

**Sanja Jelisavac Trošić**  
Institute of International Politics and  
Economics  
Centre for International Organizations and  
International Law  
Belgrade

**Biljana Stojanović-Višić**  
PE Post of Serbia  
Belgrade

## EU BUDGET AND BUDGET OF SERBIA: IMPACT ON SERBIA'S ACCESSION TO THE EU\*

Budžet EU i budžet Srbije - uticaj na proces  
pridruživanja Srbije Evropskoj uniji

### Abstract

Our research is focused on identifying the European Union's budgetary policy and the fiscal rules that must be obeyed by the European Union (EU) member states in order to compare them with Serbia's fiscal policy. We want to see how the budget balance in the EU is being achieved, and to what extent Serbia follows the EU budget principles and how much support it receives from the Union on this path. The structure of revenues and expenditures of the EU budget and the budget of Serbia is also given. The first part of this paper discusses the changes in the budgetary policy of the EU, given that the global financial crisis has revealed significant weaknesses in the design and implementation of the existing economic governance in the EU, leading to the signature of the Fiscal Compact and creation of the European Stability Mechanism. The second part deals with elements and functions of the budget of Serbia and with fiscal responsibility. The Serbian budget is burdened with fiscal deficit and the accumulation of public debt. Serbia has introduced fiscal rules that are applied in the EU, but the same unfortunately have not been fully applied in Serbia. In the third part we examine the impact of the EU budget on Serbia's accession process through the Instrument for Pre-Accession Assistance (IPA), which European Union has allocated to the EU candidate countries, to help them reform and achieve European standards.

**Keywords:** *budget, EU, Serbia, fiscal rules, deficit, accession, IPA*

### Sažetak

Naše istraživanje je usmereno ka identifikovanju budžetske politike Evropske unije (EU) i fiskalnih pravila koje moraju poštovati države članice EU, kako bi ih uporedili sa fiskalnom politikom Srbije. Želimo da vidimo kako se ostvaruje budžetska ravnoteža u EU, kao i u kojoj meri Srbija prati budžetske principe EU i koliko podrške dobija od Unije na tom putu. Date su i strukture prihoda i rashoda budžeta EU i budžeta Srbije. U prvom delu rada sagledavamo promene u budžetskoj politici EU, s obzirom na to da je globalna finansijska kriza otkrila velike slabosti u projektovanju i implementaciji postojećeg ekonomskog upravljanja u okviru EU, te je zato potpisan Fiskalni pakt i kreiran Evropski stabilizacioni mehanizam. Drugi deo se bavi elementima i funkcijama budžeta Srbije i njenom fiskalnom odgovornošću. Budžet Srbije je opterećen fiskalnim deficitom i akumulacijom javnog duga. Srbija je već uvela fiskalna pravila koja se primenjuju u EU, ali koja nažalost nisu u potpunosti primenjena u prethodnom periodu. U trećem delu ispitujemo uticaj budžeta EU na proces pridruživanja Srbije kroz Instrument za pretpristupnu pomoć, koji je Evropska unija dodelila zemljama kandidatima za članstvo u EU, kako bi im pomogla u reformama i postizanju evropskih standarda.

**Ključne reči:** *budžet, EU, Srbija, fiskalna pravila, deficit, pridruživanje, IPA*

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## Introduction

The budget is a government document presenting data on government revenues and expenditures in a certain future period, most often over a one-year period (annual budget). The European Union does not have a usual government, like its member states have, but has a budget with a revenue and expenditure structure. In addition to the budget, European Union has the Multiannual Financial Framework, which represents an approximate or indicative overview of revenues and expenditures over the next several years. Due to this framework, it is known that the EU funding has been in order since 2013, and how it will look with all planned moves until the end of 2020.

The EU budget is a controversial instrument aimed at achieving an effective common economic policy. On the one hand, we have disputes over jurisdictions between the EU Council, the European Commission and the European Parliament debated in the preparation of the budget and content of the EU budget policy objectives and actions, and on the other hand, we have the problem of righteous financial distribution of burdens between the member states.

The fiscal policy of the EU (in contrast to the fiscal policy and public finances of the member states) deals primarily with the EU budget (its revenue and expenditure side in terms of the financial expression of complex relations between the EU and the member states) and taxes from the aspect of tax harmonization between the member states in order to achieve “the four freedoms” (free movement of persons, goods, services and capital).

However, the global financial crisis has revealed major weaknesses in the design and implementation of existing economic governance within the EU, and the Eurozone in particular. In response to the global financial crisis, the European Council adopted the Treaty on Stability, Coordination and Governance (TSCG) in the Economic and Monetary Union (EMU) also referred to as the Fiscal Compact. The main feature of TSCG is limiting the deficit: the rule of a balanced budget, the automatic correction mechanism, incorporation of these rules into national legislation and in the jurisdiction of the European Court of Justice. In line with the Fiscal Compact, the Eurozone

Fund has been established in the form of the European Stability Mechanism (ESM).

In a modern economy the budget has a great importance because of its many functions and areas of operation (economic, political and legal). Through the budget, redistribution and spending of a large part of the national income is carried out. Also, through the budget, the state undertakes numerous, often decisive actions in the development of the economy. One of the main goals, and also the most difficult problem facing the fiscal policy of every modern state, including Serbia, is achieving a balanced budget and then maintaining its balance.

In order to achieve a budget balance, the main principle of fiscal policy should be fiscal responsibility and fiscal discipline. Whether the principle of fiscal responsibility when determining, adopting and implementing the budget of Serbia (with a view to the EU budget) was honoured we will determine in the paper.

Also, the impact of the EU budget on the negotiations on Serbia's accession to the EU will be taken into consideration as well, since Serbia receives funds from the Instrument for Pre-Accession Assistance (IPA). This phase of IPA use is especially significant because it represents a kind of preparation for the EU membership. EU funds are intended for EU candidate countries, to help in the reform process and to achieve European standards. IPA establishes a strong link between the budgetary and strategic aspects of enlargement.

## EU budget

The first EU budget (European Economic Community budget) was small and its primary role was to cover administrative needs of the EU (community). However, as the EU expanded and the member states became increasingly dependent on each other, the role of the budget also grew. The funds that went into the budget and the fields of its application grew as well.

Today, the EU budget policy works on different bases in relation to national policies. This means that member states simultaneously implement and finance their economic and political activities within two different public finance systems (national and European). Namely, EU membership

imposes on member states an obligation to finance a common EU budget. In accordance with the established mechanism for the functioning of the EU public finance system, each member state renounces a certain portion of its national revenues and invests them in a common EU budget, from which common EU policies are financed.

