021a). Such a small decline in GDP is partly the result of government measures as well as the structure of the economy of the Republic of Serbia. Almost all countries with a large share of agriculture in GDP, which produce less sophisticated products, whose GDP has a small share of services (especially tourism), and which are less integrated into the global economy, feel fewer negative effects of COVID-19 crisis on their GDP.

As governments intensified measures to curb the COVID-19 pandemic, the global economy grew at the fastest pace in four decades in 2021, according to IMF experts - as much as 5.9% (IMF, 2022). However, these experts are aware of the fact that due to the unpredictability of the pandemic, their forecasts are quite uncertain. Despite the measures of governments around the world, it is difficult to expect complete prevention of the spread of COVID-19 disease in 2021 and even in 2022. It is certain that the global economy will recover from this disease in 2021, but it is not certain that its recovery will be complete.

2. Fiscal Deficit and Public Debt of the Republic of Serbia - Key Generators and the Nature of Dynamics

In the period from 2006 to 2022, the fiscal policy of the Republic of Serbia changed its direction from pro-cyclical to counter-cyclical or from expansive to restrictive, and vice versa according to the production gap and fiscal impulse changes (Government of the Republic of Serbia, 2021). Concerning COVID-19 pandemic period, in 2019, fiscal policy was pro-cyclical and expansive, while in 2020 it changed to counter-cyclical and expansive. Since 2021, fiscal impulse is counter-cyclical but restrictive and it is planned to withhold that trend until 2025. On the other hand, by 2017, the fiscal deficit was realized, which was accompanied by an increase in public debt. Public debt reached a record level of 71.2% of GDP in 2015, followed by a declining trend, and only in 2017 did the successful conduct of fiscal policy enable the realization of a budget surplus (Ministry of Finance, Republic of Serbia, 2021).

In addition to the fiscal deficit, GDP growth rates, real interest rates, changes in the real exchange rate and the level of guarantees given significantly affect the projections of the public debt-to-GDP ratio. Such projections, along with a comparative analysis of other factors influencing the occurrence of the debt crisis, can serve as indicative estimates of the probability of a debt crisis in the Republic of Serbia (Arsić et al., 2012, p. 115). In the next part, the causes and dynamics of the fiscal deficit as a predictor of the public debt of the Republic of Serbia will be analysed.

2.1. Causes and dynamics of the fiscal deficit of the Republic of Serbia

Miroljub Labus compares the movement of the fiscal deficit of the Republic of Serbia with the phases of conducting neoliberal, populistic and interventionist policies. During the neoliberal policy phase, which lasted from the fourth quarter of 2000 to mid-2006, a deficit of 1.8% of GDP was inherited and by the end of this phase a surplus of 2.7% of GDP was achieved (Labus, 2020, p. 84). During the populistic policy phase, which lasted from the third quarter of 2006 to mid-2012, there was a significant increase in the deficit. In the phase of interventionist policy, which lasted from the third quarter of 2012 to the fourth quarter of 2018, measures were implemented that led to a reduction in the deficit.

In the period from 2006 to 2008, the Republic of Serbia applied an expansive fiscal policy (Government of the Republic of Serbia, 2021), which was justified by economic reasons, such as encouraging employment and economic activities, as well as combating grey economy. An important lesson about the implementation of such a fiscal policy is that it has had favourable effects in the short term, but has led to an unsustainable fiscal deficit and public debt in the long run.

The Republic of Serbia entered 2008 with a relatively low fiscal deficit, amounting to 2.5% of GDP (Table 1). The situation in the public finances of the Republic of Serbia was quite unfavourable even before the world economic crisis if we take into account the impact of cyclical economic oscillations (production gap) on the fiscal deficit. Growth has slowed, and the share of gross investment in GDP has fallen from 25% in 2008 to 18% in early 2016 (Bartlett, 2019, pp. 147-163). At the beginning of the global economic crisis, GDP and domestic demand fell sharply, leading to a decline in tax revenues and an increase in the fiscal deficit. The two-year freeze on wages and pensions, amid relatively high inflation, increased taxes and reduced transfers to local communities, kept the fiscal deficit relatively low at around 4.5% of GDP during the first two years of the global economic crisis and was among the lowest in Central and Eastern Europe (CEE) (Arsić, & Randjelović, 2014).

