Analysis on Public Debt

Serbia

CSOs as equal partners in monitoring public finances

September 2017

BALKAN MONITORING PUBLIC FINANCES

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CREDITS

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This document has been produced as a part of the project "CSOs as equal partners in the monitoring of public finance", which started beginning of 2016 and is implemented by a consortium of 10 organizations from 7 countries and will last for four years.

The aim of the project is to improve the transparency and accountability of policy and decision making in the area of public finances through strengthening the role and voice of NGOs in monitoring the institutions that operate in the area of public finances. In this way, the project will strengthen CSO knowledge of public finance and IFIs and improve CSO capacities for monitoring. Additionally, it will help advocate for transparency, accountability and effectiveness from public institutions in public finance. Moreover, this project will build know-how in advocating for sustainability, transparency and accountability of public finance and IFIs. This project will also increase networking and cooperation of CSOs on monitoring of public finance at regional and EU level. Lastly, it will increase the understanding of the media and wider public of the challenges in public finance and the impacts of IFIs.

Key project activities are research and monitoring, advocacy, capacity building and transfer of knowledge/practices and networking in the field of the 4 specific topics: public debt, public-private partnerships, tax justice and public infrastructure.

More information about the project can be found on http://wings-of-hope.ba/balkan-monitoring-public-finance/ and on the Facebook Page Balkan Monitoring Public Finances

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CONTENT

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INTRODUCTION

In process of fulfilling its by constitution and laws assigned role of social cohesion, provision of protection of human rights, provision of utilization of public ownership for public benefit (both naturally goods, different things- infrastructure in general sense of word and also financial goods in ownership of republic that are defined by separate laws) Republic of Serbia has obligation to collect resources which are used for the purpose of funding competences of the Republic of Serbia, autonomous provinces and local self-governments and that are provided from taxes and other revenues, stipulated by the Law.

Taxes and other revenues coming from utilization of public goods and taxes for socially added value are obligation to pay to every physical and legal person thus showing in practice sovereign right of society personified in Republic of Serbia to direct social development of Serbian society. While paying taxes and other duties that are general and based on economic power of taxpayers every individuum is accepting sovereignty of Republic to direct development (social contract) of society which is happening thorough formulation of budget of Republic of Serbia that is expression of all the roles of republic and all of its functional "members" all entities that are responsible for the provision of predominantly non-market services and redistribution of income and wealth at all government levels.

As such Budget is basic economic instrument of republic of Serbia and it serves as funding instruments of the obligations of Serbia and as instrument of development of basic social, economically and other instruments necessary for sustaining and improvement of material and other basis of social life. In the case when such obligations do demand more resources than available or when republic does consider that future income will enable repayment of borrowing for fulfillment of different obligations it has constitutional right to borrow in different forms and with different periods of repayment.

Social situation and demographic downturn in Serbia are showing that budgetary process (collecting, planning, executing) is failing to respond to obligations assigned by constitution. In same time number of destructive infrastructural projects and financially destructive "supportive" mechanisms for foreign and domestic corporations with detrimental socially, economically and environmentally consequences are representing big danger for the future economically and budgetary sustainability of country leading country in the situation of so called captured state where non transparent decision making about public good (both naturally, anthropogenic and financially) is leading to not sustainable social consequences and is serving the wasted private and "politically" interests of elites.

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1. LEGAL FRAMEWORK ON PUBLIC DEBT

1.1. Institutional Framework and Regulation of the Public Debt

Serbia's public debt is legally regulated by the Constitution of Serbia, *Law on Public Debt*, the *Law on Budgetary System*, *Law* on *Budget* and the *Law on the Conclusion and Implementation of International Agreements*.[1] There are also secondary legislations in the form of regulation and decisions governing mainly the issuing and sales of government securities.