The volume of EU budget revenues and expenditures was not linked to the Union's need to influence economic life and (until recently) the economic wealth of member states (agriculture is the only exception). Anyway, if the EU is unable to increase or significantly reorganize spending, then it should continue attempts to harmonize its own expenditure with the member states' expenditures [17].

The best solution would probably be that instead of choosing economic policies (areas for intervention) that can fit into limited resources, the EU should locate areas that need to be influenced at the EU level and only then create the necessary resources.

### The relationship between the EU budget and the budget of the member states

The European Union funding is closely linked to the relations between the EU and the member states and the specific nature of EU as a supranational institution. These relations are based on the application of the transposition principle, the principle of subsidiarity and the principle of proportionality of the EU competences [22, p. 74].

The transposition principle implies that the EU competencies have been derived from the competence of the member states and are generally limited by exclusivity. Exceptions to this rule have been made in agriculture, transport and international trade. In the internal market, the EU competences are significantly limited and national legislation has a primacy.

The principle of subsidiarity means that every public function should be done by the lower level of government, if it is more efficient, and if this creates the lowest possible administrative costs.

The principle of proportionality is governed by the EU enforcement mechanisms. This principle refers to the proportionality between the goals that are to be achieved and the means used in achieving these objectives.

Most of the EU jurisdictions belong to a group of non-exclusive and joint competencies with member states. A group of joint competences has a residual nature, and the so-called competencies that serve as a support to the competencies of member states are carried out in areas such as: industry, protection and promotion of citizens' health, education, youth and sport, culture, citizens' protection, etc.

For these reasons, the EU budget has very specific sources on the revenue side, different from the taxes for the member states' national budget. On the expenditure side of the EU budget there are items for satisfying public needs which can essentially be satisfied at the national level, but in the interest of all member states are met at a supranational level.

What is the role of the fiscal policy of the EU and the member states then? The main task of the member states' fiscal policy is to establish a balance between, on the one hand, the need for the flexibility of the national budget and meeting the public needs of their own citizens, and, on the other hand, the obligation to prevent the negative effects of national budget deficits from spreading to other member states. At the EU level, member states do not have the tools to counter negative economic shocks, so the national budgets must be flexible enough to play the role of an automatic stabilizer when the country is in a state of recession, whereby that role should be such as not to endanger business flows in other member states. In addition, although it does not have a centralized budget because it is not a state, the EU as economic integration and a supranational institution, has the interest to form its own budget from which it will meet agreed public needs at the EU level.

Fiscal policy and public finances of the European Union (as opposed to the fiscal policy and public finances of member states) deal with:

- The EU budget and its revenue and expenditure side in terms of the financial expression of specific and complex relations between the EU and the member states, and
- Taxes from the aspect of tax harmonization between member states in order to achieve four proclaimed freedoms in the EU, and not as public revenues of the EU budget.

## EU financial perspective

The financial perspective represents the framework for the EU spending over a certain perennial period. The financial perspective is determined on the basis of the inter-institutional agreement of the EU Council, the European Parliament and the European Commission, which marks the maximum amounts and structure of expenditures in a given period.

The European Commission is finishing the financial perspective annually to take into account prices and GDP (Gross Domestic Product) growth in the EU. The financial perspective does not represent a multi-annual budget since the annual budgetary procedure is crucial in determining the actual amount of expenditures and the structure of the various budget chapters. To date, 5 inter-institutional agreements have been concluded:

- Financial Perspective 1988-1992 (Delors I Package),
- Financial Perspective 1993-1999 (Delors II Package),
- Financial Perspective 2000-2006 (Agenda 2000),
- Financial Perspective 2007-2013, and
- Financial Perspective 2014-2020.

The multi-annual financial framework aims to ensure that costs go within the foreseen, reminding the EU of the constraints on its own sources of funding.

The EU Council, at a meeting held on 8 February 2013, reached an agreement on the multi-annual financial framework covering the period 2014-2020. The agreement reached at the EU Council limits the maximum possible spending for 28 countries of the European Union to the amount of 959.99 billion euros (of commitments), representing 1% of the gross national income of all EU member states. Compared to the financial framework for the period 2007-2013, it can be concluded that the total expenditures were actually reduced by 3.4% in real terms, which is a precedent in the history of the EU [10].

### The Fiscal Compact and the European Stability Mechanism as a response to the global financial crisis

The global financial crisis has revealed major weaknesses in the design and implementation of existing economic governance within the EU, and the Eurozone in particular.

The EU Council in December 2011 adopted a comprehensive package of measures that should provide a response to the current crisis, as well as to prevent the emergence of new crises in the future.

The Treaty on Stability, Coordination and Governance in the Economic and Monetary Union known as the “fiscal intergovernmental agreement” or “fiscal compact” was adopted on 2 March 2012, and it was signed by 25 EU member states (United Kingdom and the Czech Republic did not sign). The intention is to join this Treaty with existing EU Treaties. The main features of the Fiscal Compact are [11]:

- Limiting the deficit - the rule of a balanced budget (the so-called “golden rule”). This requires that the national budgets of the member states be in balance or in surplus, and are considered to have been achieved if their annual structural state deficit does not exceed 0.5% of the nominal GDP. A temporary exception from this “balanced budget rule” is permitted only in exceptional economic circumstances, for example, during serious deterioration of economy. If the government debt is well below 60% of GDP, the deficit limit can be set at 1% of GDP;
- Automatic correction mechanism. If a member state deviates from a balanced budget rule, an automatic correction mechanism will be launched. The concerned member state will have to correct the deviations in a certain period of time. This mechanism will fully respect the prerogatives of national parliaments;
- Incorporation of these rules into national legislation. Member states are required to include a request for budget discipline and a mechanism for automatic correction in their national legal systems, preferably at the level of the Constitution;
- The jurisdiction of the European Court of Justice. In the event that a member state does not include in its legal system a balanced budget rule and a correction mechanism, the European Court of Justice will be empowered to make a decision on the matter.

The Fiscal Compact came into force on 1 January 2013, since it was also ratified by Finland as the 12th member state of the Eurozone. This treaty is legally binding as an international agreement and is available for signing to EU member states that were not initially signatories.

In line with the new Fiscal Compact, a new Eurozone fund - the European Stability Mechanism was created. Decision-making in the ESM is simplified in emergency situations so that 85% of the capital owners' votes are needed to help countries in trouble. This should prevent smaller countries from blocking or slowing down emergency measures, as it previously happened in the case of the Greek government-debt crisis. It is envisaged that the member states of the Eurozone will pay in 80 billion euros in cash and 620 billion euros in the form of committed callable capital. With this capital in the background, ESM will sell bonds in the capital market, and with the received money it will help the countries in need. An important step towards the full functioning of this mechanism is its recognition in the global capital market [12]. It will be possible to release 500 billion euros, and the remaining 200 billion euros serves as an additional guarantee to investors that their money is well invested. The largest share in ESM, as the largest country in the Eurozone, has Germany with 27% or 190 billion euros. However, the road to Germany's consent to giving guarantees in such a large amount was not easy. In addition to the German Bundestag, Germany's participation in the ESM had to be confirmed by the German Constitutional Court [13].

