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Efekti fiskalne politike na Republiku Srbiju i zemlje u okruženju

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Apstrakt: Fiskalna politika predstavlja moćan instrument za stabilizaciju nacionalne ekonomije, i uz pomoć nje se kontroliše nivo i struktura poreza, izdataka i upravljanje dugom. Upravljanje fiskalnom politikom utiče na agregatnu tražnju, distribuciju bogatstva i sposobnost ekonomije da proizvodi dobra i usluge. Ona predstavlja alat makroekonomske politike a u ovom radu autori će se naročito baviti uticajem fiskalne politike na određene makroekonomske komponente: javni dug, platni bilans, ali i na privlačenje stranih direktnih investicija i konkurentnost. Države moraju da vode odgovornu fiskalnu politiku u skladu sa svojim mogućnostima kako bi smanjile siromaštvo i socijalne nejednakosti, a istovremeno obezbedile privredni rast. Fiskalna održivost je složeno pitanje naročito u periodima krize i zato je potrebno donositi odluke koje će dugoročno imati pozitivne efekte na privredni razvoj.

Ključne reči: fikaslna politika, privredni razvoj, javni dug, konkurentnost

Effects of Fiscal Policy on the Republic of Serbia and Neighboring Countries

Abstract: Fiscal policy is a powerful instrument for stabilizing the national economy, and with its help the level and structure of taxes, expenditures and debt management are controlled. Fiscal policy management affects aggregate demand, the distribution of wealth, and the economy's ability to produce goods and services. It represents a tool of macroeconomic policy, and in this paper the authors will particularly deal with the impact of fiscal policy on certain macroeconomic components: public debt, balance of payments, but also on the attraction of foreign direct investments and competitiveness. States must conduct a responsible fiscal policy in accordance with their capabilities in order to reduce poverty and social inequalities, and at the same time ensure economic growth. Fiscal sustainability is a complex issue, especially in periods of crisis, and therefore it is necessary to make decisions that will have positive effects on economic development in the long term.

Keywords: fiscal policy, economic development, public debt, competitiveness

1. Introduction

Taxes are one of the most important and powerful instruments of the state through which it redistributes GDP, so taxation has its economic, social, regional, and political dimensions. They also represent a key component when it comes to a country's international competitiveness, so it is important to favor tax incentives in order to make the economic environment more competitive. The main characteristic of tax systems in countries in the region is low tax rates on capital and labor, with the aim of providing appropriate guarantees for their economic performance in business investments and activities. In recent years, all Balkan countries have recognized this fact and have embarked on tax law reforms to become more competitive (Taxation trends in Western Balkans, 2020).

States must pursue responsible fiscal policies in line with their capabilities in order to reduce poverty and social inequalities, which are particularly pronounced in rural areas where agriculture is the dominant economic activity. Economic policy should not be limited to responsible implementation of fiscal policy alone but should encompass all elements that contribute to sustainable development. This should involve all social groups that will reduce inequality and create conditions for economic development (Veselinovic et al., 2019). The reform of corporate profit tax in Serbia has abolished some tax incentives, such as incentives for companies for professional rehabilitation, for companies operating in free zones, for companies operating in underdeveloped areas, tax credits, etc. It is estimated that the abolition of these incentives, under the conditions of still low tax rates, is justified and will contribute to reducing the possibility of abusing tax incentives, but it will not significantly contribute to an increase in tax revenues, as the number of companies that have used these incentives is very small. Considering that even with a rate of 15%, the tax burden on profits for companies in Serbia will be significantly lower than in most other European countries, retaining these incentives is considered unjustified and an expensive mechanism for attracting foreign direct investments. Based on empirical analysis in other Central and Eastern European countries, we come to the conclusion that tax incentives do not significantly contribute to the inflow of foreign direct investments.