Constitution of Serbia regulates that Serbia should fulfill its obligations related to fulfillment of its by constitution and by separate laws assigned duties using material resources collected thorough taxation and other fees established by separate law[2]. Obligations assigned to State of Serbia, provinces of Serbia and autonomous local communities are assigned by constitution of Serbia and separate laws. Constitutional obligations fulfillment is being financed by Budget of Serbia ad budgets of autonomous provinces and those of local communities. Those resources are collected and systematized within the Budget of Republic of Serbia, Budgets of autonomous provinces, Budgets of cities and municipalities of Serbia .[3]

Law on budgetary system regulates formulation of budgets and its implementation moreover it regulates issuing of guarantees and contra guarantees to for the local self-governments, public companies and public utilities.

Important characteristics of the Budget is that income and liabilities of the budget should be in the equilibrium and that short term and long term liabilities cannot overcome by law regulated levels. As regulated by Law on public debt Republic can borrow a) Liquidity borrowing means taking loans and/or issuing government securities for the purpose of financing imbalances of revenues and expenses of the budget during a budget year, b) Borrowing for budget deficit financing means taking loans and/or issuing government securities. For this borrowing, the amount of debt is carried forward to the following budget years, c) The Republic may borrow for refinancing purposes by taking loans and/or issuing government securities, d) Borrowing for investment projects financing means taking loans and/or issuing

[1] http://www.javnidug.gov.rs/default.asp?P=42&MenuItem=3
[2] https://www.ilo.org/dyn/natlex/docs/ELECTRONIC/74694/119555/F838981147/SRB74694%20Eng.pdf. Article 91 of constitution of Serbia
[3] https://www.ilo.org/dyn/natlex/docs/ELECTRONIC/74694/119555/F838981147/SRB74694%20Eng.pdf, Article 92 of Constitution of Serbia and BUDŽET REPUBLIKE SRBIJE and PREGLED PRIHODA I RASHODA, UDK: 336.14/.153(497.11)"2005/2014", page 2.

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government securities for the purpose of financing development projects which would enable improvement, efficiency and effectiveness of the industry and provide for social development of the Republic, provided that the financing lasts longer than a year.

Budget is reflection of social role of state , or rather it is reflection of priorities of civilizational development and as such it is historically developed. Monitoring of implementation of all the obligations assigned (contracted) in budget of Serbia is assigned to the Supreme auditory institution.[4] Parliament of Serbia is the one that discusses and approves Budget of Serbia after its approval from side of Government and also it is discussing it **after** Parliament **obtains the opinion** of Supreme auditory institution.[5]Supreme auditory institution is established by constitution, it is independent, it is assigned obligation to revise public resources in State of Serbia, and it is responding to the parliament of Serbia. Separate law is regulating work of Supreme auditory institution.[6]

[4] https://www.ilo.org/dyn/natlex/docs/ELECTRONIC/74694/119555/F838981147/SRB74694%20Eng.pdf,, Article 92, point 2
[5] https://www.ilo.org/dyn/natlex/docs/ELECTRONIC/74694/119555/F838981147/SRB74694%20Eng.pdf,, Article 92, point 3
[6] https://www.ilo.org/dyn/natlex/docs/ELECTRONIC/74694/119555/F838981147/SRB74694%20Eng.pdf, article 96

