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NO TIME TO LOSE: FISCAL CONSOLIDATION RELOADED

Nema vremena za gubljenje: o nastavku fiskalne konsolidacije

Abstract

Public finance deficits and structural weaknesses of the Serbian economy and society are so severe, that there is no time to lose. After emergency measures, taken in the last quarter of 2012 in public finances, a responsible control over public finances in 2013 is necessary in the first place in order to prevent deficit increase above the projected. It is of key importance for the Government to keep under control what is in its power, i.e. expenditures, including a solution to be found for the arrears problem. Second, along with monitoring execution of this year's budget, the Government has to adopt and implement the Fiscal Strategy measures: solving problems in enterprise restructuring, limiting and reducing subsidies and guarantees, limiting the public sector wages, developing and implementing a rationalization programme as regards the public sector employment, and the like. Third, several systemic fields are improperly regulated, primarily the pension system and vertical imbalance in the public finances between the central and local government levels.

Key words: *fiscal deficit, public debt, fiscal consolidation, budget, fiscal strategy, reforms*

Sažetak

Deficiti u javnim finansijama i strukturni nedostaci privrede i društva Srbije toliko su izraženi da nema vremena za gubljenje. Nakon interventnih mera u javnim finansijama u poslednjem kvartalu 2012. godine, treba, prvo, odgovorno kontrolisati javne finansije u 2013. godini, kako bi planirani deficit bio dostignut. Ključno je da Vlada drži pod kontrolom ono što je u njenoj moći, a to su rashodi, uključujući rešavanje problema docnji. Drugo, uporedo s praćenjem izvršenja budžeta za tekuću godinu, potrebno je da Vlada usvaja i sprovodi mere iz Fiskalne strategije: rešavanje problema preduzeća u restrukturiranju, ograničavanje i smanjenje subvencija i garancija, ograničavanje zarada u javnom sektoru, izrada i primena programa racionalizacije zaposlenosti u javnom sektoru i drugo. Treće, nekoliko sistemskih oblasti nije na pravi način uređeno, a prvenstveno je reč o penzionom sistemu i vertikalnoj neravnoteži u javnim finansijama između centralnog i lokalnog nivoa vlasti.

Ključne reči: *fiskalni deficit, javni dug, fiskalna konsolidacija, budžet, fiskalna strategija, reforme*

Introduction

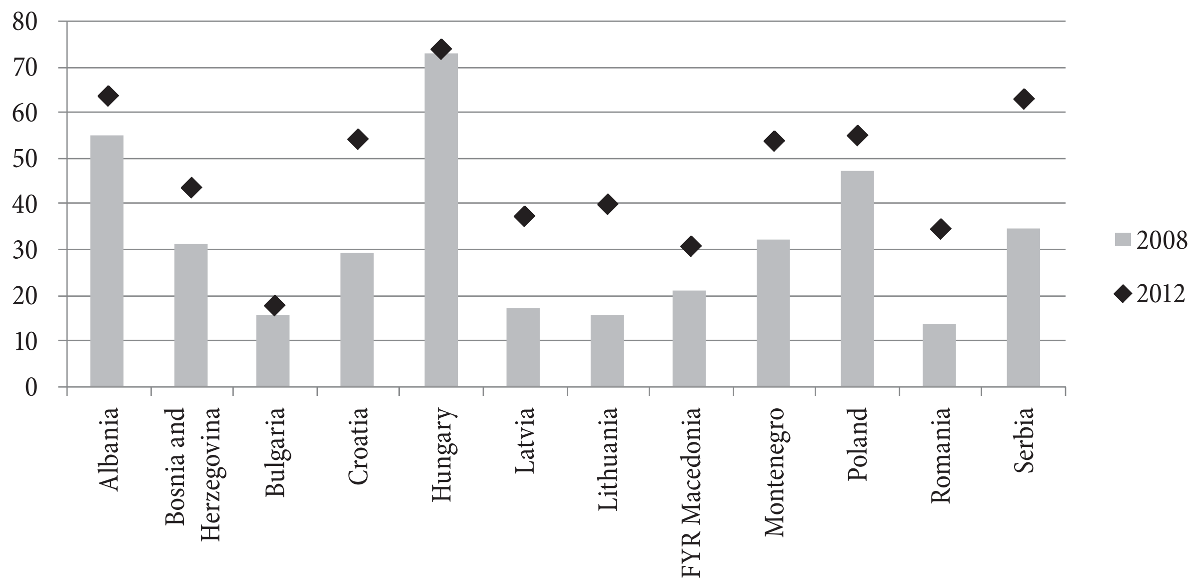
In the first two months of 2013, economic policymakers have directed their efforts to promote foreign investments, preserve certain endangered domestic enterprises, introduce incentives for export-oriented sectors and companies, as well as to develop agriculture. After emergency measures, taken in the last quarter of 2012 in public finances, initial energy channeled towards regulating public finances seems to be lost. It remains to be seen whether this is calm before the (new) storm or the Government considers it has already completed most of the work. It is important to emphasize that the public finance deficits and structural weaknesses of the Serbian economy and society are so severe, that there is no time to lose. It is necessary to set the grounds in the first half of 2013 for avoiding the public finance crisis in the next three-year period. It is important to place the focus back on fiscal policy and public finances. Such a conclusion results from two facts: first, the budget deficit and the public debt are (long since and quite far) in the red zone and they are threatening with the future public finance crisis and; second, the effects of measures can be experienced only in the time span – therefore, it is important to act immediately.