2. Effects of Taxation Policy on Economic Development

Despite the contribution taxation can make to the gross domestic product (GDP) of a country overall, it is important to pay close attention to the secondary effects of taxes on the growth of small and medium-sized enterprises (SMEs). This is because SMEs play a crucial role in driving economic growth both in developing and developed countries. Taxes imposed on income are only worthwhile if they can generate significant revenue at acceptable rates and procedures (Musgrave and Musgrave, 1984). According to Gordon and Dawson (1987), through taxation, the government takes money from individuals that would otherwise be spent in the private sector. As a result, the purchasing power per unit of production in the private sector diminishes. They further argue that one of the most common arguments against taxes is that they destroy incentives for business people and employees to work more and efficiently. A study on SMEs shows that regulations and laws concerning companies in the manufacturing and retail sectors have a negative impact on SMEs (Oludela and Emile, 2012). Atavodi and Ojeka (2012) explain that the choice of tax policy for employment depends on the use of one or both sets of instruments. The first is the use of special tax privileges and other incentives to support the establishment and growth of small companies (Atavodi & Ojeka, 2012). These incentives consist of reducing corporate tax rates, special tax exemptions or reliefs, and concessions for small enterprises. The underlying reason for all of this is to effectively increase revenue through measures that suit the country's circumstances and administrative capacity (Atavodi & Ojeka, 2012).

Fiscal policy can play an important role in fostering innovation through its effects on research and development, entrepreneurship, and technology transfer. However, some scholars have shown that excessive government financial intervention hinders the technical input and output of companies (Busom, 2000; Klapper and Larraín, 2012). Zhang et al. (2017) found that the corporate profit tax inhibits investment in innovation in the Eastern region; the tax burden on companies in the Eastern region is higher than in the Central and Western regions, but companies in the Eastern region attract more innovative investments.

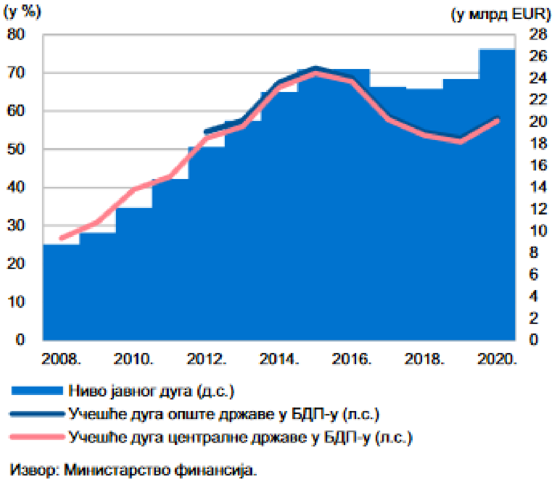
Different results on the effectiveness of tax incentives for research and development do not provide a valid basis for dismissing the effectiveness of such incentives. A successful fiscal strategy for research and development largely depends on understanding the benefits of different policy instruments.
Government fiscal subsidies and tax incentives are the two most important policy instruments for the government to support business innovation (Lee, 1996; Aghion et al., 2012). In many economies, fiscal subsidies and tax incentives have become an integral part of a broader strategy to increase investment in research and development and promote innovation.

3. Fiscal Consolidation of the Republic of Serbia

In 2020, the Republic of Serbia recorded a fiscal deficit amounting to 442.8 billion dinars, or 8.1% of GDP (compared to 0.2% of GDP in 2019). Examining the levels of government, the general government budget deficit of the Republic of Serbia amounted to 459.1 billion dinars.

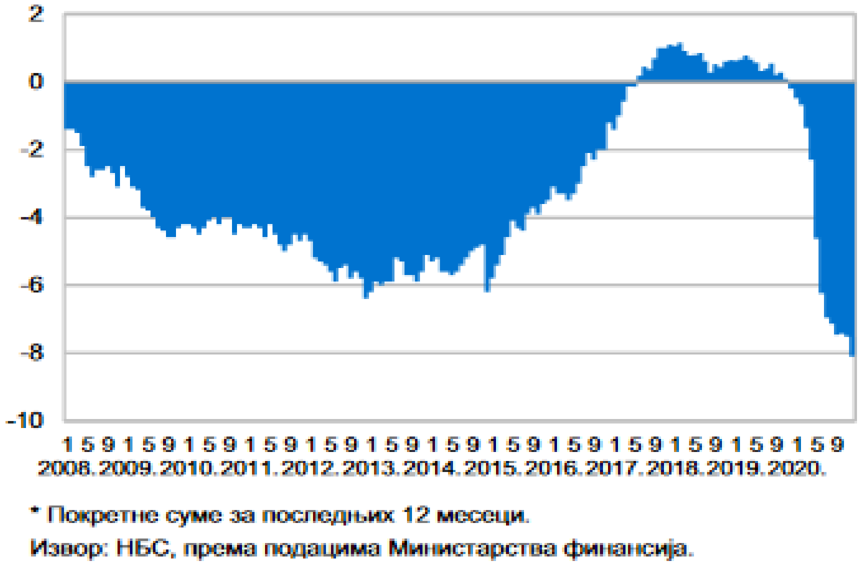
The primary fiscal result in 2020 was also negative, reaching 332.5 billion dinars, or 6.1% of GDP (compared to a positive primary result of 1.8% of GDP in 2019). Considering that interest costs are a consequence of fiscal policy and past deficits, the primary fiscal result indicates that the fiscal revenues generated were sufficient to cover fiscal expenditures that are not a result of debt servicing costs.