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2. PUBLIC DEBT

Table 1, Debt statistics, public Debt Administration, June 2017,

Debt stock of the Republic of Serbia

PUBLIC DEBT OF THE REPUBLIC OF SERBIA DEBT STOCK OF THE REPUBLIC OF SERBIA ON JUNE 30, 2017			
	In Thousands		*In Million*
A. Direct Liabilities	EUR	USD	RSD
I - Total Domestic Debt (direct liabilities)	8,972,935	10,264,143	1,084,367
II - Total External Debt (direct liabilities)	12,997,898	14,868,299	1,570,778
IBRD	1,940,597	2,219,849	234,518
IDA	353,288	404,127	42,694
EIB	989,354	1,131,722	119,562
EBRD	80,123	91,653	9,683
CEB	75,121	85,931	9,078
Foreign Government loans	2,894,508	3,311,028	349,797
Eurobonds	4,589,561	5,250,000	554,642
KfW Development Bank	80,220	91,764	9,695
Paris and London Club of Creditors	1,402,287	1,604,076	169,464
European Union	120,700	138,069	14,586
IMF	472,139	540,080	57,057
Commercial Bank loans	0	0	0
Total Direct Liabilities (I + II)	21,970,833	25,132,442	2,655,144
B. Contingent Liabilities	EUR	USD	RSD
III - Total Domestic Debt (contingent liabilities)	297,595	340,419	35,964
IV - Total External Debt (contingent liabilities)	1,626,582	1,860,648	196,570
EBRD	511,465	585,065	61,810
EIB	792,220	906,221	95,739
KfW	70,708	80,883	8,545
European Union	0	0	0
EUROFIMA	47,497	54,332	5,740
IDA	12,911	14,769	1,560
Japan International Cooperation Agency - JICA	3,790	4,335	458
Foreign Government loans	32,768	37,483	3,960
Commercial Bank loans	155,223	177,560	18,759
Total Contingent Liabilities (III + IV)	1,924,177	2,201,066	232,534
C. Non-Guaranteed Local Government Debt	EUR	USD	RSD
V - Total Domestic Non-Guaranteed Local Government Debt	245,976	281,372	29,726
VI - Total External Non-Guaranteed Local Government Debt	102,485	117,232	12,385
Total Non-Guaranteed Debt (V + VI)	348,460	398,604	42,111
Central Government Debt (A + B)	23,895,010	27,333,508	2,887,679
General Government Debt (A + B + C)	24,243,471	27,732,112	2,929,789

Taxation, collection of other by law regulated fees excises and other incomes are source for financing of obligations of Republic of Serbia, its Government and governmental institutions and agencies, President of Serbia and other state institutions (education, security, social care etc) in the fulfillment of their obligations. Constitution of Serbia lists all the systems and obligations that Republic of Serbia (its

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Parliament, its Government and other institutions) should fulfill using resources organized within budget of Serbia.[7]

In the cases when fulfillment of obligations of Republic of Serbia including developments of infrastructure or other investments that are considered that those are of national interest[8] or are in the realm of regular obligations of Republic of Serbia but without provided for sufficient financial resources from regular sources of income, or if it considers that it will be able to improve fulfillment of its obligations in providing material basis for equal development of material conditions of life in all the regions of Serbia and for all the, or to fulfill in better and more prosperous way its obligations to improve (regulate) and improve environment, sustainable development, infrastructure, natural common goods, social security , health system etc according to article 94 and 97 of constitution of Serbia it has right to borrow money in national or foreign currencies under the conditions regulated by separate law (according to law on Public Debt)[9].

According to Serbia constitution Serbia has right to take loans or as article 93 of constitution regulates "The Republic of Serbia, autonomous provinces and local self- government units may be indebted. Terms and procedure of getting into debts shall be stipulated by the Law.[10]

According to Serbian Law on public debt, article 2, point2:
"Public Debt is:
(1) Debt of the Republic, based on agreements concluded by the Republic;(2) Debt of the Republic based on issuing securities (3) Debt of the Republic based on contracts/agreements according to which obligations of the Republic, pursuant to previously concluded agreements, have been rescheduled;(4) Debt of the Republic, based on the guaranty issued by the Republic and/or based on counter-guaranty issued by the Republic; (5) Debt of local government and legal entities indicated in Article 1 hereof for which the Republic has issued guarantees."[11]

[7] Ibidem, article 97
[8] (nota bene, we do consider that such process of discussing such public interest is not actually regulated properly and that the present setting of institutions and practice of discussing public interest in parliament of Serbia and in corridors of not transparent decision making process in Government of Serbia does not guarantee protection of public interest and does not at all provides strategically opportunities for citizens of Serbia to participate in reality)
[9] **PUBLIC DEBT LAW** , "Official Gazette of the Republic Serbia", No.61/2005, 107/2009 and 78/2011.
[10] https://www.ilo.org/dyn/natlex/docs/ELECTRONIC/74694/119555/F838981147/SRB74694%20Eng.pdf, article 93
[11] "
Official Gazette of the Republic Serbia", No. 61/2005, 107/2009 and 78/2011., http://ujd.gov.rs/upload/Zakoni/Zakoni%20engleski/Public_Debt_Law_RS.pdf

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Serbian Law on budgetary system is regulating maximum allowed level of **public debt as 45% of national GDP**".[12] According to law on public debt, article 3: "The Republic may borrow in country or abroad, i.e. on domestic or foreign market. "[13] Serbian Law do not recognize possibility that any loan could be retro actively refused if any government in any circumstances due to politically or any other reasons while taking loans or guaranteeing loans or issuing bonds could be in position to take illicit or illegitimate loans.