The current situation in the Serbian public finance is alarming and requires decisive measures of fiscal policy. Developments in 2012 and in the previous years have confirmed that public finances remained at unsustainable path requiring a comprehensive programme of fiscal consolidation in order to reduce the deficit and avoid the public debt crisis. The first half of 2012 was characterized by markedly expansive fiscal policy. At the time, the general government deficit stood at RSD 111bn instead of the projected RSD 61bn. The deficit of RSD 61bn was projected for the first half of 2012, and as such would then correspond to total annual deficit of RSD 152bn. However, the general government deficit in the first half of the year was by RSD 50bn higher than the projected and stood at RSD 217bn at the end of 2012.The new Government also failed to seize the opportunity to reverse negative trends by the 2012 supplementary budget [4]. The main reason for exceeding the annual deficit, by as much as RSD 65bn, is an expansive fiscal policy over the year, because the changing macroeconomic environment could justify up to a third of exceeded projection.

At the end of 2012, public debt exceeded 60% of GDP, whereby the legal limit of public debt (45%), sustainable in the long run in economic terms, was also exceeded. Serbia is an infamous regional leader as regards the extent and dynamics of public debt recorded after 2008. Apart from being ranked among the top regional countries in terms of the public debt, Serbia stands out with the public debt growth dynamics – over four years (2009-2012), Serbia's public debt to GDP ratio doubled. Such a ratio was also recorded by Romania, Latvia and Lithuania, but at a significantly lower public debt level (Figure 1). Even under the assumption that financial markets will continue to lend Serbia, thus postponing the public debt crisis for the far future, it should be noted that about RSD 100bn will be paid in 2013 only for interest on previous debts. Interests increase most dynamically as the public expenditure item; they are higher than expenditures on goods and services from the Republic budget, and also higher than expenditures on subsidies, defense, agriculture… In short, interests supersede other budget expenditures, thus becoming an unsustainable burden for Serbia.

The new Government and Parliament of the Republic of Serbia were active in the period August – end 2012. Basically, emergency and intervention measures were carried out: the 2012 supplementary budget was adopted as well as the set of laws on public finances, the 2013 budget and the

Figure 1: Public debt of Serbia and of the comparable countries (% of GDP, 2008 and 2012)



Source: IMF, World Economic Outlook Database (estimates for 2012)

Fiscal Strategy – an important document establishing the guidelines for the future three-year period. Calculations show that the projected path of deficit reduction will require drafting of new measures in 2013, to take effect in 2014. The previous efforts, primarily VAT increase and limiting of the public sector wages and pensions, will not nearly result in sufficient savings for the next year.

This paper presents the overview of the previous efforts to prevent the fiscal system collapse, then the obligations assumed by the Government in the adopted Fiscal Strategy, and finally a set of questions still without proper answers by the economic policy.