How and to what extent the fiscal rules apply in Serbia, as a candidate country for the EU membership, will be analysed in the next chapter of this paper, especially given the fact that the fiscal rules applied in the EU will be binding for Serbia when it becomes a full member of the European Union.

### Financing the EU budget

Today, the EU financing system consists of several own resources and resources from other sources. In line with the EU Council decision, the EU's own resources are [9]:

- Traditional own resources (duties and charges on agricultural products). The characteristic of these revenues is that member states pay to the EU budget only 75% of the funds collected, while the rest (25%) belongs to the national budgets in a form of compensation for the costs of collection;

- VAT-based own resources. This resource is charged on the so-called "abstract" harmonized VAT base of all member states. The abstract base is calculated in order to compensate for the differences in the national VAT regimes since no harmonization of VAT was performed at the EU level. Also, the unique percentage rate, the so-called "obligatory rate" is calculated on the limited and harmonized VAT bases of all member states and cannot exceed 0.5% of the base;
- GNI (Gross National Income)-based own resources. Unlike VAT-based own resources, GNI-based own resources is charged as a single rate in proportion to the GNI of a single member state. There is no specific restriction mechanism applied here, the only limitation is the limitation of total own resources to 1.24% of GNI in the EU.

Member states are obliged to transfer funds generated by collecting their own resources into the EU budget. If they avoid doing so, the European Commission can file a special lawsuit within the European Court of Justice whose decisions always contain high penalties for the accused country or countries<sup>1</sup>.

In addition to the EU's own resources, the budget also belongs to the so-called miscellaneous revenue that is comprised of: fines, revenues generated by administrative activities of the EU institutions, contributions related to activities in the European economic area and other revenues. Although in the group *miscellaneous revenue* there is more income than in the group *own resources*, from the first group the EU budget accounts significantly less funds than from its own resources. This is, at the same time, the main reason why it is usually talked only about own resources as a source of EU budget funding.

Also, one of the elements of the EU's own resources system is the United Kingdom (UK) "abatement", "rebate" or "correction" mechanism. This mechanism, in effect since 1985, lowered the UK's contribution to the EU budget by reimbursing 66% of the country's budgetary

<sup>1</sup> Article 228 of the Treaty establishing the European Community provides that if a member state fails to fulfill its obligation to pay contributions to the budget, a suit may be brought against it before the European Court of Justice, requesting that the accused state pay a one-time fine.

imbalance (the difference between payments and receipts), but for the same amount increased the payment of other member states (with the exception of Germany, Austria, Netherlands and Sweden) [16].

Bearing in mind the evolving nature of the EU's own resources system, as well as many changes made in the past few years, general conclusion is that the current system abounds with shortcomings. First of all, it is very complex and non-transparent. The EU is mainly financed by VAT and GNI revenues, which, in fact, represent a form of contributions paid by member states. Therefore, there is no direct link between the EU budget and the EU citizens, which leads to limiting the financial autonomy of the EU. Also, the current system is very inefficient. The only real EU revenues are traditional own resources, which have a direct impact on relative market prices and allocation decisions. One more disadvantage is that the current financing system significantly distorts equality among member states. This is mainly due to the application of the general compensation mechanism and the reduction of the participation that individual member states pay on this basis [5].

### EU budget revenue for 2017

The EU's total budget revenue for 2017 amounts to 134.5 billion euros (Figure 1), and includes an inflow of funds from [7]: Traditional own resources of 21.5 billion euros (16%), VAT-based own resources of 16.6 billion euros (12%), GNI-based own resources of 93.6 billion euros (70%), and Miscellaneous revenues of 2.8 billion euros (2%).

Revenues are budgeted in a manner that is proportional to the wealth of each member state. UK, the Netherlands,

Germany, Austria and Sweden, however, have some benefits when finalizing their contributions. On the other hand, the EU funds are "converging" towards member states according to the priorities defined within the EU. Fewer prosperous member states receive proportionately more resources than those rich, so more countries receive more money from the budget than they give. Some early analyses were made about what consequences Brexit will have on the future EU budget [16].

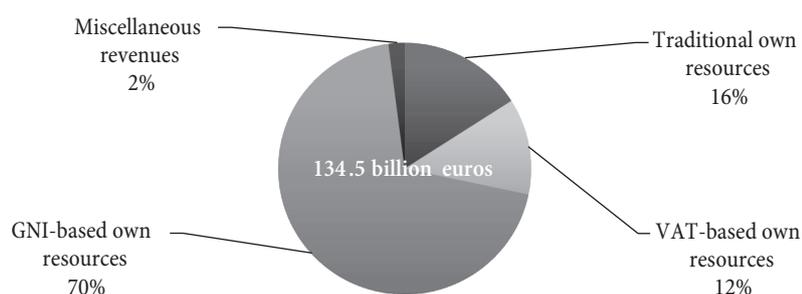
### EU budget expenditures for 2017

The total EU budget expenditure for 2017 amounts to 134.5 billion euros (Figure 2), and that includes funds allocated for [7]: Competitiveness for growth and jobs; Economic, social and territorial cohesion; Sustainable growth: natural resources; Security and citizenship; Global Europe; Administration; and Other special instruments.

By allocating funds for Competitiveness for growth and jobs in 2017 in the amount of 19.3 billion euros (14%), the EU member states have decided to devote most of the joint forces to creating a more economically sustainable development, which has become one of the EU's top priorities. The economy of the European Union has to be more competitive, and less developed regions have to catch up with others. Achieving long-term sustainable development depends on increasing the EU's development potential.

The allocation for Economic, social and territorial cohesion (linkage) in the amount of 37.2 billion euros (28%) shows that the EU member states are helping regions to a lesser extent, in order to transform their economy towards achieving global competitiveness. Innovation

**Figure 1: Structure of the EU budget revenue for 2017**



Source: Authors [7].

and the knowledge economy provide a new framework for the opportunities for launching economic growth in these regions.