In the period from 2008 to 2012, the fiscal deficit in the Republic of Serbia showed constant growth (Table 1), which led to an increase in public debt and the possibility of jeopardizing macroeconomic stability. Since mid-2011, the government has re-enacted decisions that have resulted in a permanent increase in the fiscal deficit and the pursuit of counter-cyclical expansionary fiscal policies (fiscal decentralization, wage increases) (World Bank, 2020). As a result of these decisions, the fiscal deficit in 2012 reached 6.4% of GDP.

Table 1 Fiscal result of the general government of the Republic of Serbia from 2008 to 2024

Year	Primary deficit/surplus (% of GDP)	Consolidated deficit/surplus (% of GDP)
2008	-1.9	-2.5
2009	-3.6	-4.2
2010	-3.4	-4.3
2011	-3.4	-4.5
2012	-4.7	-6.4
2013	-3.0	-5.1
2014	-3.5	-6.2
2015	-0.5	-3.5
2016	1.7	-1.2
2017	3.6	1.1
2018	2.7	0.6
2019	1.8	-0.2
2020	-6.0	**-8.0**
2021	-2.4	-4.1
estimate for 2022	-1.3	-3.0
estimate for 2023	0.1	-1.5
estimate for 2024	0.6	-1.0
estimate for 2025	1.1	-0.5

Source: Ministry of Finance (2021). *Basic indicators of macroeconomic trends, November 4th , 2021*; Government of the Republic of Serbia (2022). *Fiscal strategy for 2023 with projections for 2024 and 2025* (p. 67).

In order to successfully respond to extremely unfavourable fiscal trends and the growing possibility of a public debt crisis, the Government of the Republic of Serbia began implementing a three-year program of sharp consolidation of public finances at the end of 2014 (Bartlett, 2019, pp. 147-163). The implementation of the measures of this program (temporary reduction of pensions, ban on employment in the public sector and payments to the budget of funds from the reduction of salaries in public companies) enabled the fiscal deficit of 6.2% of GDP in 2014 to be reduced to 1.2% GDP in 2016. Although these measures had positive effects, the problems of public enterprises remained unresolved (Fiscal Council, 2016). In 2017, the fiscal surplus of 1.1% of GDP was realized, for the first time since 2005, thanks to the growth of investments and personal consumption. However, net exports in 2017 remained negative (Jakopin, 2020, pp. 191-208). In 2018, the fiscal surplus was maintained at the level of 0.6% of GDP. In 2019, a deficit of 0.2% of GDP was recorded again, while public debt remained on a downward trajectory (Table 1 and Table 3). Since 2020, various measures had non-structural and structural effects on fiscal deficit. For example, postponed tax revenues will be collected in 2021 and 2022, but expenses connected with infrastructure projects will be increased due to materials' prices disorders (Fiscal Council, 2022).

2.2. Pandemic COVID-19 as a cause of increasing the fiscal deficit of the Republic of Serbia

At the end of 2020, the fiscal deficit of 8.0% of GDP was achieved at the general government level (Table 1), which is below the rebalance of the planned fiscal deficit of 8.9% of GDP (Fiscal Council, 2020a). In the same year, the primary fiscal deficit was 6.0% of GDP.

For a more complete understanding of the effects of the COVID-19 pandemic on the fiscal deficit of the Republic of Serbia, it is important to identify its movement in the EU and Eurozone countries. According to published Eurostat data, in the Eurozone, the fiscal deficit against GDP increased from 0.6% in 2019 to 7.1% in 2020, and in the EU from 0.6% to 6.8% (Table 2). In all Member States, the share of the fiscal deficit in GDP increased in 2020, with Spain (10.3%), Greece (10.2%), Malta (9.5%) and Italy (9.6%) having the highest rates. It is noticeable that all 27 EU member states, except Denmark, had a deficit of more than 3% of GDP in the state treasury.

The fiscal deficits of the Eurozone and the EU increased significantly in 2020 compared to 2019. This was mainly due to the measures taken in response to the COVID-19 pandemic and the decline in tourism revenues. In 2021, deficit in EU member states decreased and that trend is expected to continue in 2022 and 2023 as COVID-19 measures continue to fade and economic expansion takes over even during future energy crisis (European Commission, 2022a). According to projections for 2022, the deficits in the EU and the Eurozone are expected to halve to around 3.7% of GDP and 3.8% of GDP (respectively), thanks to the continued economic recovery and the gradual abolition of pandemic support measures.