What did the Government do?

The supplementary budget for 2012

In the fall of 2012, the 2012 supplementary budget was executed and numerous laws with fiscal implications were adopted and amended. The basic assessment is that supplementary budget failed to produce efforts to immediately tighten the public finance, but, on the other hand, a large number of measures were aimed well and should provide for more successful year 2013. The overall package of measures, related to changes in tax laws, is an important structural measure for permanent reduction of fiscal deficit. Therefore, general assessment of these measures is positive [1].

By the 2012 supplementary budget, compared to the initial one, the Government of the Republic of Serbia envisaged more pronounced increase in public expenditures compared to increase in public revenues, due to which the deficit of the Republic was higher by the end of 2012 that it would be if the budget revision was not conducted. The additional deficit increase was due to impact of new measures related to the expenditure side of the budget, such as: the "13th pension" payments, subsidies for mitigating drought effects, increase in subsidies to the corporate sector and increase in expenditures on acquisition of financial assets. On the other hand, the supplementary budget also provided for certain savings whereby certain effects of the said expenditure measures were mitigated. The increase in tax revenues was projected on the revenue side due to tax rates change (VAT, income tax, tax on dividends, interest income tax) and excise duties increase. On the expenditure side, deficit reduction resulted from lower indexation of pensions and wages in October, as compared to the one that would be valid if the October adjustment was conducted in accordance with inflation.

Value Added Tax

The overall package of measures related to changes in tax laws, enacted in the fall of 2012, is an important structural measure for permanent reduction of fiscal deficit. Major amendments to the Law on Value Added Tax (VAT) include an increase in general tax rate from 18% to 20%, VAT increase to agricultural producers from 5% to 8%, increase in the threshold for (mandatory) entry into the VAT system from RSD 4 million to RSD 8 million of annual turnover, abolishing of the threshold for voluntary entry into the VAT system, increase in the threshold for monthly increase in VAT from RSD 20 million to RSD 50 million, enabling small and medium-sized enterprises with annual turnover less than RSD 50 million to settle their obligations upon colleting the receivables instead of upon invoicing the receivables.

Excise duties

Basic amendments to the Law on Excise Duties include increasing excise duties on tobacco products, unification and partial increase in excise duties on petroleum products, as well as the shift from proportional to the absolute amount of the excise duties on coffee. It was decided to increase the specific amount of excise duties on tobacco products from RSD 33 to RSD 43 per pack (i.e. RSD 45 as from 1 July 2013), as well as to reduce the proportional amount of excise duties from 34% to 33%. Excise duties on (unleaded) gasoline remained at the same level (RSD 49.6 per liter), while the amounts of excise duties on gas oil and liquefied petroleum gas increased (from RSD 37 to RSD 42 per liter i.e. from RSD 18 to RSD 30 per kg).

Personal income tax

The main change in the personal income tax is an increase in the financial capital income rate from 10% to 15%, as well as increase in tax rate on income from interest, dividends and capital gains, from 10% to 15%. Nominal tax rate on corporate income increased from 10% to 15%.

Other laws

Amendments to the Budget System Law, to the Law on Local Self-Government Financing and the Law on Republic Administrative Fees, envisaged abolition and limitation of various forms of quasi-fiscal levies and establishment of a transparent and controlled framework for determining non-tax levies. Seven local utility taxes were abolished. The limited business sign display taxes were also abolished at the local level, as well as the maximum fees for motor vehicles. In addition, the mandatory local utility fee for displaying company signs on office space was also abolished for entrepreneurs, i.e. small enterprises, while the maximum fee to be paid was defined for medium-sized and large companies. Deletion of files and activities was envisaged, for which the republic administrative fee was paid as regards registration of endowments, foundations, funds, associations and other similar associations and activities.

From a fiscal standpoint, the main changes envisaged by amendments to the Law on Tax Procedure and Tax Administration and the Law on Fiscal Cash Registers, include abolition of obligation to register turnover through cash registers for entrepreneurs engaged in production activities who pay the flat rate tax, as well as limiting the possibility of banning the activity of taxpayers who failed to regularly register their turnover through fiscal cash registers, and expanding the competence of Tax Administration as regards the control over the execution of fiscal obligations.