Therefore, according to national legislation especially article 13 point 1 that states that "Public debt constitutes an absolute and unconditional obligation of the Republic, regarding repayment of principal, interest and other borrowing costs." And that (point 4): "Any provision of the Budget System Law that provides for a temporary suspension of budget execution shall not apply to the public debt repayment", there is no circumstances where parliament could refuse to service some of loans that have being taken or for which guarantees where issued from side of some previous government for loans that are without compliance to strategically interest of Serbia or that are product of corruptive decision making.

2.1. Structure of public debt

Serbia is highly indebted country. Its structurally imbalance and heavy reliance on imports is main reason why level of debt that Serbia has in period after 2010 is hardly sustainable. To reduce fiscal pressure Government of Serbia under close watch and support of IMF and World Bank have initiated restructuring process that had as it main goal reduction of spending mostly in form of pensions that are considered as main budgetary burden. Goal of such fiscal tightening is that actually ratio of pension would be below 10%of GDP. As shown by S. Komazec and Radenkovic[14] after 2012 and especially after 2014 with SBA with IMF **deflationary** policy targeting low inflation rates is in place in Serbia.

Coming from the decade of political instability, economically and politically sanctions Serbia came in to period after 2000 politically and economically changes as highly indebted country with high levels of debt per GDP. Immediately after renewing status in World Bank and IMF (in early 2000) and after politically decision to start process of politically and economically approximation to EU Serbia started to restructure its economy, to repay significant debts from period prior to 2000. In same time while doing so Serbia had negotiation with so called Paris and London clubs of investors (both private and

[12] Article 27, www.mpn.gov.rs/wp-content/uploads/2015/09/Zakon-o-budzetskom-sistemu.pdf
[13] Official Gazette of the Republic Serbia", No. 61/2005, 107/2009 and 78/2011., http://ujd.gov.rs/upload/Zakoni/Zakoni%20engleski/Public_Debt_Law_RS.pdf
[14] https://www.ilo.org/dyn/natlex/docs/ELECTRONIC/74694/119555/F838981147/SRB74694%20Eng.pdf, http://www.magazin-tabloid.com/casopis/?id=06&br=360&cl=09

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institutional ones) that have reprogramed[15] significant parts of Serbian debt that was in that time at level of 12 bUS$.[16] According to official overview of Serbia debt ratio in 2000 Serbia had more than 200% of GDP in debt, both foreign and domestic.

After "democratically changes" in 2000Serbia decided to restart process of privatization (re introduction of capitalism was actually ongoing since 1989 and reintroduction of equality of all forms of ownership) which did meant that money obtained by privatization of some of public or socially owned companies was also used for repayment of debts.

In period between 2001-2016 about 96billion EUR have went in to Serbia and from selling of 2420 companies, 2,6 billion of EUR of income. Despite such heavy investments Serbian economy is not showing signs of sustainability. Serbia was allowed in first years after 2000 to borrow cheaper money, to receive even support as highly indebted country from World Bank and EU and it have actually received number of loans and donations that have significantly helped country to stabilize its macro economically position, seriously reduce its inflation and moreover to reduce its deficit. Such process have led to the serious improvement of national macro position and seriously reduced its public debt.
Relying on foreign resources of finance and income from privatization, serious tightening of all the social spending have led to increase in economically position but didn't actually tackled technologically and structurally problems of real sectors, related to the high reliance on fording resources and technologies. Such problem that was managed in period before 1990 by industrialization and development of domestic products and services, after 2000 was not managed properly and Serbia increased its vulnerability with regards to over reliance on foreign technologies, services, finances and resources.