Allocating funds for Sustainable growth: natural resources, in the amount of 54.9 billion euros (41%), are due to geographical and climatic diversity. EU countries produce a large number of different agricultural products, which European consumers can buy at reasonable prices. EU efforts in this field have two objectives: first, what products must correspond to what consumers want, including a high degree of safety and quality of agricultural products, and second, from the production point of view, manufacturers should plan and adapt products according to customer requirements, but in line with the environment, through the inclusion of direct environmental protection measures, the restructuring and diversification into the rural economy and the promotion of sustainable fishery. Animal diseases, oil spills and air pollution do not stop at national borders. Such threats require action in different fields and in a large number of countries.

Then, the allocation funds for Security and citizenship in the amount of 3.8 billion euros (3%) is for the fight against terrorism, organized crime and illegal immigration, because it is more effective if the EU member states share information and act together.

The allocation funds for Global Europe in the amount of 9.5 billion euros (7%) is because the impact of the EU funds does not stop at external borders. In many cases, the EU budget provides the necessary assistance in the emergency situations like natural disasters. In other cases, it is a long-term help in achieving prosperity, stability and security.

The allocation funds for Administration in the amount of 9.4 billion euros (7%) covers the costs of staff salaries and construction of all EU institutions, including the European Parliament, the European Council, the European Commission, and the European Court of Justice.

By allocation for Other special instruments in the amount of 0.4 billion euros (which are less than 1%), other costs are covered.

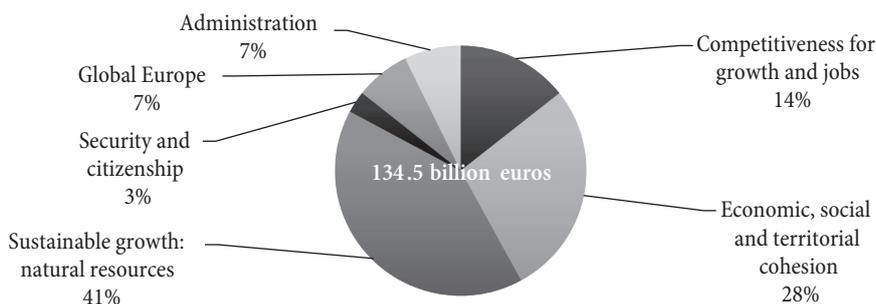
Almost half of total EU budget expenditures relate to sustainable growth: natural resources due to the fact that the common agricultural policy is one of the most important EU policies. On the other hand, allocations for administration are the smallest, but still very important, because without it functioning of the European Union would not be possible.

### Budget of Serbia

As part of the Serbia’s public finance system and policy reform on the road to the EU, in the middle of 2009, a new Law on the Budget System was adopted and on its basis a number of bylaws were adopted. That fully rounded up the matter of the budget system in Serbia.

With the aforementioned law regulating the planning, preparation, adoption, control and budget revision, the budget system in Serbia began to receive outlines of a developed market economies budget. Based on the fact that most European countries develop and improve their budget systems for one hundred years or more, it is understandable that in Serbia this is a system that is only being built and is undergoing many difficulties, ranging from inadequate personnel to the absence of a clear strategy for its development.

Figure 2: Structure of EU budget expenditures for 2017



Source: Authors [7].

## Elements and functions of the budget of Serbia

Following general activities that precede the formation of a budget, the identification of available resources and needs is the first of a number of practical activities that are carried out in the procedure for budget adoption.

Based on statistical data, sources are formed and potential resources are estimated. Serbia's resource for budgetary purposes is located in: taxes (VAT, property tax, corporate income tax, personal income tax), excises (special types of public revenues, in the literature referred to as "taxes on luxury"), and contributions for compulsory social security and customs [19].

Therefore, the available resources come from the economic activity of enterprises, i.e. from each activity of traffic and the transfer of values, rights and licenses between individuals. Based on the results of the previous year and the values of individual volumes, turnover and growth development projections for the next year, the planned budget inflows are formed, which are constantly monitored and, if necessary, their reassessment is carried out. The other side of the budget is for the use of budget funds. This side of the budget represents the needs of society and state institutions so that they can function. It is called public expenditures. Public expenditures are based on the financing following activities and functions: activities of public administration bodies and local self-government, activities of the Ministry of Interior, military activities, activities of public enterprises, health sector activities, education activities, etc. Based on the needs of individual budget users, the demand side of the budget is formed [19].

If there are significant differences between the amount of resources and needs, there is a deficit (resources are smaller than needs) or a surplus (resources are higher than needs) of the budget. If there is a budget deficit, it is necessary to determine in the process of budget adoption the ways to finance this deficit [21]. If a surplus is planned in the budget, it is transferred in the next year and its use is defined, most often in capital investments and formation of investment zones.

Since resources in modern conditions are limited and their effective use is imperative, it is completely logical

and understandable that in the set of all needs it is not possible to satisfy everything. It is necessary to prioritize among all needs and to choose the ones that are necessary and those that will lead to the fulfillment of the highest number of goals that are conditioned by the budgetary, economic and development policies in Serbia.

There are a number of economic functions of the modern state, but the most important ones are as follows: providing conditions for the best inflow of investments, adequate social policy (employment policy, social health care policy, etc.), then appropriate tax policy, which affects redistribution of income for the benefit of the poorer population through impact on consumption [23].

The advanced economic functions of the modern state are mainly incorporated into the Fiscal Strategy of the Government of the Republic of Serbia for 2017 with projections for 2018 and 2019, where, in accordance with the fiscal balance rule, fiscal consolidation will be focused on the limitation of current budget expenditures, in the state sector and pensions, while creating a space for increasing public investment. At the same time, the measures for the protection of the most vulnerable parts of the population will be strengthened through dedicated programs. By reducing the current consumption of the state sector, a room for maintenance and then an increase in public investment for the next medium-term period is created. Bearing in mind the limited resources, investments of national importance will have special significance in the planning of investments in the medium-term.

## Fiscal policy in Serbia

Uncontrolled fiscal deficits and the accumulation of public debt endanger economic stability, development prospects of the state and the well-being of future generations. Responsible fiscal policy is transparent, predictable and takes care of fiscal risks [24].

The effects of fiscal policy depend on how the public assesses the government's long-term policy. That means, if the government permanently increases public spending and fiscal deficit, the public can expect a significant tax increase in the future, which leads to a reduction in the expected future income of the population (wealth), and

consequently the current private consumption (net effects of fiscal expansion can be restrictive). Otherwise, if the government reduces public spending and if the public estimates that this is a permanent change of policy, the expected future income of the population (wealth) increases, private consumption and total domestic demand increases (the net effects of fiscal restriction can be expansive) [15].