When it comes to the Republic of Serbia, the original budget for 2021 envisaged a general government fiscal deficit of 3% of GDP, while its rebalances planned for this year amount to 4.9% of GDP (Fiscal Council, 2021a). The fiscal deficit of 4.9% of GDP was assessed by the Fiscal Council as anti-crisis. Most of the expenses were incurred due to the elimination of the consequences of the COVID-19 pandemic and the implementation of measures to mitigate them. In case of successful elimination of the consequences of the COVID-19 crisis in 2021, the planned deficit level of 3% of GDP for 2022 (around 1.7 billion euros) can be revised downwards.

The increase in the fiscal deficit in 2020 was primarily due to the health crisis caused by the COVID-19 pandemic, but also due to structural weaknesses in the economy and inadequate economic policy measures. Indicators of economic growth point to the conclusion that the Republic of Serbia is less affected by the health crisis than the CEE countries. Its 0.9% decline in GDP is far less than the average 3.8% decline in GDP in CEE countries (Fiscal Council, 2021a). Due to the smaller decline in economic activity, the Republic of Serbia should have had a significantly smaller fiscal deficit than the CEE countries. However, quite the opposite happened. There are several reasons for such a high deficit. First of all, "helicopter money ", inadequate investment in the health system and irrational management of state-owned enterprises (Air Serbia and EPS) have led to the expenditure side of the 2020 budget of about 2.5 percentage points (Fiscal Council, 2020a).

Table 2 General government deficit/surplus in EU countries from 2019 to 2022, % of GDP

Country	Deficit/Surplus (% of GDP)			
	2019	2020	2021	2022 (estimation)
EU – 27	-0.6	-6.8	-4.7	-3.6
Euro area - 19	-0.7	-7.1	-5.1	-3.7
Belgium	-2.0	-9.0	-5.5	-5.0
Bulgaria	2.1	-4.0	-4.1	-3.7
Czech Republic	0.3	-5.8	-5.9	-4.3
Denmark	4.1	-0.2	2.3	-0.9
Germany	1.5	-4.3	-3.7	-2.5
Estonia	0.1	-5.6	-2.4	-4.4
Ireland	0.5	-5.1	-1.9	-0.5
Greece	1.1	-10.2	-7.4	-4.3
Spain	-3.1	-10.3	-6.9	-4.9
France	-3.1	-8.9	-6.5	-4.6
Croatia	0.2	-7.3	-2.9	-2.3
Italy	-1.5	-9.6	-7.2	-5.5
Cyprus	1.3	-5.8	-1.7	-0.3
Latvia	-0.6	-4.5	-7.3	-7.2
Lithuania	0.5	-7.3	-1.0	-4.6
Luxembourg	2.3	-3.4	0.9	-0.1
Hungary	-2.1	-7.8	-6.8	-6.0
Malta	0.6	-9.5	-8.0	-5.6
Netherlands	1.7	-3.7	-2.5	-2.7
Austria	0.6	-8.0	-5.9	-3.1
Poland	-0.7	-6.9	-1.9	-4.0
Portugal	0.1	-5.8	-2.8	-1.9
Romania	-4.3	-9.3	-7.1	-7.5
Slovenia	0.4	-7.8	-5.2	-4.3
Slovakia	-1.3	-5.5	-6.2	-3.6
Finland	-0.9	-5.5	-2.6	-2.2
Sweden	1.7	-3.7	-2.5	-0.5

Source: Eurostat (2022a); European Commission (2022a).

2.3. Causes and dynamics of the public debt of the Republic of Serbia

Before the world economic crisis, the Republic of Serbia had the lowest public debt in 2008, when it amounted to 28.7% of GDP (Government of the Republic of Serbia, 2021). From 2008 to the end of 2015, public debt was constantly increasing, so in 2015, it reached a record 71.2% of GDP, i.e., it was higher by 42.5 p.p. compared to 2008 (Table 3). An even worse indicator of the state of the public debt of the Republic of Serbia is reflected in the fact that three-fifths of the public debt was of external nature and was exposed to the risk of constant changes in the exchange rate (Bartlett, 2019, pp. 147-163).

Fiscal consolidation measures adopted at the end of 2014 led to a reduction in the primary deficit and a slowdown in public debt growth already in 2015. The reduction of public debt occurred in 2016, a year earlier than envisaged by the arrangement with the International Monetary Fund (IMF). In 2016, a primary surplus of 1.7% of GDP was achieved, which finally created the conditions for a decline in the share of public debt in GDP (Table 3). This trend continued during 2017, so the primary fiscal surplus of 3.6% of GDP led to a significant reduction in public debt of 10 p.p. of GDP, to 58.6% of GDP. Although restrictive fiscal policy measures were eased in 2019, this did not negatively affect the decline in public debt, which was 52.8% of GDP at the end of this year. From 2015 to 2019, the public debt of the Republic of Serbia was reduced by 18.4 p.p.