Graph 1. Public Debt Trends



Achieved macroeconomic and fiscal stability, as well as the timely implementation of monetary and fiscal policy measures, have been confirmed by maintaining the credit rating throughout 2020. The credit rating agency, Fitch Ratings, maintained Serbia's credit rating for long-term domestic and foreign currency borrowing at the level of BB+ (one step below investment grade) with stable outlooks in March and September 2020, and then in March 2021. This was possible due to Serbia's strong economic indicators, which were sustained even during the COVID-19 pandemic.

Graph 2. Fiscal Result Trends (% of GDP)



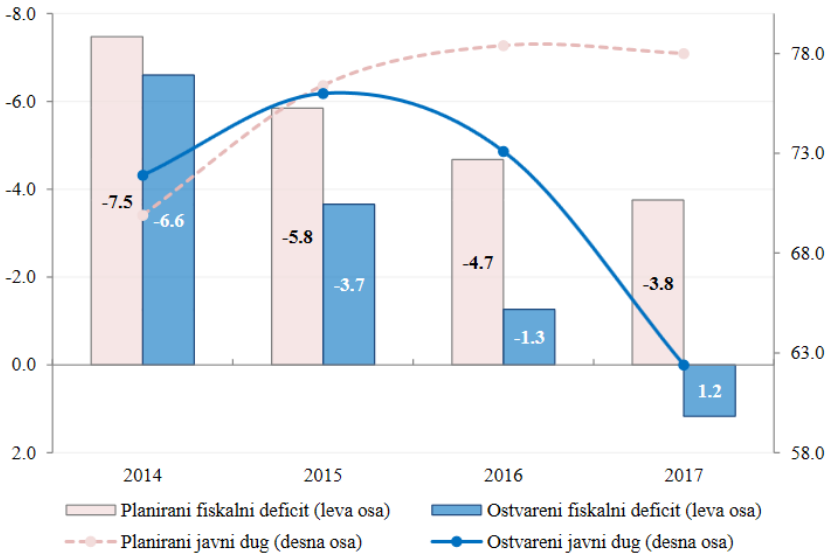
Tax rates in Serbia are currently lower than the average in the Central and Eastern European region, and significantly lower compared to Western European countries. Value-added taxes burden domestic consumption. This form of taxation does not diminish the international competitiveness of the Serbian economy. The current corporate profit tax rate in Serbia of 15% is in line with the regional tax rate and does not pose a significant obstacle to its economic growth. An optimal approach to reducing the tax burden that would stimulate economic activity is the reduction of wage taxes. By reducing labor costs, the domestic economy would become more competitive compared to other countries in the region. (Fiscal Council of the Republic of Serbia, 2019)

Table 1. Tax Rates in the Republic of Serbia and Surrounding Countries

Country	Income Tax and Contributions	VAT	Corporate Profit Tax
Bulgaria	52	20	10
Czech Republic	78	21	19
Croatia	67	25	18
Hungary	79	27	9
North Macedonia	48	18	10
Romania	75	19	16
Slovakia	78	20	21
Slovenia	78	22	19
Montenegro	68	21	9
CEI Average	69	21	15
Serbia	62	20	15

Source: Calculation by the Fiscal Council based on official national statistics

Image 1: Fiscal result and public debt 2014-2017, plan & realization (% of GDP)



Source: IMF (2015). Republic of Serbia: 2014 Article IV Consultation and Request for Stand-By Arrangement – Staff Report; Press Releases; and Statement by the Executive Director for the Republic of Serbia. IMF Country Report 15/50.