The public funds management system

Changes in the budget treatment of own revenues represent a positive change. The term "budget users' own revenues" was deleted from the Budget System Law, thus creating the assumptions that (former) own revenues shall be the general budget revenue. It was common for own revenues to remain available to the authorities who generate them. Now, users' funds should be directly available to the Ministry of Finance.

The public funds management system has been improved. The conditions have been created to consider in general the public funds users' revenues and expenditures. The system of user records was established at the Treasury. It has been envisaged that users shall open the accounts and sub-accounts within the consolidated Treasury account, while the provision according to which the Minister may authorize opening of the budget user accounts with the bank, for own revenues, was deleted. The provisions regulating that the users shall inform the Treasury of the new contract on assuming the obligations, and on the obligations (payment terms) already assumed as well as on requests for payment and Treasury obligations to keep the register of all public fund users, lead towards improvement in the public funds management system.

The changes in the Budget System Law, related to fees and charges, are positive. Given unregulated field of fees and charges, it was good to adopt the provisions that will lead to more predictable and stable framework for business operations, to abolishing of state authorities autonomy in determining the levies and to reduced pressure on the corporate sector and on citizens. It was determined that fees can be imposed only by law and that the amount thereof shall be stipulated by the law, or that the law shall entitle the entity to determine the fee amount (only in the absolute amount), whereby the consent of the Ministry (or of the local authority) has to be previously obtained.

Public sector wages

The maximum wages in the public sector have also been determined. The Law on determining maximum wages in the public sector establishes the maximum pay at agencies and similar institutions, public enterprises at all government levels, organizations of mandatory social insurance, legal entities in which the Republic or the local authority has majority ownership. Determining the maximum wage and the highest wage for the ancillary tasks is justified. The current legal framework for determining the public sector wages is very complicated and contains five different bases and about 600 different grades for various employment positions within different sectors.

The "13th pension"

On the other hand, the adopted programme of the "13th pension" is not fiscally responsible and does not act in accordance with the current concepts of social protection and pension system. The "13th pension" programme implies that all pensioners whose monthly pensions are less than RSD 15,000 shall be paid an additional transfer from the republic budget in the amount of RSD 16,000 a year (quarterly, in four equal installments). The "13th pension" programme shall arbitrarily define the criterion according to which the retired may be considered vulnerable and thus may be eligible for this programme. The programme is not in compliance with the current solutions and concept of the social protection since it does not consider the overall financial standing of the pensioner's household. It is neither in compliance with the concept of the current pension system based on the ratio between the contributions paid during the working life and the amount of the retirement pay.

Arrears

According to estimates from the last quarter of 2012, the state authorities' arrears (at all levels) reached the amount of about RSD 50bn in the fall of 2012, whereby the health arrears (Republic Institute for Health Insurance and health care institutions) were the highest, accounting for about 60% of total arrears. By the end of 2012, the government took over RSD 13bn worth debt of health care institutions as public debt, under the special law. Amendments to the relevant laws limited the health care expenditures (expenditures are executed according to financial plans, supervised employment, centralized acquisition of medications), which should reduce the possibility of arrears increase in the future. Also, the government settled its debts to the road construction industry in December, in the amount of RSD 4.73bn. Finally, in early 2013, the Republic offered to local self-government to regulate its arrears for capital investments. According to the proposal, the Republic shall issue debt securities to creditors (thus regulating the local self-government obligations), and shall assume the revenues of local self-government for settling obligations of the Republic due on the securities. The grace period shall be one year, and the call for local self-government and creditors to apply shall be open till late April this year. To prevent new arrears, the Budget System Law and the special decision limited expenditures of local self-government, as follows: by wage planning (according to fiscal rules), by maximizing the number of employees, through recommendation for savings, by payment priorities (fixed costs), through reporting on planned expenditures to the Treasury. Limiting the public sector payment deadline to 45 days, starting as of 2013 (90 days for the health care fund, starting as of 2015) should also be helpful as a general principle.

What did the Government promise?