Table 3 Public debt of the general government of the Republic of Serbia from 2008 to 2024

Year	GDP growth rate (in %)	The public debt of the Republic of Serbia (% of GDP)
2008	5.7	28.7
2009	-2.7	32.8
2010	0.7	41.4
2011	2.0	44.7
2012	-0.7	54.6
2013	2.9	57.5
2014	-1.6	67.5
2015	1.8	71.2
2016	3.3	68.7
2017	2.1	58.6
2018	4.5	54.4
2019	4.3	52.8
2020	-0.9	57.8
2021	7.4	57.1
estimate for 2022	3.5	54.6
estimate for 2023	4.0	53.1
estimate for 2024	4.0	52.0
estimate for 2025	4.5	50.7

Source: Government of the Republic of Serbia (2022). *Fiscal strategy for 2023 with projections for 2024 and 2025* (p. 67). Public Debt Administration (2021). *Quarterly report on the state and structure of public debt on 30th September 2021.*

The public debt in 2021 decreased but it is still close to the breaking point of 60%. In 2022 it is expected to be 54.6% (Government of the Republic of Serbia, 2022). On the other hand, after overcoming the negative effects of the COVID-19 crisis and implementing fiscal relaxation measures, a period of reduction of the public debt of the Republic of Serbia will follow. The fiscal strategy for the next medium-term period envisages the stabilization of public finances and significantly lower levels of deficits that will return the public debt to the zone of a declining trend. In this regard, the Public Debt Administration will define a medium-term strategy for public debt management based on a transparent lending process in the domestic and foreign markets, reviving the government securities market and reducing risk exposure (especially foreign exchange risk, because it is the higher part of the debt that is denominated in foreign currencies, as much as 70.5%) (Ministry of Finance, 2021). The reduction of the deficit will be accompanied by the GDP growth rate projected for the end of 2022 in the amount of 3.5%, while in the following years it will be around 4%. On the other hand, previous prognosis of economic growth for 2022 was 4.5% and in the following years 5.0%. Due to contemporary trends on the global market, less optimistic prognosis of economic growth is envisaged.

2.4. The COVID-19 pandemic as the cause of the increase in the public debt of the Republic of Serbia

Public debt of the Republic of Serbia in 2020 and 2021 was close to the maximum level defined by the Maastricht Treaty. This is an unsustainably high debt in relation to the level of development of the Republic of Serbia. The most important factors that influenced the development of public debt during 2020 and 2021 are: the level of the total and primary fiscal deficit, additional financing needs and repayment of the due part of the debt. The realized fiscal deficit of 8.0% of GDP (primary deficit of 6.0% of GDP) in 2020 and the fiscal deficit of 4.1% of GDP in the 2021, have influenced the fact that, so far, the declining path of public debt participation reversed (Fiscal Council, 2021a).

It is expected that after two crisis years, public debt control will be established and measures to reduce it will be implemented. Most of the budget deficit in 2020 was financed by borrowing and increasing public debt by issuing Eurobonds and green bonds. If we look at the structure of public debt, the debt denominated in euros dominates, while the rest is in dinars and US dollars. The money from the sale of Komercijalna banka was used to service the debt that was taken at a high-interest rate. In that way, the average interest rate on the debts of the Republic of Serbia was reduced (Government of the Republic of Serbia, 2021). The problem of the relatively high public debt appeared also in 2021. Because of an increasement of interest rates in the world, future growth of public debt is not recommended. In that case, the costs of new borrowing of the Republic of Serbia and refinancing of public debt would be higher, especially because of high borrowing interest rates that are even higher than average interest rates for CEE countries. Therefore, it is envisaged to decrease public spending and consequently debt until 2025 (Fiscal Council, 2022).

The COVID-19 pandemic also affected the dynamics of public debt in the EU and Eurozone countries (Table 4). The share of public debt in GDP in Euro area countries increased from 83.8% in 2019 to 97.2% in 2020, and in EU countries from 77.5% of GDP in 2019 to 90.0% GDP in 2020. Greece and Italy had the highest percentages of public debt in GDP (206.3% and 155.3%, respectively). During the 2021, public debt increased in several EU countries compared to the previous year (Germany, Bulgaria, Czech Republic, Latvia, Malta, Romania and Slovakia). On the other hand, reductions in public debt were recorded in all other member states and future prospects are inclined to further reductions in public debt due to higher interest rates and “snowball effect” caused by it (Eurostat, 2022b).