The expectations of the private sector can significantly reduce, neutralize or even change the direction of the impact of fiscal policy (instead of expansionary, there are restrictive effects and vice versa). Given that the behaviour of the private sector depends on expectations, the government can try to manipulate expectations. If the Government violates the promises, the public will expect future violations of the promises, even when the Government really intends to implement them. In order to avoid the problem of time inconsistency in the realization of economic policy, it is necessary for the Government to commit to a certain type of policy. The obligation is assumed by the adoption of a particular law or by imposing certain restrictions on economic policy in the Constitution: it is forbidden that the Central Bank directly credits the state, it is forbidden for the Government to influence the monetary policy, the possibilities for the change of the management of the Central Bank are strictly restricted, limiting the maximum size of the public debt, limiting the maximum fiscal deficit, or the average fiscal deficit during the economic cycle is determined, and so on. In order for the legal provisions to work on expectations, it is necessary that the Government consistently implement the adopted rules over a longer period of time, to gain public confidence.

Fiscal rules should be general in order to allow different governments to implement different policies, therefore fiscal rules limit the basic aggregates: debt (in Serbia, public debt is limited to 45% of GDP), deficit (in Serbia, the deficit is limited to 3%), total expenditures and revenues, while the structure of revenues and expenditures is a matter of discretionary policies of different governments, although discretion is limited by other laws (in Serbia less than 20% of expenditures are discretionary) [24].

Fiscal rules have, on average, improved the fiscal performance of the countries in which they are applied,

and the importance of introducing rules is higher in developing countries, including countries in transition in which the institutions are weak, which was the case in Serbia. The main reasons for the introduction of fiscal rules are: relatively weak institutions, the existence of broad coalition governments, and the existence of the risk of excessive public debt growth. The introduction of fiscal rules is certainly part of the process of European integration (there has been a sharpening of EMU conditions after the experience with Greece).

Improving fiscal procedures introduces a medium-term horizon in fiscal policy where the government is obliged to: deliver the medium-term objectives and guidelines of economic and fiscal policy to the Parliament and the public, to publish medium-term expenditure frameworks, to quantify fiscal risks, and to analyze the fiscal implications of economic policies and reforms.

In many countries where there are fiscal rules, a fiscal council has been formed. In Serbia, the Fiscal Council and fiscal rules were established in October 2010 with the amendments to the Law on the Budget System. The new institution and new principles in the fiscal system of Serbia should help to achieve fiscal and financial stability, transparency and predictability. The mission of the Fiscal Council is to evaluate the credibility of fiscal policy from the aspect of respecting established fiscal rules and to ensure the publicity and accountability in the conduct of fiscal policy. Fiscal Council should improve the culture of fiscal responsibility in Serbia, give independent analysis of fiscal policy and foster expert discussions on fiscal policy. Serbia will be obliged, when it becomes a full member of the EU, to implement the rules prescribed by the EU fiscal intergovernmental Regulation No. 472/2013 [11], and in particular:

- The rule of a balanced budget (limiting the deficit in the amount of 0.5% of nominal GDP), and
- Mechanism for automatic correction of deviations from a balanced budget (EU recommendation is to introduce this mechanism at the level of the Constitution).

The Serbian Law on the Budget System stipulates similar fiscal rules, as well as the rules that apply in the EU, but the same unfortunately have not been applied fully

in Serbia, which will be shown in details in the following part of this paper.

### Serbia's budget revenues and expenditures in the period 2006-2017

This period was taken as the subject of the analysis, given that the budget of Serbia was in surplus only in 2006, while in the remaining years it was in a big deficit, which tells us that Serbia in the period from 2007 to 2017 did not comply with the fiscal rules prescribed by the Law on the Budget System (Table 1).

By analyzing the budget, we can conclude that the budget revenues and expenditures, in the observed period, were constantly increasing, that only in one year a budget surplus was achieved, and that in the 2006-2017 period a total deficit of 1,088 billion dinars was accumulated, which was financed through various loans on the domestic and foreign markets (Figure 3).

Also, by analyzing the Law on the Budget of the Republic of Serbia for 2006, 2007, 2008, 2009, 2010, 2011, 2012, 2013, 2014, 2015, 2016 and 2017, we can conclude that Serbia in the observed period conducted a mainly expansive fiscal policy, with constant growth of external

(and internal) debt. In the first year of the observed period, a surplus was achieved because the revenues from privatization represented a significant item in the total budget revenues, while in the subsequent years due to the lack of revenues from privatization and the reduced interest of foreign investors (due to investments risks), lack of capital and the global economic crisis, the budget revenue was reduced. In addition to these macroeconomic indicators, a significant element of the Serbia's budget is expenditure for government investments, through a national investment plan. This specifically implies an increase in the volume of investments in transport infrastructure, education, science and technology, as well as the establishing of industrial zones (which is expected to accelerate the attraction of foreign direct investment, employment, GDP growth and, consequently, export growth), as the most important macroeconomic indicators [1].

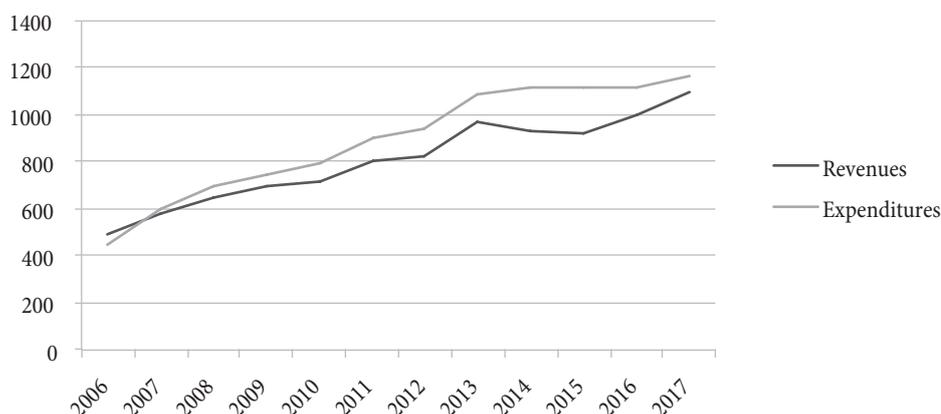
Growth in budget revenues came from (apart from privatization) growth in consumption and growth in economic activity in Serbia. We can notice that Serbia's budget revenues (and expenditures) more than doubled for the 2006-2017 period. It means that the budget and its constituents grew more than 10% per year, while the economy and production grew by an average of 1.7% [20].

**Table 1: Overview of Serbia's budget revenues and expenditures in the 2006-2017 period in billions of dinars**

Year	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Revenues	488	582	651	699	715	805	824	966	930	925	997	1,093
Expenditures	448	596	696	749	797	899	940	1,088	1,113	1,116	1,119	1,162
Deficit/Surplus	40	-14	-45	-50	-82	-94	-116	-122	-183	-191	-122	-69

Source: Authors [26].

