Republic of Serbia
FISCAL COUNCIL
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ASSESSMENT OF THE REVISED FISCAL STRATEGY FOR 2025 WITH FORECASTS FOR 2026 AND 2027*

SUMMARY

The Revised Fiscal Strategy sets out an increase of the general government deficit in the medium run – to 3% of GDP. After the outbreak of the health crisis in 2020 and the record-high fiscal deficit of 7.7% of GDP (calculated with the revised GDP), fiscal policy in the subsequent three years was pursued with a view to stabilizing the budget, i.e., narrowing the deficit. However, 2024 has seen a turnaround. The Government made the first step towards increasing the fiscal expansionism in the middle of the year, with the Draft Fiscal Strategy for 2025 with Forecasts for 2026 and 2027. The initial plan to cut the general government deficit to 1.5% of GDP in 2025 and to stabilize it over the coming years at that level was abandoned by this Draft, which also means that the application of the fiscal rule (statutorily defining this level as a deficit cap) was postponed. Instead, the fiscal deficit in 2025-2027 has been projected at slightly more than 2% of GDP. The next change was introduced by the supplementary budget for 2024, which increased the budget deficit for the said year to 2.7% of GDP. The third step towards more expansionary fiscal policy has now been taken with the Revised Fiscal Strategy. The changes made relative to the Draft Strategy have further sharply increased public expenditures in the coming years, surpassing the public revenue growth, resulting in a consequent increase in the planned fiscal deficit to 3% of GDP per year in the period 2025-2027.

* The Fiscal Council prepared the Assessment of the Revised Fiscal Strategy for 2025 with projections for 2026 and 2027 (hereinafter referred to as the “Assessment”) based on the Revised Fiscal Strategy (hereinafter referred to as the “Revised Fiscal Strategy”) submitted to the Fiscal Council on October 24, 2024. At its session of October 31, 2024, the Government of the Republic of Serbia subsequently adopted the final version of the Revised Fiscal Strategy, which differs in minor technical details from the submitted version on which the Fiscal Council based its Assessment (different definition of certain state investment projects, etc.). The Fiscal Council was not informed of these changes, nor were they published on the website of the Government of the Republic of Serbia by the time the Fiscal Council prepared its Assessment. Taking all of the above into account (especially the fact that none of the Fiscal Council's assessments were called into question by the final amendments to the Revised Strategy), the Fiscal Council maintains the integral text of its assessment, which was prepared on November 4, 2024. Subsequent footnotes, marked with an asterisk (*), indicate the places where the Assessment refers to parts of the Revised Fiscal Strategy that were amended in the final version of this document.

In addition to the widening deficit, several other important changes have been made in the Revised Strategy compared to the Draft Fiscal Strategy. Besides the above-mentioned increase in the fiscal deficit, we will highlight another two changes in the Revised Strategy significant for Serbia's public finances. The first refers to a considerable change in all fiscal aggregates measured as a ratio to GDP (public debt, fiscal deficit, expenditures for pension benefits and wages and salaries in the public sector, etc.). The underlying reason is a major revision of GDP carried out by the Statistical Office of the Republic of Serbia (SORS) in October, which has notably increased Serbia's GDP. Thus, as a consequence of the higher GDP, Serbia's official public debt figure for 2023 is no longer 52.3% of GDP, but rather 48.4% of GDP. A similar decrease is then automatically carried forward to the following years, and so the public debt remains below 50% of GDP throughout the period of the Strategy, which was not the case in the previous Draft. The second important novelty in the Revised Strategy is the publication of a list of the largest investment projects of the Republic, with their so far incurred and anticipated costs. This table allows for better monitoring and evaluation of public investments to which hefty amounts of funds are currently allocated in Serbia, i.e., it introduces a significant improvement in the (still inadequate) transparency of public investments.