In 2015, the Republic of Serbia reached its highest level of public debt, which was the moment that called for serious fiscal consolidation. A more detailed analysis can identify three main reasons responsible for this unplanned increase in public revenues, driven by domestic factors and favorable international circumstances. These reasons include:

- Improvements in the macroeconomic environment,
- More efficient tax collection,

- Combating the informal economy (with some minor changes in tax policy) and several one-off factors that temporarily boosted public revenues in 2017. (Fiscal Council of the Republic of Serbia, 2018).

The largest contribution to the unexpected increase in public revenues during the period of 2015-2017 (around €700 million) can be attributed to higher economic growth than projected by the program. Accordingly, labor market developments also exceeded initial expectations, resulting in nearly three-quarters of the overall increase in public revenues coming from higher contributions for mandatory social security and income taxes. The remaining unplanned increase in public revenues is reflected in higher VAT and customs revenue due to a stronger recovery of private consumption.

4. Effects of Fiscal Policy on Surrounding Countries

It is important to note that differences between macroeconomic projections and actual economic performance are one of the most common reasons (positive or negative) for deviations in fiscal results compared to the fiscal consolidation plan (Mauro & Villafuerte, 2013). It is evident that there have been macroeconomic improvements that generated high revenue growth. It is estimated that this partly occurred as a result of fiscal consolidation itself, which contributed to reducing the country's risk and consequently lowering interest rates on government and private sector borrowing, thus providing a stimulus to economic growth. However, what seems indisputable at this moment is that it is largely a positive shock that came from external sources, as the macroeconomic developments in Serbia and other Central and Eastern European (CEE) countries have been exceptionally favorable in the past few years. Exploring the drivers of economic growth in CEE countries during 2015-2016, Petrović et al. (2017) have shown that a significant portion of the unexpected acceleration of regional economic activity (including Serbia) in the observed period can be explained by the positive impact of external factors such as the decline in commodity prices (particularly oil and gas), lower interest rates in Europe, and increased export demand for these countries due to a stronger recovery of the Eurozone and the CEE region itself.

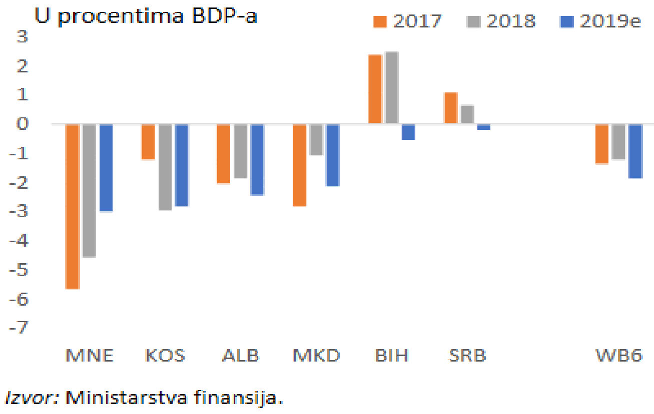
Many transitional countries have realized that fiscal policy is a powerful tool for attracting foreign investments. During the 1990s, countries in Central Europe used "tax holidays" and other fiscal incentives for this purpose. As a result, there was an increase in the volume and quantity of capital inflows, leading to economic growth in those countries and an increase in their competitiveness.

As taxpayers strive to reduce their tax liability to the lowest possible level, they have an interest in taking advantage of tax breaks offered through tax competition between countries. There is a conflict of interest for the state, on the one hand, to attract as many investments as possible (through lower tax burdens), and on the other hand, to collect as much revenue as possible to finance public functions (through higher tax burdens). Research conducted by Djankov et al. (2010) shows that taxes in non-OECD countries affect FDI flows, but they do not have a significant impact in OECD countries.

In recent years, economic growth and fiscal consolidation have contributed to the improvement of the fiscal position in Western Balkan countries. However, aggregate data conceal the existence of underlying sensitivity factors. After reaching high values of over 4% of GDP in 2013 and 2014, deficits since 2016 have not exceeded 2% due to fiscal consolidation measures taken by countries in this region. Nevertheless, expenditure structures have changed slowly, and countries with inflexible consumption patterns have little fiscal space for maneuvering.