According to certain forecasts, public debt will reach 87% of GDP in the EU in 2022, while in the Eurozone it will be around 95% of GDP. The reduction of public debt is expected in the next two years. In 2023, public debt would account for 85% of GDP in the EU and 93% in the Euro area (European Commission, 2022b).

Sapir (2020) proved in his research that the low level of public debt before the COVID-19 crisis did not significantly affect the number of losses that EU countries suffered due to this crisis. It should be borne in mind that the Maastricht Agreement defines two criteria relating to the fiscal deficit and public debt of EU countries: 1) that the eligible deficit does not exceed 3% of GDP and 2) that public debt is less than 60% of GDP (Savage, 2001). Nevertheless, the data indicate a completely different state of public finances in the EU, i.e., noticeable non-compliance with these criteria. It is paradoxical that some members of the EU do not respect these criteria, but that all countries that want to become members of the EU are uncompromisingly required to do so. The justification that the COVID-19 crisis is to blame for such behaviour of some EU members does not sound logical. However, the COVID-19 crisis has disrupted the process of managing public finances in the EU. Namely, in order to improve this process, the EU adopted the architecture of fiscal management (the so-called European Semester) in the period from 2011 to 2013. The objectives of this public finance control mechanism are: 1) to define medium-term plans and bear the consequences of inadequate management of their public finances and macroeconomic instability, and 2) not to repeat the cases of over-indebtedness of Italy and Greece, following the example of Germany and northern European countries in managing their public finances (Greer, & Brooks, 2021). The COVID-19 crisis led to the suspension of this control mechanism, but planning and oversight remained in place.

Table 4 Public debt and GDP growth rate in EU countries from 2019 to 2022

Country	Public debt (% of GDP)				GDP growth rate (%)			
	2019	2020	2021	2022 (estimation)	2019	2020	2021	2022 (estimation)
EU – 27	77.5	90.0	88.1	**87.1**	1.8	-5.9	5.4	2.7
Euro area - 19	83.8	97.2	95.6	**94.7**	1.6	-6.3	5.3	2.7
Belgium	97.7	112.8	108.2	107.5	2.1	-5.7	6.2	2.0
Bulgaria	20.0	24.7	25.1	25.3	4.0	-4.4	4.2	2.1
Czech Republic	30.1	37.7	41.9	42.8	3.0	-5.5	3.5	1.9
Denmark	33.6	42.1	36.7	34.9	1.5	-2.0	4.9	2.6
Germany	58.9	68.7	69.3	66.4	1.1	-3.7	2.6	1.9
Estonia	8.6	19.0	18.1	20.9	3.7	-0.6	8.0	1.0
Ireland	57.2	58.4	56.0	50.3	5.4	6.2	13.6	5.4
Greece	180.7	206.3	193.3	185.7	1.8	-9.0	8.3	3.5
Spain	98.3	120.0	118.4	115.1	2.1	-10.8	5.1	4.0
France	97.4	114.6	112.9	111.2	1.8	-7.8	6.8	3.1
Croatia	71.1	87.3	79.8	75.3	3.5	-8.1	10.2	3.4
Italy	134.1	155.3	150.8	147.9	0.5	-9.0	6.6	2.4
Cyprus	91.1	115.0	103.6	93.9	5.3	-5.0	5.5	2.3
Latvia	36.7	43.3	44.8	47.0	2.5	-3.8	4.5	2.0
Lithuania	35.9	46.6	44.3	42.7	4.6	-0.1	5.0	1.7
Luxembourg	22.3	24.8	24.4	24.7	3.3	-1.8	6.9	2.2
Hungary	65.5	79.6	76.8	76.4	4.6	-4.5	7.1	3.6
Malta	40.7	53.4	57.0	58.5	5.9	-8.3	10.3	4.2
Netherlands	48.5	54.3	52.1	51.4	2.0	-3.9	4.9	3.3
Austria	70.6	83.3	82.8	80.0	1.5	-6.7	4.6	3.9
Poland	45.6	57.1	53.8	50.8	4.7	-2.2	5.9	3.7
Portugal	116.6	135.2	127.4	119.9	2.7	-8.4	4.9	5.8
Romania	35.3	47.2	48.8	50.9	4.2	-3.7	5.9	2.6
Slovenia	65.6	79.8	74.7	74.1	3.5	-4.3	8.2	3.7
Slovakia	48.1	59.7	63.1	61.7	2.6	-4.4	3.0	2.3
Finland	59.6	69.0	65.8	65.9	1.2	-2.2	3.0	1.6
Sweden	34.9	39.6	36.7	33.8	2.0	-2.2	5.1	2.3

Source: Eurostat (2022a); European Commission (2022a).