As graph 1. shows despite explicit regulation Serbia have violated its own regulation with regards to the maximum allowed level of public debt since 2010, despite the fact that public debt was reduced until the 2008 structurally problems remained (import dependence, low technologically competitiveness, high energy and resource intensity, high subsidies to foreign companies for labor intensive activities with low value added etc) that have exposed Serbia to risks that in conjunction with the external pressures have led to the sharp increase in levels of domestic and foreign liabilities of State of Serbia.

[15] Read wrote-off
[16] https://www.rferl.org/a/1096667.html

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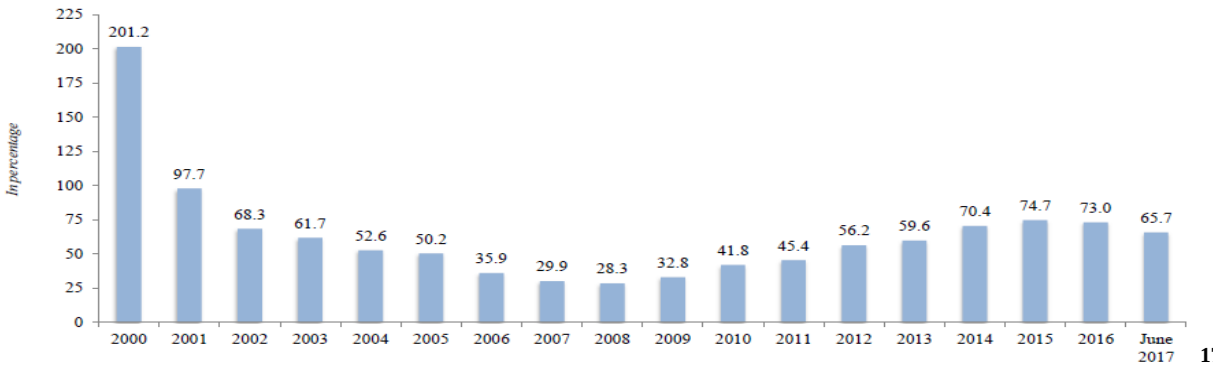

[17]

Graph1, Debt to GDP Ratio since 2000

After almost 8 years of strict fiscal and economically measures in 2008 which led to serious reduction of public debt once global crisis from 2008 have hit hard Serbia it became obvious that country without real competitive products and economy relying heavily on services will not be able to manage exposure to external economically forces.

Structure of debt is rather reflecting strong risks since it is denominated in According to the data as of 30 September 2016, the largest portion of public debt of the general government of the Republic of Serbia is still denominated in Euros and amounts to 41.3%. US dollars follow with 32.5% and dinars with 21.4%.. [18] According to national strategy for debt management for period 2017-2019 structure of debt is as follows:

[17] http://www.javnidug.gov.rs/upload/Stanje%20i%20struktura%20za%20mesecni%20izvestaj%20o%20stanju/Web%20site%20debt%20report%20-%20ENG.pdf , page 5

[18] Economically Reform Program 2017-2019, page 19

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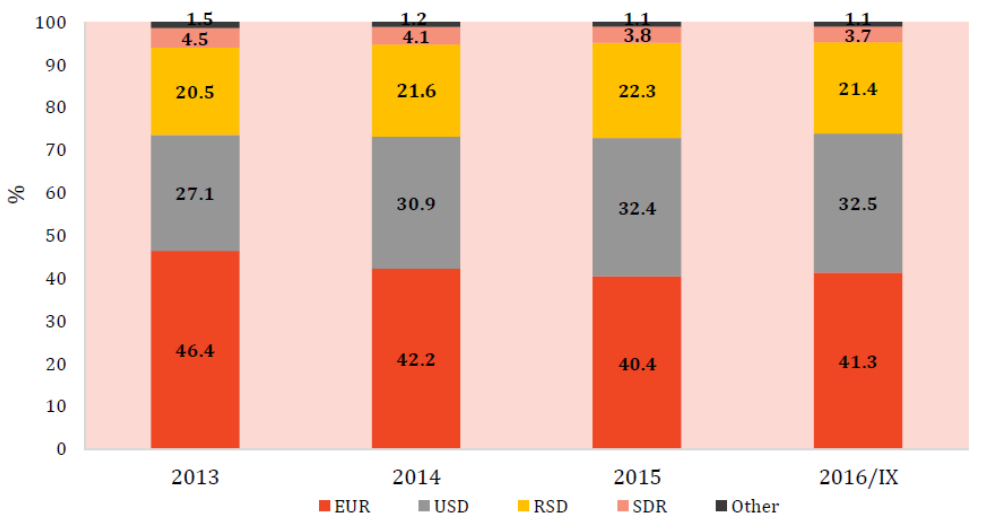
Currency structure of the government public debt state in the period 2013 – September 30, 2016