**Figure 3: Growth of Serbia's budget revenues and expenditures in the 2006-2017 period in billions of dinars**



Source: Authors [26].

This information clearly tells us that the expansive fiscal policy was carried out during the observed time interval. Since this type of economic policy must be coordinated and given that in the course of one economic cycle (from 3 to 5 years) certain results can be achieved, in the absence of such results we can conclude that the elements of the budget were created in the wrong way. Most important events in this period were privatization on the revenue side, and costs of public enterprises restructuring on the expenditure side. Therefore, we can conclude that in the observed period, Serbia did not keep fiscal policy in line with the principles prescribed by the Law on the Budget System.

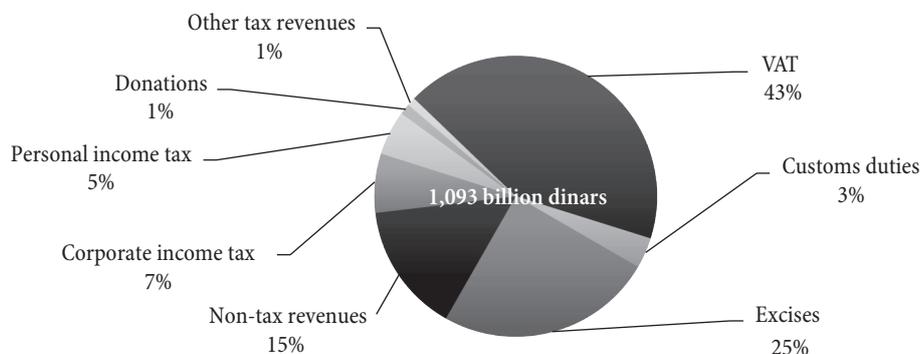
### Budget revenues and expenditures of Serbia for 2017

It should be emphasized that the total Serbia's budget revenues for 2017 [25] are nominally higher by 9.6% and amount to 1,093 billion dinars (Figure 4), in comparison to the total budget revenues in 2016; while the total Serbia's

budget expenditures for 2017 are nominally higher by 3.8% and amount to 1,162 billion dinars (Figure 5), compared to the total budget expenditures in 2016. Serbia's total budget revenues for 2017 include the inflow of funds from [25]: VAT in the amount of 466 billion dinars (43%), customs duties in the amount of 39 billion dinars (3%), excises in the amount of 271.5 billion dinars (25%), non-tax revenues in the amount of 163 billion dinars (15%), corporate income tax in the amount of 74.5 billion dinars (7%), personal income tax in the amount of 56 billion dinars (5%), donations in the amount of 13 billion dinars (1%), and other tax revenues in the amount of 10 billion dinars (1%).

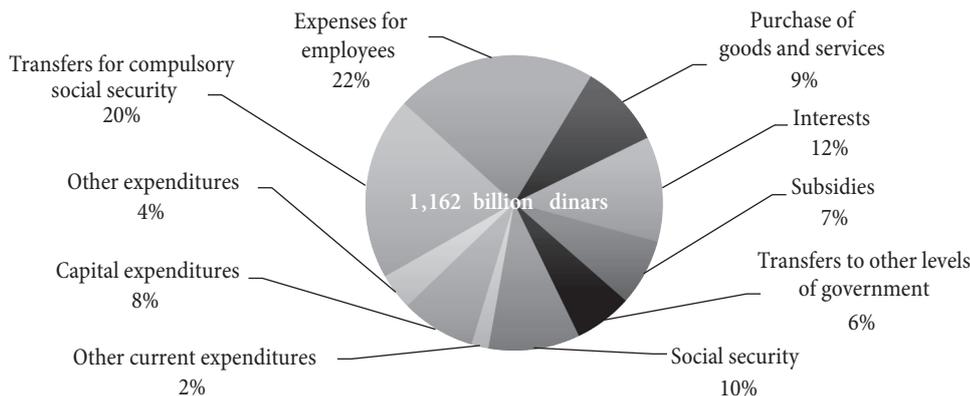
Serbia's total budget expenditures for 2017 include funds allocated for [25]: purchase of goods and services in the amount of 106 billion dinars (9%), interests in the amount of 134 billion dinars (12%), subsidies in the amount of 84 billion dinars (7%), transfers to other levels of government in the amount of 73 billion dinars (6%), social security in the amount of 116 billion dinars (10%),

Figure 4: Structure of budget revenues of Serbia for 2017



Source: Authors [25].

Figure 5: Structure of budget expenditures of Serbia for 2017



Source: Authors [25].

other current expenditures in the amount of 22 billion dinars (2%), capital expenditures in the amount of 94 billion dinars (8%), other expenditures in the amount of 46 billion dinars (4%), transfers for compulsory social security in the amount of 233 billion dinars (20%) and expenses for employees in the amount of 254 billion dinars (22%).

The Budget of the Republic of Serbia for 2017 is planned with a deficit of 69 billion dinars, which is 1.7% of GDP. The necessary funds for financing the budget deficit is provided from loans from domestic and foreign financial commercial and multilateral institutions and foreign governments, then through the issuance of government securities (bills and bonds issued on the domestic market in domestic and foreign currency), as well as from the revenue from the issuance of Eurobonds (government securities issued on foreign markets in domestic and foreign currency).

The Serbian government adopted a program of fiscal consolidation measures to stop further debt growth, and this program envisages a significant fiscal adjustment in the next three-year period (Table 2).

Even in the case of higher GDP growth rates, with the current state of debt, a strong shift and a change in the fiscal policy course is needed. The shift should be in the direction of applying measures to bring the actual fiscal deficit to the target in the medium term, given that the fiscal rules define the maximum level of deficit. The Fiscal Strategy established the fiscal framework by which the deficit in 2019 drops to 1% of GDP and the general government debt to 67% of GDP, in order to restore the stability of public finances and ensure sustainable debt financing.

If the Serbian government succeeds in achieving an ambitious plan foreseen by the Fiscal Strategy, we can expect Serbia to meet the strict fiscal rules of the EU even before joining the EU. However, we note that the intention

to comply with fiscal rules has also existed in the previous period, but it has not been implemented.

### The impact of the EU budget on the Serbia's accession process

After the political changes in 2000, the EU's accession becomes the main foreign policy priority of Serbia. European integration and entry into full EU membership are proclaimed as the strategic goal of the entire society. Achieving European perspective and looking at the future within the EU is one of the few topics on the political scene of Serbia around which almost all political factors and a large part of the citizens agree. In the preceding decade, the relations between the two have reached the point that the European Union has become Serbia's largest trading partner. With more than 60% of Serbia's total exports and total imports is realized with the EU as traditionally Serbia's key trading partner, and with over 3 billion euros in non-returnable aid invested in Serbia since 2000, the EU is also the largest donor of funds for support of political and economic reforms in Serbia [3].