In addition to the increase in the fiscal deficit and public debt, the consequence of the COVID-19 crisis in 2020 is a drop in economic activity in the EU of 5.9% of GDP. Recovery after this crisis can be monitored based on projections of GDP growth rates in 2022 (Table 4). On the other hand, Cifuentes-Faura (2021) points out that it is necessary to implement an expansive fiscal policy while increasing public debt and respecting the postulates of Kenyanism on the path to the economic recovery of EU countries from the

COVID-19 crisis. In order to reduce supply-side shocks, an expansive fiscal policy would maintain employment levels and reduce the tax burden on companies (Jalles, 2021).

3. MEASURES TO REDUCE THE FISCAL DEFICIT AND PUBLIC DEBT OF THE REPUBLIC OF SERBIA

The speed of the recovery of the Republic of Serbia from COVID-19 will largely depend on the recovery of the EU countries as well as on the movements on the world capital market. Due to the COVID-19 pandemic, the recovery of the economy of the Republic of Serbia in the first half of 2021 was slow. But at the end of the year, instead of the projected growth of the GDP of the Republic of Serbia in 2021 of 6%, it was 7.4% and the prognosis for the following medium term is less optimistic and around 4%. Public debt in 2021 was on the level of public debt in year before (Government of the Republic of Serbia, 2021). Therefore, it is advisable for the Republic of Serbia to base the recovery of its economy to a greater extent on public debt reduction, especially on expenditure side of debt.

The focus of the activities of the Government of the Republic of Serbia should be on reducing the fiscal deficit and limiting the issuance of guarantees. These two variables crucially affect the dynamics of public debt and are under the control of the Government.

In 2021, the Republic of Serbia submitted the medium-term *Program of Economic Reforms for the period 2021-2023* to the European Commission, as part of the dialogue between the EU and the countries of the Western Balkans and Turkey. Although the contraction of the economic sector in 2020, due to the COVID-19 crisis in the Republic of Serbia, was mild thanks to the previously implemented fiscal and monetary reform, the reduction of private consumption and investment and the increase in government spending conditioned the growth of the budget deficit and public debt (Table 5).

Table 5 Budget projections according to *Program of Economic Reforms for the period 2021-2023 of the Republic of Serbia*

Category	2019	2020	2021	2022	2023	Change: 2020-2023
Revenues	42.1	40.3	40.4	40.5	39.7	-0.6
Taxes and social security contributions	36.8	35.8	36.2	36.3	35.6	-0.3
Other (residual)	5.3	4.5	4.2	4.2	4.2	-0.3
Expenditures	42.3	49.2	43.4	42.1	40.7	-8.5
Primary expenditures:	40.3	47.2	41.5	40.4	39.1	-8.1
Gross fixed capital formation	4.9	5.2	5.5	5.6	5.7	0.5
Consumption	16.5	18.7	17.7	17.2	16.7	-2.0
Transfers and subsidies	16.7	19.4	16.3	15.8	15.3	-4.1
Other (residual)	2.1	3.9	2.0	1.7	1.5	-2.5
Interest payments	2.0	2.0	1.9	1.7	1.6	-0.4
Budget balance	-0.2	-8.9	-3.0	-1.6	-1.0	7.9
Cyclically adjusted	-1.0	-8.1	-3.1	-1.7	-1.2	6.9
Primary balance	1.8	-6.9	-1.1	0.1	0.6	7.5
Cyclically adjusted	1.0	-6.1	-1.2	0.0	0.4	6.5
Gross debt level	52.9	59.0	58.7	57.9	56.0	-3.0

Source: European Commission (2021c). *Economic Reform Programmes of Albania, Montenegro, North Macedonia, Serbia, Turkey, Bosnia and Herzegovina and Kosovo**: *The Commission's Overview & Country Assessments (Institutional Paper 158).*