[19]

In line with the orientation toward decreasing the exposure to currency risk, extending the maturity and continuing with the development of new borrowing instruments in the local financial market, the key source of funding in the period 2013 – 2016 was the issuing of dinar securities, which resulted in an increase in the share of public debt in dinars from 20.5% at the end of 2013 to 21.4% of the public debt of the Republic of Serbia at the end of September 2016.[20]

As of 30 September 2016, the greatest portion of public debt of the general government of the Republic of Serbia had a fixed interest rate – 78.1%, while the public debt with variable interest accounted for 21.9% of total public debt. Of the variable interest rates, the most common ones are EURIBOR and LIBOR for euro, which account for 68.4%, then LIBOR for US dollar which accounts for 10.8%, while liabilities linked to the NBS key-policy rate account for 7.2% and other liabilities 13.6%, mostly variable interest rate for special drawdown rights).[21]

Additionally heavy burden on to the national economy is problem of Non-performing loans and as it is shown in officially presentation structure and level of NPLs in "Serbian" banks it Gross Non Performing Loans in RSD[22].

[19] Public debt management strategy 2017-2019, page 3
[20] Ibidem, page3
[21] Ibidem, 4
[22] https://www.nbs.rs/internet/english/55/55_4/quarter_report_III_16.pdf, page 17

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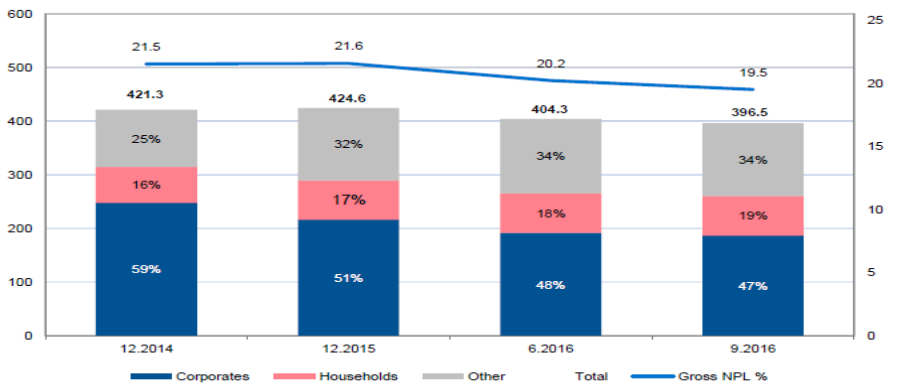

Source: National Bank of Serbia.

The draft amendments of the corporate insolvency law, which underwent public consultations in October and are expected to be discussed by Parliament of Serbia and to solve problem of NPLs. In same time according to IMF the NPL strategy continues to be implemented and is delivering good results. The NBS implemented a range of prudential and regulatory measures envisaged under the NPL strategy, including the introduction of additional provisioning practices, enhanced asset quality reporting, and guidance for preparation of the NPL resolution strategies for individual banks.[23]

In same time while Debt to GDP ratio is at about 70% **Serbian International Investment position** (IIP) is rather very negative since it is every year after 2010 higher than 100% and as our calculation shows (supported by ERP 2017-2019 calculation on page 19)

	2013	2014	2015	2016	2017
direct investment, liabilities	**22 851**	**24 376**	**26 676**	**28 766**	**29 294**
Equity liabilities	16 909	18 347	20 247	21 546	21 914
Equity assets	**2 078**	**2 343**	**2 656**	**2 876**	**2 898**
Equity assets	255	290	330	351	362