Serbia is at the top of the list of EU aid per capita, which confirms that the EU's commitment to Serbia is long-term and solid. EU aid to Serbia is financed through the EU budget, precisely from the EU budget fund envisaged for a Global Europe [8]. The European Agency for Reconstruction in Serbia (EAR), which has been in the 2000-2007 period the main institution for the EU financial assistance distribution, was managing with a budget of close to 1.3 billion euros. The EAR started operations in Serbia in December 2000 when it implemented the Emergency Aid Program in the amount of 182 million euros, which was supposed to help the country recovery. In 2002, the EU strengthened its support to the long-standing challenges of economic development, the promotion of

**Table 2: Planned growth of Serbia's GDP, changes in fiscal deficit and general government debt in the 2017-2019 period**

Year	2017	2018	2019
Real growth rate of GDP in %	3	3.5	3.5
Fiscal deficit in % of GDP	1.7	1.3	1
General government debt in % of GDP	74	71	67

Source: Authors [14].

state administration and the rule of law. That year EAR managed a 168 million euros program for Serbia, which included reconstruction of infrastructure, SME support, reform assistance, and support to independent media and civil society. The focus in 2003, when the EAR in Serbia realized 216 million euros of aid, moved to the field of public finance, judiciary and internal affairs, as well as to the process of decentralization of administration. Support to Serbia's European path has also been high on the agenda of helping Serbia to harmonize institutions and regulations with EU-wide standards. In 2004, EAR managed a 206 million euros budget for reconstruction in Serbia, and in 2005 this budget amounted to 152 million euros. During this period, EAR's priority was to strengthen the partnership with the Serbian government in the process of European integration. The programs were aimed at improving economic development as well as paving the way for future foreign financial institutions investments. In 2006, the European Commission entrusted EAR with a budget of 148 million euros for the financial assistance to Serbia [18, p. 23].

Since September 1, 2008, the responsibilities of EAR have been transferred to the Delegation of the European Union to the Republic of Serbia. In April 2008, the Agreement on EU financial assistance to Serbia under IPA was signed, giving Serbia grants of approximately 170 million euros [18, p. 23]. This is the first tranche of the IPA funds to Serbia, which amounts to 1 billion euros for the entire period from 2007 to 2013. These funds are not a loan but a non-repayable aid, which should help accessing countries to reform, transform and prepare for membership.

#### The use of the Instrument for Pre-Accession Assistance - IPA

IPA is a directional mechanism created by the EU for the successful delivery of assistance to the countries of the Western Balkans and Turkey. This instrument is designed to help reforms in these countries through a single and flexible system, from which citizens would have direct benefits, while countries would receive additional assistance in meeting European standards. The total amount allocated

to IPA projects in this region for the 2007-2013 period amounted to 11.5 billion euros [6].

IPA has replaced the five previous EU instruments for pre-accession assistance: PHARE (Poland and Hungary Assistance for Reconstruction of the Economy), ISPA (Instrument for Structural Policies for Pre-Accession), SAPARD (Special Accession Programme for Agriculture and Rural Development), the Program for Turkey and CARDS (Community Assistance for Reconstruction, Development and Stabilization). IPA is based on needs. Therefore, its priorities are based on clear estimates. Key elements are: the accession or European partnership that the EU has introduced for each of the beneficiary countries, the European Commission's strategy for enlargement and the annual reports for each country.

The criteria for allocating funds take into account the capacities of each country to use the funds and manage them. They also take into account compliance with the conditions for accession. If conditions are not met, a suspension clause can be applied. In this way, IPA links the political framework for enlargement and the EU budget process. IPA provides various forms of assistance to countries that conduct political and economic reforms on their way to the EU membership: investments, subsidies, member states' experts to develop administrative cooperation, support activities for beneficiary countries, assistance in implementing and managing programs, and in exceptional cases budget support.

IPA also provides the EU with a coherent framework for governance and gradual decentralization or, in other words, management that it transmits to beneficiary countries. In addition, it provides flexibility in the application of assistance. IPA establishes a strong link between the budgetary and strategic aspects of enlargement. It makes it clear to the beneficiary countries what they can expect in terms of assistance, provided that they meet the conditions for obtaining it. In this way IPA further strengthens the guidance given by the EU to candidate countries and potential candidate countries on the priorities to be followed. But first of all, IPA helps countries which are EU neighbours and possible future EU members, to meet the standards and values on which the European Union is built. In this way we may consider IPA to be an

investment in the future for beneficiary countries, but also for the EU itself. It introduces a new focus in helping to expand the European Union.

IPA resources can basically be used in four ways [4]:

- As “technical assistance”, which usually involves the engagement of experts, consultants, who then provide services to Serbian institutions, prepare project documentation, prepare strategies, conduct workshops and trainings, etc.;
- Through “twinning” projects, in which local institutions “pare-up” with a similar institution from one of the EU member states, and implement a project of transferring knowledge, experience, assistance on the harmonization of regulations;
- Through “investment” projects, which mainly include the procurement of equipment, construction works, the implementation of financial arrangements with other financial institutions;
- Through “grants”, which represent the allocation of funds for financing specific civil society projects, local governments, agencies, etc.

Total value of EU financial support to Serbia through IPA funds for the 2007-2013 period amounts to about 1.1 billion euros, and the total sum intended for Serbia in the period 2014-2020 through IPA projects amounts to a total of 1.5 billion euros (about 200 million euros per year) [2].

In essence, IPA is the mechanism of additional assistance that EU provides for reforms in Serbia. At the current stage of European integration, Serbia can count on assistance in transition and institution building as well as cross-border cooperation.

Given that Serbia has formally become a candidate for the European Union membership (1 March 2012), it has accessed IPA funds for regional development, human resource development and rural development. By obtaining the candidate status, the entire pre-accession fund management will, from the EU Delegation in Serbia, move to Serbia through a “decentralized management system” of EU assistance. Previously, Serbia must build a system of independent institutions, authorities and control mechanisms that will ensure that the funds are used for the purposes for which they are intended.

This phase of IPA funds management is especially significant because it represents a preparation for EU membership. The decentralized management system corresponds to the way member states use funds from the EU’s structural and cohesion funds, so this system represents the “training” of institutions for functioning when Serbia becomes a member of the EU.

However, in contrast to the financial recourses available to Serbia from the EU funds, our country will, after receiving full EU membership, have to give up a certain portion of its national revenues that it will have to invest in a common EU budget, in accordance with the established mechanism for the functioning of the EU budget. How much will Serbia pay into the EU budget is difficult to predict at this time, but it will certainly be the subject of future negotiations with the EU.