The rise in the fiscal deficit in the coming years is driven by a fairly strong increase in public expenditures. The Revised Strategy has introduced quite extensive changes in the forecasts of public revenues and public expenditures compared to the Draft Strategy. Public revenues in the period 2025-2027 are higher on average by about 1.5% of GDP per year, while public expenditures are higher by about 2.4% of GDP (resulting in an increase of the average fiscal deficit from 2.2% to 3% of GDP). Part of the rise in public revenues and public expenditures (0.6% of GDP) is of a technical nature. i.e. comes as a result of improvement in fiscal data consolidation. More specifically, for the first time, all own-source revenues (and expenditures) of indirect budget beneficiaries are included in the fiscal forecasts in the Revised Strategy. This is a methodological improvement that is deficit-neutral and does not constitute a change in fiscal policy compared to the Draft Strategy. The growth of public revenues after excluding these methodological changes stands at about 0.9% of GDP a year in the next three years. This is a consequence of: (1) the impact of the higher revenue collection in 2024, i.e. due to base effect; 2) slightly less conservative planning of certain public revenues; and 3) a one-off increase in 2025 due to the expected proceeds from the sale of 5G mobile network licenses. On the public expenditure side, the Revised Strategy provides for a rise of 1.8% of GDP a year compared to the Draft (excluding methodological changes). This is a consequence of the higher statutory indexation of pensions (0.5% of GDP), an increase in public investment (0.5% of GDP), as well as a rise in other current expenditures – subsidies, goods and services and wages and salaries in the public sector (0.8% of GDP).

The Fiscal Council's assesses that the additional increase in the fiscal deficit over the next three years was not necessary – especially given that it is primarily driven by the rise in current budget spending. When examining the individual reasons for the rise in Serbia's public expenditures over the next three years, it is evident that certain increases were unavoidable. These primarily concern pension expenditures. Due to an upward GDP revision, the share of pensions in GDP has fallen below 10%. This will trigger a more generous indexation of pensions in 2026 and 2027, as mandated by law. Consequently, public expenditures for pensions will increase compared to the Draft Strategy. The increase in public investment of about 0.5% of GDP annually roughly corresponds to the cost of purchasing Rafale fighter jets. This purchase was not envisaged in the Draft Fiscal Strategy and represents another expected expenditure. However, these new expenditures on pension benefits and public investment (amounting to about 1% of GDP) are offset by an almost identical upward adjustment of public revenues in the coming years. Therefore, the fiscal deficit would not have widened compared to the Draft Strategy if not for the larger-scale growth of other budget expenditures. This growth is not properly explained in the Revised Strategy. It is particularly unfortunate that the opportunity was missed to bring forward the lowering of Serbia's public debt to below 45% of GDP. This could have been achieved by implementing a more austere plan with a lower fiscal deficit, thus eliminating the need to postpone the introduction of fiscal deficit rules to as late as 2029.

The planned increase in fiscal deficit will not threaten the country's macroeconomic stability. Although the Fiscal Council believes that planning a lower fiscal deficit in the next three years (and consequently less borrowing) would have been more economically prudent and feasible, Serbia's macroeconomic stability should remain intact even under the current plan. According to the new forecasts, public debt as a ratio to GDP is projected to decline gradually. The public debt forecasts in the Revised Strategy are actually moderately conservative, suggesting that the actual reduction in the debt-to-GDP ratio may be even greater.

From a technical point of view, the key forecasts in the Strategy appear well-founded. The Fiscal Council's analysis has shown that there is little risk of public revenue underperformance relative to the plan in the Revised Strategy. Similarly, there is little risk that the relatively broad scope of public expenditures will exceed the medium-term plan, barring the potential introduction of new, generous policies. The macroeconomic outlook is also generally well-presented. Therefore, the key forecasts in the Strategy appear to have been made objectively at the technical level. However, the overall credibility of the Strategy is a separate issue, as it has not been a binding document in the pursuance of public policies for quite some time. This is evidenced by the fact that the planned medium-term fiscal deficit has doubled over the last year, coupled with a change in the composition of the planned budget. Furthermore, new policies are frequently introduced in an ad hoc manner, without being planned in previous Strategies.

The Government should provide greater support to the Statistical Office of the Republic of Serbia for strengthening its professional and operational capacities. The most recent GDP revision has significantly changed Serbia's macroeconomic picture. This is evident in the new estimate of Serbia's 2024 GDP, which now amounts to EUR 82 billion. In the Draft Strategy (before the revision), this estimate stood at EUR 76.4 billion. At the same time, the real GDP growth rate in 2024 has remained unchanged in the Revised Strategy. Notably, this is the third significant revision of Serbia's GDP in the past ten years. The GDP level has increased relatively sharply (between 5 and 7% per revision) with each revision. These are not typical changes seen in other European countries. Sound economic policy requires reliable data. Therefore, it is crucial for successful economic policy that the SORS provides high-quality, comprehensive, and timely data. Every improvement in the methodology and quality of data produced by the SORS is commendable. However, large revisions of statistical data, which significantly modify the level and trends of key economic and fiscal indicators, inevitably raise questions about data quality in Serbia. To ensure greater accuracy and reliability, the Fiscal Council calls on the Government to channel more resources to support the SORS. This support should aim to strengthen its operational and professional capacities. High quality in the work of this institution is of paramount importance for the proper conduct of public policies.