After the exclusion of temporary measures for COVID-19 crises effect mitigation, recovery and return of budget balance are expected in the forthcoming period 2021-2023. Revenues will be stable until 2023. The main change is going to be seen in the social contributions due to a prolonged period of payment from 2020 to 2023. Moreover, tax revenues will decrease due to an increment of non-taxable part of the wage. The most important changes are expected on the expenditure side because no extraordinary expenditures will be expected. Savings will be encountered in subsidies, other current expenditures and consumption (European Commission, 2021c. pp. 158). On the other hand, the Government bases its economic reform mostly on expenditures reduction, while it is continuing with fiscal support for recovery from the COVID-19 crisis. Social transfers are also expected to decrease and supporting reforms of pension and wage indexation are following this prognosis. Precisely, pensions are increased by 5.9% and minimum wage by 6.6%. Bigger budgetary expenses are seen in ad-hoc increasements of wages for public employees. Lastly, capital expenditures are planned to have an upward trend, while investments in road and rail building will make its main part. New events on the global market will cause slowing down in capital investments in following medium term period and decrease in foreign direct investments.

The budget deficit for 2021 and the following years are subject to change due to packages for crisis effects mitigation. So plan for 2021 according to the *Economic Reform Programmes for 2021-2023* has been already changed because subsidies for wages, „helicopter money" for citizens, support for the service sector (hospitality and transport) are introduced. Although the government deficit is increased and debt followed the rise, the reduction of debt is expected from 2021. Debt-to-GDP ratio is planned to gradually decrease, 0.3, 0.8 and 1.9 pp from 2021 to 2023. The positive trajectory of GDP is mostly secured by previous fiscal adjustments before the COVID-19 crisis. But one very threatening fact is the large percentage of debt denominated in foreign currencies and exposed to the exchange rates fluctuations. Therefore, firm fiscal policy will be the main basis of sustainable government finances.

Based on the results of research into the causes (strict closure measures, participation of tourism in GDP and quality of public administration) of economic shock during the COVID-19 crisis (Sapir, 2020), it can be concluded that the recovery of public finances in Serbia depends primarily on improving governance mechanism of the state during the implementation of the recovery policy. Gootjes and Haan (2020) point out that most EU countries in times of crisis implement pro-cyclical fiscal policy instead of counter-cyclical because although fiscal plans are acyclical, the final effects in the budget are pro-cyclical. However, the results of their research showed that if the government is efficient, compliance with fiscal rules contributes to the successful overcoming of the pro-cyclical response of fiscal policy to economic trends. It should be noted that during 2020 and the COVID-19 crisis, a countercyclical fiscal policy was implemented in the Republic of Serbia (Government of the Republic of Serbia, 2021).

The basis for pursuing a policy of reducing the fiscal deficit is to replace expensive debt with the cheaper one. This measure was implemented after the process of sale of Komercijalna banka, but in the next period new borrowing is questioned because of interest rates increase (Government of the Republic of Serbia, 2021). The moderate reduction of the fiscal deficit in the coming years aims to leave the possibility of a timely response to external shocks such as the health crisis (Ministry of Finance, 2021). Also, in the coming years, the deficit reduction is expected to be due rather to the slower growth of public sector wages than the growth of economic activity. The increase of wages in public sector or employing additional labour force in public sector will significantly increase the state budget imbalance (Fiscal Council, 2022). The Fiscal Council does not expect the medium-term Economic Reform Program for the period 2021-2023 to succeed without the adoption of pay grades (Fiscal Council, 2020b). Based on this program, the EU Council suggests that it is necessary to help households and companies in a planned way that will return the deficit to the planned path by 2022. It also supports the control of salaries as a percentage of GDP through the adoption of fiscal rules that will be followed by fiscal policymakers. In addition to the expenditure side of the budget, it is necessary to increase tax revenues by reducing the grey economy, introducing fiscalization according to the new model, and quantifying and publishing financial reports of public companies that increase fiscal risk of the state budget (Council of European Union, 2021).

The policy of reducing public debt and bringing it closer to the limit of 45% of GDP by 2028 depends on increasing indebtedness and efficient use of previous loans, conversion of expensive for cheap loans and good management of fiscal risks (Government of the Republic of Serbia, 2021). The state must stimulate economic growth by increasing investments in infrastructure, especially in communal infrastructure and environmental protection, which have been at a low level for years (Fiscal Council, 2021b).