Some countries, such as Bosnia and Herzegovina (BiH) and North Macedonia, have implemented consolidation measures by limiting capital expenditure. Despite fiscal consolidation efforts in all of these countries, expenditures for mandatory items such as wages in the public sector and pensions remain high. BiH and Montenegro spend relatively less on wages in the public sector compared to 28 EU member states or smaller EU member countries. Additionally, social benefits in BiH, North Macedonia, and Serbia are more generous than in smaller EU countries. All of this indicates that countries in the region have less flexible budgets and narrower room for maneuvering in times of crisis.

Picture 2. Fiscal balance of observed countries.



Furthermore, after two years of tightening fiscal policies, several countries in the Western Balkans have relaxed these measures, resulting in the depletion of funds that are now crucially needed. The deficit in this region increased by 1.8% in 2019, representing a 0.6% GDP increase compared to the previous year.

5. Effects of tax policy on external trade and balance of payments

Fiscal policy is the management of the national economy using fiscal policy tools. It involves adjusting government spending and taxation to influence the economy in desired directions. On the other hand, the balance of payments is the accounting record of financial transactions (receipts and payments) between the domestic economy and the rest of the world. These transactions include the import and export of goods and services, as well as the flow of capital and financial transfers. The main components of this account (balance of payments) include the current account and the capital account. Any imbalance between a country's income (exports, receipts of loans and investments) and payments (imports, foreign investments) can result in the country accumulating net foreign assets or liabilities in the case of a surplus or a decrease in reserves in the case of a deficit in the balance of payments.

A country's foreign reserves are crucial for its economic stability, and therefore, managing them is an important responsibility of any government. To achieve this goal, the national government has various tools at its disposal, including fiscal policy. By adjusting different fiscal policy instruments, the government is able to steer or influence the economy in the desired direction.

Most developing countries face the challenging task of fiscal management due to multi-year resource deficits resulting in high levels of borrowing and high interest rates on borrowed funds. This has led to a fiscal crisis exacerbated by weak institutions, spending and tax control, debt servicing, and unstable domestic capital flows (Talvi, Vegh, 2005; Blejer, Chu, 1989).

When considering fiscal policy in terms of competitiveness among countries in the region (BIH), it can be said that it is not the most significant factor for economic growth and attracting investments, especially in conditions of fiscal deficits and a global crisis. It is even increasingly perceived as a reflection of unfair competition under conditions of fiscal deficits and a global crisis. In comparison to neighboring countries, no level of government has excessively high tax burdens. The key cause of weak competitiveness should be sought in other factors. Tax policy can only provide limited contributions, mainly through simplifying administrative procedures to make them more favorable to foreign and domestic investors, and thus, be easily understandable and implementable.

6. Conclusion

Fiscal policy in modern business conditions is an important tool for stabilizing economic and social policies, and public revenues, expenditures, and public debt are powerful forms of government intervention. Tax systems reflect the effects of global trends in which many public goods have crossed national borders and become global, while national governments are facing increasing difficulties in financing their public needs. In practice, taxes are seen as a tool for achieving budget revenues, and elasticity is expected from them, that is, the ability to quickly adapt to emerging changes in order to establish budget equilibrium. Tax elasticity is particularly important in conditions of economic growth, as it requires high government investments in infrastructure, and revenue growth ensures that such investments are not financed by foreign sources or domestic borrowing.

After the year 2000, the Republic of Serbia implemented significant reforms of its tax system, following the examples of tax systems in European Union countries, and similar policies were pursued by countries in the region. Tax competition has emerged among these countries, manifested through the reduction of tax rates on corporate profits and the provision of significant incentives to foreign investors, with the aim of attracting foreign capital and promoting faster economic development. It is necessary to ensure stable business conditions over a longer period of time, through the influx of foreign and domestic investments in sectors that can be drivers of sustainable growth and economic development.

The structure of the tax system provides stable and relatively high tax revenues that approximate the relative tax revenues in Europe, although tax rates are generally moderate or significantly lower than the European average. The reason for this lies in the structure of the economy, as Serbia is a net importer while most European countries are net exporters. It is estimated that the structure and creation of such a tax system in Serbia are relatively favorable from the perspective of stimulating economic growth, as the rates of the most distortionary taxes (profit tax and income tax) in Serbia are significantly lower than the European average, and there are also incentives for entrepreneurship and investment in innovation.

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