## Conclusion

Even though the EU budget represents only slightly more than 1% of the combined GDP of member states, it has become an arena of political battles and numerous compromises within the EU. Compared to the national budgets, the EU budget has an almost unimportant role in the redistribution of income and the allocation of resources, as well as in the stabilization of the economy. EU funding is closely linked to the issues of relations between the EU and the member states and the specific nature of the European Union as a supranational institution. It is noticeable that the EU budget has items like large subsidies for agriculture and accession countries, because those objectives stand out in the plans and political goals of the EU itself.

An increase in the EU budget cannot be expected in the near future, as shown by the EU’s Financial Perspective 2014-2020. If the EU budget were to increase, it could be a built-in macroeconomic management stabilizer, and transfers between regions could increase economic convergence and EU cohesion. Given that there is no political will among member states to increase the budget and thus create a stronger political EU, it is not realistic that the EU budget becomes a major financial instrument for the EU’s developmental economic policy.

It is important to stress out that creating ESM does not create moral hazard, but enhances incentives for sustainable fiscal and economic policies in all countries of the Eurozone. For this reason, any financial assistance to a country is a subject to a very strict macroeconomic policy of conditioning. Financial assistance should not act as a fiscal transfer, but only as a bridge for liquidity that allows the Eurozone countries in trouble to “buy time” in order to take the necessary measures for restoring fiscal sustainability and competitiveness in the medium term. Therefore, it is of utmost importance that the range of measures focuses on crisis prevention and control policies in order to avoid the need to use the ESM. Based on everything else, especially considering the EU budget, it can be concluded that uncontrolled fiscal deficits and the accumulation of public debt endanger economic stability, development perspectives of society and the well-being of future generations in the European Union. If the EU member states, and in particular the Eurozone member states, fail to pursue a sustainable fiscal and economic policy, the crisis in the EU can deepen. There is more than one flaw to the current EU budget system, it is complex, inefficient and distorts equality among member states, but still this protection mechanism, especially in cases of crisis, is the most important function of the EU budget.

By analyzing the budget of Serbia in the period from 2006 to 2017, we can conclude that Serbia in the observed period conducted an active expansionary budget policy that was supposed to lead to the economic growth. However, a broad state apparatus with its increased consumption and an unreformed pension system, which accounts for almost half of the budget revenues, has not led to the expected growth in economic activity.

Fiscal policy in Serbia must be managed in accordance with the principle of fiscal responsibility, and with strict adherence to the legally prescribed fiscal rules, which in particular means slowing down the growth of public debt, reducing fiscal deficits, and generating savings among all budget users, otherwise it may result in a macroeconomic instability and slowing down of economic growth.

The growth of Serbia’s budget revenues came from the growth of consumption, the growth of privatization revenues, and the growth of economic activity in Serbia.

Serbia’s budget revenues (and expenditures) more than doubled between 2006 and 2017. The budget and its constituent parts grew by more than 10% per year, while the economy and production grew by an average of 1.7% of GDP. At the same time, there was an increase in the fiscal deficit, which was compensated by the increased state borrowing, both from international financial institutions and from domestic ones, which led to the growth of public debt in the amount of over 50% of GDP.

In order for the budget and budgetary policy in Serbia to be a key instrument of development economic policy, it is important to establish macroeconomic stability and to accelerate structural reforms of the public sector, and above all public enterprises. Economic policy should create the conditions for economic growth based on increasing investment, exports, savings, productivity and competitiveness, along with a reduction in macroeconomic imbalances, primarily fiscal deficits, public debt and inflation. Monetary policy must be harmonized with fiscal and should be focused on the stability of prices and exchange rate and on the stability of the financial system, while maintaining an adequate level of foreign exchange reserves.

Given that Serbia’s long-term goal is to join the European Union, an important prerequisite for this is that the state implements fiscal consolidation. It is also important to carry out the necessary institutional, political and economic reforms, especially bearing in mind that Serbia will have an obligation when it becomes a full EU member to implement the rules prescribed by the EU Fiscal Compact.

It should be emphasized that EU procedures in the period from 2000 to 2018 confirm EU readiness to receive Serbia in full membership, which is also indicated by the fact that Serbia is at the top of the list by the amount of financial support per capita. EU aid to Serbia is financed through the EU budget from allocation funds for Global Europe.

Through various forms of financial support and assistance, the total funds allocated to Serbia in the period from 2000 to 2013 amount to over 3 billion euros, and for the 2014-2020 period a total of 1.5 billion euros is planned. Whether the allocated funds will be used

depends primarily on the willingness and capability of the Serbian institutions to prepare appropriate development projects that will meet the strict EU rules for granting financial support.

Finally, the use of IPA funds is very important and represents a sort of preparation for the EU membership, as it is equal to the way member states use funds from the EU's structural and cohesion funds. It also represents a kind of "training" for the period when Serbia becomes a full EU member state.

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**Sanja Jelisavac Trošić**

works at the Institute of International Politics and Economics in Belgrade. She is Head of the Centre for International Organizations and International Law and editor in chief of the journal *Review of International Affairs*. Her main areas of academic interest include international economic relations, regional economic cooperation, Serbia's accession to the EU and intellectual property. Sanja obtained her PhD in 2013 from the Faculty of International Economics of the Megatrend University in Belgrade. Previously, after having graduated from the Faculty of Economics of the University of Belgrade (Department of Foreign and Domestic Trade), she majored in International Economics and gained the title of Master of Economic Sciences at the same Faculty. Sanja also completed specialization in High Administration and Comparative Administration (*Corso di specializzazione in Alta Amministrazione e Comparative Governance*), University of Bari, Italy, as well as Diplomacy and the Internet at the Diplomatic Academy in Malta.



**Biljana Stojanović-Višić**

holds a PhD in Economics and works at the PE Post of Serbia in Belgrade. She is a member of the International Paneuropean Union based in Strasbourg, and as a delegate from Serbia participated in numerous conferences throughout Europe, attended by senior European officials. She is a member of the Association of Business Women and Entrepreneurs of Serbia. The main areas of her academic interest are European integration, Serbia's accession to the EU, socially responsible business and business communication. She obtained her PhD in 2016 at the Faculty of Business Studies in Belgrade, John Naisbitt University. She defended her master thesis in 2008 at the Faculty of Management in Zaječar, where she completed her basic studies in 2004. She graduated from the ICT College of Vocational Studies, University of Belgrade, in 2002. She also completed the course of diplomatic protocol of the *Instituto Europeo Campus Stellae*.