The 2013 budget

The 2013 budget envisaged a sharp reduction of the Republic deficit by about RSD 70bn, i.e. to RSD 122bn. Sharp deficit reduction is required so as to terminate almost uncontrolled public debt growth at the end of 2013. The planned deficit reduction in 2013 will be achieved primarily by higher taxes and decreasing growth of the public sector pensions and wages, i.e. based on the effects of measures established back in 2012. For realization of the planned budget deficit in 2013, it will also be necessary to sharply reduce expenditures on the purchase of goods and services and expenditures on subsidies.

Reduction of expenditures on the purchase of goods and services and of expenditures on subsidies has not been prepared well enough. The main mechanism for reducing expenditures on the purchase of goods and services, and partly subsidies, is a limitation of allowable expenditures of the state authorities for this purpose. Obviously, there is a lack of a clear plan for exactly specifying the government functions and programmes to be abolished or markedly reduced, as well as the reason thereof. This plan is required in order for the announced deficit reduction to be credible, but also for rationalization of public expenditures to be implemented in economically optimal way – by reducing least useful expenditures. It is therefore possible that the 2013 deficit shall be by about RSD 25bn higher than the projected. There are additional risks that the republic budget expenditures, therefore the deficit as well, will be even higher. The budget has not envisaged the funds for the Smederevo steel mill, even though substantial funds were allocated for this company in 2012. If this company is not to be privatized soon, it is certain that some unplanned expenses, related thereto, will appear in 2013. In addition, the announcements have appeared in the public that one-off programme, the "13th pension", would evolve into a permanent right. The budget proposal envisaged only payment of the remaining installments of this programme, so the continuation thereof would lead to deficit increase. However, the most dangerous risk certainly covers the potential problems that may occur in implementation of the announced 2% indexation of wages and pensions in April, since it is possible that inflation could be slightly higher than expected [2].