[23] Article IV report, December 2016, page 74

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Portfolio investments	**6 369**	**7 272**	**7 552**	**6 938**	**6 645**
Other investments	**19 403**	**19 359**	**19 664**	**20 497**	**20 400**
Loans	**17 235**	**16 765**	**16 680**	**16 512**	**16 102**
Foreign exchange reserves	**11 189**	**9 907**	**10 378**	**10 205**	**9 730**
External Financial liabilities	**48 623**	**51 007**	**53 892**	**56 202**	**56 339**
International Investment Position	**-30 787**	**-32 745**	**-34 471**	**-35 534**	**-35 892**
GDP	34 263	33 319	33 491	34 115	

Table 2; showing IIP of Serbia that is at level of 103-104% of GDP (own calculation based on data of National Bank of Serbia[24])

2.2. Prospect and stability of domestic debt

"The International Investment Position (IIP) is a statistical balance of a country's foreign assets and liabilities. IIP also serves international financial institutions as a basis for the evaluation of a country's risk in economic relations with other countries, since it contains the sectoral distribution and maturity of external liabilities.

External financial *liabilities* represent the value of domestic assets owned by foreigners"[25] The difference between the external financial assets and liabilities of a country is its net IIP.

However, the Balance of Payment (BOP) deficit directly reflects the state of the IIP. For example, if the current account deficit in the BOP is financed by foreign loans, this means that the IIP will record an increase in the country's obligations to foreign creditors. Since Serbia is a net debtor country, for the repayment of its debts it will be necessary to run a current account surplus in order to improve its IIP.

[24] https://www.nbs.rs/internet/cirilica/80/ino_ekonomski_odnosi/mip/index.html
[25] Ivan Radenković Foreign Direct Investments in Serbia, p37, www.rosalux.rs/sites/default/files/publications/6_Radenkovic_engl_web.pdf

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But the accumulated liabilities created by FDIs and borrowing from abroad have not been stabilized by trade surpluses since there are no such surpluses.[26]

With its wrong structurally setting of its economy for the repayment of its debts Serbia will need to be able to achieve current account surplus if it wants to improve its IIP position. But the accumulated liabilities created by FDIs (in form of subsidies, tax deductions, tax holidays etc) and borrowing from foreign resources not been stabilized by trade surpluses since there are no such surpluses.

Surplus is impossible since Serbia is not able to structure support for such economically improvement that would lead to the significant reduction of energy consumption, improvement of technologically profile of energy sector, transport sector and moreover structure of the industrial and agriculturally production and establishment of new sectors of economy that are not possible to develop due to overreliance of Serbia on to the private comprador interests of foreign investors that are selling outdated low capital value industries to Serbia.

IFIs and IMF that are micro managing Serbia spending for the SOCIAL COHESION thus directly participating in social fall a part of Serbian society especially its working clusters, are not at all able to provide SENSIBLE and reasonable advices for structuring criteria for industrial development that will strengthen domestic competitiveness while in same time providing increase of social distribution. It is obvious that industrial policy left to private interests of foreign companies is not actually bringing real improvement in efficiency and increase of social cohesion in Serbia.

Long term reliance on imports of both products and services is clearly leading to not ability to develop domestic competitive tradable sector. It is directly contradicting sense of capitalist market and profit driven economy that any foreign corporation would ever come to Serbia to increase employment (since first measure for increase of profitability is exactly the opposite), to redistribute know how (especially that which would undermine competitive edge of companies coming to Serbia).

In same time **Banks that are in hands of foreign owners** are actually interested to maximize profits, establish good environment for transfer of profits to countries of origin, thus it is counter reason to expect that those will be ever interested to support development of Serbian national companies.

[26] www.rosalux.rs/sites/default/files/publications/6_Radenkovic_engl_web.pdf, *p.38*

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2.3. Illicit loans

There is number of loans taken without national wide discussion for the projects that are clearly violating some of best socially, economically, health and environmentally interests of Serbian population taken and voted in parliament without strategically, transparent and accountable discussion in Serbian society. In that sense discussion about the methodology of proclamation of public interest, or strategically importance for some projects or programs is actually clearly one of main missing points for any future sustainable policy that should (could) sustainably decrease national debt and enable free and distributive national economic policy.