The Fiscal Strategy now contains an overview of large investment projects from the Republic budget, which is a significant improvement. In its Opinion on the Draft Strategy 2025-2027, the Fiscal Council recommended that the Government provide more detailed information on medium term plan for individual investment projects. This information should include planned value, execution by year, sources of financing, etc. The Revised Strategy shows improvement in this area by including a separate section with details on 66 republic capital projects worth more than EUR 20 million each (excluding defense and security).* This section presents a table with information on each project, including its estimated value, funds invested until the end of 2023, and planned allocations for 2024-2027. This provides taxpayers with valuable information that was not previously available. For instance, it is now clear that some large projects will cost significantly more than initially announced. One example is the National Stadium with accompanying facilities, now estimated at RSD 112.4 billion (EUR 960 million).* The publication of this table is an important step towards more transparent reporting on public investments. However, it also has some shortcomings that should be resolved. For example, it omits important projects such as the construction of the Bački Breg-Kikinda road ("The Smile of Serbia"), the construction and reconstruction of the ancillary infrastructure at Constantine the Great Airport in Nis, and only partially presents the Belgrade metro project."

The country's strategic plans in the domain of public investment have remained unclear. One of the key shortcomings of the Fiscal Strategy is that it continues to omit a section on three-year public investment priorities. This is a statutory obligation that has not been fulfilled for years. Under the 2018 Law on the Planning System, the Government was required to submit a proposed Development Plan of Serbia to Parliament by January 2020. This plan is the country's most important planning document and should cover at least ten years. It should then serve as a basis for drafting an Investment Plan for a period of at least seven years, encompassing all government investment plans in all major social sectors and linking them with the three-year fiscal forecasts. To date, none of these plans have been adopted. In fact, the obligation of the Fiscal Strategy to include a medium-term plan of investment priorities does not depend exclusively on the adoption of a ten-year Development Plan. It is directly defined by the Budget System Law. The Budget System Law (in Articles 27d and 27j) stipulates that medium-term public investment priorities are to be included in the Fiscal Strategy, and this obligation is further underscored in Article 31 of the Law.

The Revised Strategy provides for a limited and insufficient progress in the segment of structural reforms. Reform measures have traditionally been the least elaborated part of the Strategy. However, the Revised Fiscal Strategy shows some limited progress. One important new measure is the planned employment campaign within the Tax Administration, starting in January 2025. This campaign will include changes in job classification and streamlining of the employment process. Another significant development is the planned revision of distribution system access prices that EPS pays to EDS, as well as the prices at which EDS compensates EPS for distribution network losses. This should contribute to fairer relations between the two companies and improve the performance of EDS, which has been systematically recording losses. An important step forward in the energy sector is the announced revision of the priority investment plan for energy in 2025, which should include an assessment of project values, their contribution to energy transition, sources of financing, etc. Despite these welcome additions, the overall reform plans in

*****In The final version of the Revised Fiscal Strategy includes 56 projects.

***** In the final version of the Revised Fiscal Strategy, a separate project "Construction of the National Football Stadium" (without accompanying facilities) has been extracted from this project and its total planned value is 67.5 billion dinars, or 560 million euros. The accompanying facilities cannot be directly found in the amended table, and most of them are most likely contained in the project "Linear Infrastructure" with a total value of 40.5 billion dinars (about 350 million euros), which did not exist in the original version of the table.

Strategy are not satisfactory. The Strategy implicitly suggests that a comprehensive reform of the public sector wage and employment system—a reform that has been repeatedly announced and postponed for over a decade—will not begin before 2027. This delay is attributed to the ongoing process of integrating all parts of the general government into the Iskra information system. This plan lacks credibility. Similarly, there are no credible announcements of necessary reforms in other public systems requiring attention, such as social protection, healthcare, and education.