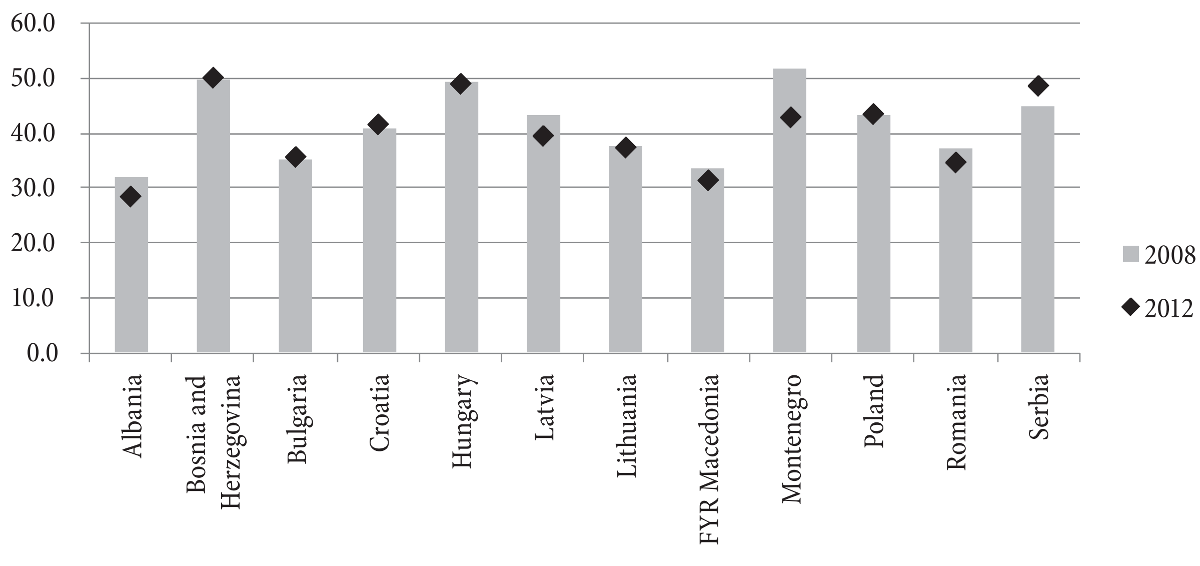
Fiscal Strategy

From a standpoint of a medium-term path of fiscal deficit and public debt, the contents of the "Fiscal Strategy for 2013 with projections for 2014 and 2015" is of a particular importance. So, this is a document that determines the budget frameworks for 2014 and 2015. In this regard, it should be noted that high systemic deficit of Serbia's public finance is necessary to be eliminated in the forthcoming years primarily through expenditure reduction. Discrepancy between the levels of public revenues and the existing public expenditures is systemic in its nature (the so-called structural deficit), so this imbalance shall not disappear with a mere economic recovery, but it is necessary to implement structural measures. Given the empirical regularity, according to which a bloated public sector slows down economic development of countries in transition, as well as the fact that Serbia's public spending is among the highest in Eastern Europe (Figure 2), it is necessary to achieve the fiscal deficit reduction primarily through the reduction of public expenditures.

Fiscal Strategy envisaged the fiscal deficit reduction to terminate the public debt increase and a decrease thereof in the medium term. The Fiscal Strategy proposal has planned the deficit to stand at 3.6% of GDP in 2013, 1.9% of GDP in 2014 and 1% of GDP in 2015. The deficit path is defined in such a way to terminate the increase in public debt share in GDP at the end of 2013, and, in the coming years to result in the public debt to GDP ratio decrease [3].

The projected sharp deficit reduction in 2013 should be provided by short-term measures – based on the effects of higher taxes and limited increase in pensions and wages. It is planned to achieve the fiscal deficit reduction as of 2014 only through public expenditure reduction but not through the additional increase in public expenditures. The Fiscal Strategy stipulates that the public expenditure share in GDP, over only two years (2014-2015) shall decrease by about 3% of GDP. The approach, according to which the necessary reduction of fiscal deficit is achieved in the medium term, by public expenditure reduction, is good.

Figure 2: Public expenditures in Serbia and in comparable countries (% of GDP, 2008 and 2012)



Source: IMF, World Economic Outlook Database (estimates for 2012)

Large savings will yet not be achievable only by more rational consumption and by reduction of government discretionary expenditures, but they may only result from implementation of comprehensive structural reforms in public expenditures.

Pension system

Fiscal Strategy envisages several important reform moves. In the field of pension reform, it is stated that factors of actuarial fairness for retirement, before and after normal retirement age, will be introduced in the first half of 2013. Employee who retires at a younger age shall receive his/her pension, as a rule, much longer than the employee who retires at older age. It is therefore necessary for actuarial fairness factors (actuarial penalties) to provide for the workers who retire at a younger age to receive proportionally smaller amount of the pension benefit, i.e. the workers who retire later to receive a proportionally greater amount of pension, depending on how long they are expected to receive pension. It is good that this principle has been included in the Fiscal Strategy. A concrete solution is expected in 2013 in order to start with application thereof as of 2014. This is about establishment of the percentage reduction of pension for each retirement year prior to normal retirement age, i.e. the pension increase for each year of retirement after normal retirement age.

Public sector wages

As regards the public sector wages, the Government has committed itself to consistent application of indexation rules. According to data, the public sector wages increased by 11.4% in the period 2010-end 2012, more than it was projected by legal indexation. Bad practice has continued in the year of 2013, in which the projected wage indexation stood at about 4.2% (2% in April and 0.5% in October), while the 2013 Budget Law projected increase in the wage pay budget item, by as much as 7.6%. One explanation for the increase in wages over the planned indexation is employment growth, while the other is justified by advancement of civil servants during the year. However, these factors can explain only portion of the increase, primarily because employment did not significantly increase in this period, and the advancement of some employees coincides with the retirement of other employees in the civil service – since the employees who retire usually have higher wage grades than those who are still to advance, it is reasonable to assume that these two pathways have neutral impact on wage bill growth. Therefore, it is necessary to prevent any increase in wages above indexation and abuse leading to growing wages against fiscal rules – the Government has committed itself to the aforesaid in the Fiscal Strategy.

The Government is committed to introduction of a unified system of wage grades, which would solve the issue of wages for similar positions in different state and public services, in a consistent and systematic manner. According to the current regulations, workers with equal qualifications and equal job descriptions earn even as much as multiple-different wages in different segments of state administration.