Of course, several systemic problems were present in the years before the COVID-19 pandemic, such as weakening the rule of law, growing corruption, inequality of economic entities, the inefficiency of public enterprises, high allocations for subsidies and other assistance to state-owned enterprises (guarantees and budget loans), which were pushed into the background by the COVID-19 pandemic. Potential risks are higher when most of the deficit is financed by the government and private sector borrowing rather than remittances and foreign direct investment. Additional risks of public debt increasement such as high interest rates and public guaranties for state companies occurred at the beginning of 2022 (Fiscal Council, 2022). Therefore, it is equally important to have balanced control measures for both revenues and expenses of the government budget.

CONCLUSION

From 2000 to 2021, the Republic of Serbia pursued a different fiscal policy in accordance with changes in conditions on the domestic and foreign markets. Although there are opinions that fiscal policy was neoliberal, populist or interventionist, it was accompanied by a large number of internal and external shocks (world economic crisis, floods, droughts, COVID-19 crisis, etc.) that affected its end effects.

Macroeconomic stability in the Republic of Serbia was preserved during 2020 and the COVID-19 crisis, but in the coming years, it will be a great challenge to maintain it while stimulating economic recovery. Conditions for recovery and reaching the potential level of development will be more difficult than in the period before the COVID-19 crisis because the recovery of developing countries always goes after the recovery of developed countries.

Fiscal consolidation in the Republic of Serbia in the period before the COVID-19 crisis was a necessary condition for eliminating the immediate danger of state bankruptcy and improving macroeconomic stability. However, fiscal consolidation in the Republic of Serbia is still not complete, as the fiscal deficit and the share of public debt in GDP increased during 2020. In this context, the 2021 budget strikes a balance between supporting economic recovery and maintaining fiscal discipline. Successful implementation of fiscal policy should:

1) lead to an improvement in the structure of public expenditures and reduce fiscal risks in the future, and

2) enable a permanent recovery of public finances of the Republic of Serbia.

In order to reduce public debt in the coming years, it is necessary to significantly reduce the fiscal deficit. This can be achieved through: 1) moderate indexation of salaries and pensions, 2) reduction of subsidies, 3) more successful tax collection, and 4) high level of public investment. Specifically, corrective measures are needed both on revenue and expense's side of the government budget. On the revenue side, measures for tackling down grey economy on the labour market should be considered. Inspections on the regular basis and subsidies for new employees could have significant effect on this problem. On the expense side of the budget, taking control of the public companies spending and guaranties given is the long-term solution to the problem of public finances in the Republic of Serbia. Lastly, unplanned increases in wages and number of employees in public sector led to greater deficit so these *ad hoc* changes in budget should be avoided.

When it comes to the growth of the economy of the Republic of Serbia in 2021, one can talk more about the recovery from the COVID-19 crisis than about the typical growth of the economy. If significant epidemiological restrictions are not applied in the next period and if European economies start to recover quickly, the Republic of Serbia could count on reducing the fiscal deficit and increasing GDP in the medium term. However, there is still no clear answer to the question of how reliable the forecasts for the recovery of the economy of the Republic of Serbia and the EU are. It is important to keep in mind that forecasts of fiscal deficit and public debt are very sensitive to the political situation in the country and changes in fiscal policy. Probably because of that, the forecasts are sometimes wrong with state institutions, as well as the European Commission and the IMF.

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PROMENE FISKALNOG DEFICITA I JAVNOG DUGA REPUBLIKE SRBIJE U PERIODU PANDEMIJE KOVID-19

Cilj rada je da se, na bazi analize odabranih statističkih i akademskih izvora, sagleda karakter promena fiskalnog deficita i javnog duga Republike Srbije i predloži mere za njihovo smanjenje. Fiskalni deficit i javni dug Republike Srbije čine predmetno određenje rada. Nakon prezentovanja određenih efekata pandemije Kovid-19, autori istražuju: uzroke promene fiskalnog deficita i javnog duga Republike Srbije; uticaj Kovid-19 krize na fiskalni deficit i javni dug Republike Srbije; i aktivnost Vlade na planu smanjenja fiskalnog deficita i javnog duga Republike Srbije. Saznanja koja su rezultat ovog istraživanja treba da: doprinesu unapređenju fiskalne discipline i omoguće utvrđivanje faktora koji javni dug i rast BDP-a čine održivim, uzimajući u obzir fiskalna ograničenja i rizike.

Ključne reči: BDP, fiskalni deficit, javni dug, pandemija Kovid-19, fiskalna konsolidacija