Public sector employment

It is also envisaged to develop a rationalization programme of the public administration employees in 2013, including local self-government as well. The previous policies of reducing the number of civil servants were conducted *ad hoc* and mostly occurred at the time of budget adoption – when there was a need to cut expenditures. Such policies were irrational and inefficient. The Government considers offering a systematic solution for inefficiency and redundancy to certain state and public services in 2013. Introduction of the central register of employees, planned for the first half of 2013, is very important since, paradoxically, the number of public sector employees at different levels is still unknown.

Public enterprises

An important segment of reforms planned in 2013 is related to public enterprises. The Fiscal Strategy has envisaged for 2013 the adoption of action plan for completing the restructuring procedure by mid-2014 and initiation of bankruptcy in 2013 as regards some enterprises, as well as abolition of the respective subsidies. Also, the plan to define certain efficiency criteria for public enterprises in state ownership in the first half of 2013 is very important for measuring their performance.

Subsidies

As regards subsidies, there is a large room for improvement in public finances. The Fiscal Strategy envisaged that subsidies to "Serbian Railways" shall be limited to 0.5% of GDP per year. As for the public enterprise "Resavica", it is planned to find a strategic partner until privatization, i.e. until a complete termination of subsidies to this enterprise by 2015. Furthermore, the subsidies for employment and for investment will be limited to local public enterprises, as well as funds for employment and investing (though, the method and the amount have not yet been determined).

Social protection

In the field of social protection, the Government has committed itself in the Fiscal Strategy to develop the social map in 2013 and to provide local self-government with more active role in social protection of the poor, which is justified given higher funds that local self-government was granted after the so-called fiscal decentralization in 2011.

What did the Government fail to promise?

Expenditure control in 2013

The first challenge is to realize the plans of the 2013 budget. In addition to the aforementioned possibility that expenditures may be higher than planned, the risks are also pronounced on the public revenue side. The budget plan thereof is optimistic, even though the 2013 inflation, higher than planned, could increase revenues and bring them closer to the planned level [4]. Therefore, there is a much greater risk of exceeding the planned fiscal framework in 2013 on the expenditure side than on the budget revenue side. In any case, it is crucial for the Government to control what is in its power, i.e. the expenditures. In this regard, the Fiscal Council proposed to the Government to define quarterly goals of expenditure execution [4]. Quarterly execution goals should be defined for total expenditures of the republic budget and for individual expenditures that are particularly risky for exceeding the planned budget framework – such as expenditures on the purchase of goods and services and expenditures on subsidies. If the quarterly goals fail, conditional measures should be defined, to automatically take effect. Measures should be defined in advance and they would automatically take effect if the quarterly goals are infringed. Conditional measures would bring additional credibility to the Government determination to limit the budget expenditures. These measures could be related to indexation of pensions and wages in October, to suspension of some subsidy programmes or to something else.

Arrears

The second challenge is related to arrears. It is particularly important to prevent the emergence of new Government arrears in 2013 and to solve the problem of the existing ones (as said, the latter decreased in late 2013 but the highest portion of arrears remained unsolved). The accumulation of arrears as regards Government payments is dangerous from two aspects – on the one hand, it threatens public finance since the outstanding liabilities are mostly shifted to public debt at the end, and, on the other hand, the Government arrears increase illiquidity of the economy that fails to receive funds for the product or service sold.

Pension system

The third open issue is the pension system. In addition to the announced introduction of actuarial fairness factors, it is necessary to introduce a gradual increase in the retirement age of women in order to reduce unreasonably big difference, of as much as five years, between the retirement age of women and men. It is possible to gradually expand the age for six additional months during one calendar year, so that the retirement age for women is at least 63 years at the end of the transitional period of six years. Demographic and social situation in Serbia does not provide for justification for a lower retirement age of women than that of men – 60 years for women, compared to 65 for men. The largest number of developed countries equalized retirement age of men and women over the past years. Among the comparable countries experiencing similar problems like Serbia, Bulgaria recently adopted the solution according to which men retire at 65 years of age and women at 63 years of age, while Poland opted for more pronounced reform – retirement age of both women and men was gradually increased to 67 years of age.

Fiscal decentralization

The fourth challenge is the relationship between the Republic and the local self-governments. By legislative changes in 2011, local self-government received about RSD 40bn of additional funds for reduction of the Republic revenues. With this in mind, it is surprising that additional transfers are approved in 2013 from the national level to local self-government, this time for the maintenance of road infrastructure (RSD 4bn). In addition to the said (unnecessary) transfer, the amount of other, non-earmarked transfers to the local level, in the amount of about RSD 7bn, should be reconsidered and reduced. In addition to the current issues, it is necessary to systematically reconsider the relations between the Republic and the local self-governments. The vertical fiscal imbalance is obvious between the central government and local levels, due to multiple unilateral and unsystematic legislative amendments in the past few years. The optimal approach would cover restored relations under the 2007 Law. This would imply reduction of the municipalities and cities' share in income tax, from 80% to 40%, is in accordance with good economic practice according to which main tax forms, with pronounced effects on economic activity (such as payroll tax), should dominantly belong to central government levels. Also, returning to the previous practice would imply increasing amount of transfers from the current 1.1% of GDP to 1.7% of GDP. Finally, if local self-governments accept the obligation to maintain 6.000 km of local pre-categorized roads, legal provisions from 2007 should be finally expanded within this package, in order to transfer a total amount of RSD 4 billion of funds to relevant municipalities and towns.

The fifth task – which certainly should stay in focus – is commencement of fulfilling the commitments assumed in the Fiscal Strategy. This has to do with solving the problem of enterprises in restructuring, limiting and reducing subsidies, limiting the public sector wages, developing and applying the programmme of employment rationalization in the public sector, as well as other relevant questions mentioned above. Only by implementation of planned measures and by introduction of new ones, can we reach a desired path of sharp decrease in fiscal deficit and, consequently, in public debt.

Conclusion

The first wave of fiscal consolidation was intended to prevent escalation of the government financial problems and was aimed at late 2012 and at 2013. Changes made in the set of laws on tax implications and regulation of the public finance system, as well as limitation of expenditures (primarily the public sector wages and pensions), can be said to have laid solid foundations to achieve this goal. With consolidation measures taken, achievement of this goal was also supported by abundance of funds in the international market and by low interest rates. The situation in the financial market was appropriate for smooth and relatively cheap government borrowing and provision of funds for financing a larger portion of this year's deficit. Still, the "honeymoon" is coming to an end. The current year is full of uncertainty; we are nearing the year of 2014 which is more demanding in budgetary terms than 2013. Upon considering the situation and trends, the Government has committed itself late last year to start carrying out the reforms on several tracks, in order to further reduce the deficit in 2014 and 2015. Vigilant attention is required within this time frame, in three directions.

First, public finances should be controlled in 2013 in order to achieve the general government deficit, planned at 3.6% of GDP. This would help create a good position to further go on in 2014, in terms of an additional deficit reduction and, finally, of refraction of the public debt entrance trajectory downwards. According to present situation, this task will not be easy at all, since pronounced risks are also present on both the public revenue side and on the expenditure side. Therefore, it is necessary to react, starting from the beginning of the year and no later than the first quarter, if observed that expenditures are exceeding the plan and deficit is spinning out of control. An arrangement with the International Monetary Fund would be desirable since it would strengthen the mechanism for monitoring public finances and implementing the potential corrective measures.

Second, along with monitoring the execution of this year's budget, the Government has to adopt and implement the Fiscal Strategy measures (companies in restructuring, limiting and reducing subsidies and guarantees, restrictions on the public sector wages, development and implementation of rationalization programme related to public sector employment, etc), since these measures are necessary in order to further reduce the deficit as from 2014, and to push public debt to a downward path.

Third, the calculations show that if all the said is achieved, it will not be enough for a desirable and necessary consolidation in the medium term, and for avoidance of the public debt crisis. Profundity of our problem and the necessary of adjustment require additional measures, which are not announced to be taken yet. Several systemic fields are improperly regulated, primarily vertical imbalance in public finances between the central and local government levels. There are different modalities for solution thereof, but the best would imply a decrease in the municipalities and towns' share in income tax, from 80% to 40% by amended legal framework, whereby the funds transferred from the Republic to the local level should increase.

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