Since program of structural reforms described in 2012 main goals of national debt reduction policies have being mostly focused on reduction of spending for social security, pensions and other spending to health and education sectors. With such pressure on cohesion functions of the state (society) it is not surprise that since 2010 Serbia is facing major social and demographically crisis in both negative birth rate and massive emigration of most productive citizens towards global North.
Despite clear obligation of Republic of Serbia to provide distributive role towards vulnerable parts of population and also to provide improvement of life of all the citizens thorough exercise of budgetary process (collection, planning, execution) number of cases from number of sectors is showing that public good is due to ideologically pressure of so called "market forces" endangered.

By legalized reduction of pensions (which is regulated in Law on reduction of pensions)[27], salaries in public sector and ban on new employment in public sector Serbia is facing major problem in providing human capital for middle and long term social and economically improvement and establishment of sustainable economically environment.

Strict and exclusive focus of both government of Serbia, EU, IMF and WB towards saving with goal to provide fiscal space for necessary infrastructural investments **without** providing serious criteria for ecologically, resource efficiency, socially distributive criteria, criteria supporting positive discrimination of domestic companies (en)able(ing) to design and implement such projects and moreover without focus on to the development of domestic alternative technologies such investments will not have positive impact on to the macro economically position of Serbia in longer term.

As shown in chapter about public infrastructure heavy focus on resource intensive and import based technologies and moreover focus on centralized energy system based on coal without any serious

[27] http://www.parlament.gov.rs/upload/archive/files/lat/pdf/predlozi_zakona/3798-14Lat.pdf

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attempt of systematically support for new decentralized, low resource, de carbonized solutions will not bring macro economically resilience to Serbian economy.

Big part of Serbian debt is coming from more than 15 years of systemic and massive support for the SMEs and also to large companies thorough different mechanisms including tax incentives, subsidies, tax holidays, cheap electricity, cheap loans thorough financial intermediaries etc. looking at the assessments made by main macro assisting institutions (World Bank, IMF, EU) one would never get impression how big and lucrative was financial and other support of Serbia to private initiative and also attracting foreign large and middle sized corporations and financial institutions. **Data about all the forms of support are lacking and it is very hard to present amount of financial resources that was in-vested in to transition to market economy**. Such not transparency is partly caused by interest of large Neo- liberal economy promoting institutions to demand always more support.

There is principal question why would national budget support at all private initiatives in any form if we are living in capitalism and private initiative is by definition interested in exclusively private benefits. It is almost unbelievable that practically every and any discussion about economically activity of be it small or big companies is ending up in outcry that **"STATE SHOULD HELP"** by reducing taxes, providing, subsidies, providing investment in infrastructure, reducing social and pension taxes etc.

Serbia have invested serious money in energy, transport, and small, medium and large companies both domestic and foreign thorough different subsidy and tax support schemes even before 2008 but even so Serbian structure of production and consumption was not prepared for challenges of reduced capital accessibility and also reduced consumption in EU. According to official assessments of macro economically reasons for not ability of Serbia to withstand crisis in 2008 main explanation was that not reformed public companies (not privatized ones) are the main reason for such inability. As global experience shows structure of ownership is not the only reason for such inability of companies to with stand macro economically pressures or in other words privatization (especially of big infrastructural systems) is not actually guaranteeing efficiency and sustainability.

Case of Serbia clearly shows that despite massive investment in biggest infrastructural systems prior to 2008 these systems did not reduce import exposure, reliance on heavily polluting technologies and moreover no steps was taken to reduce fiscal disbalance coming from such import driven economically development. Same heavy investment using IFIs and other sources of loans is not bringing almost no improvement in structure of energy and transport consumption and production.

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2.4. Support to the foreign companies

Immediately after 2000 Serbia initiated process of support to the foreign investors. In same time strong support was provided for privatization of domestic companies that were mostly provided with the goal to appropriate their market and their real estates while most of companies was actually significantly reduced in labor force. It is not yet clear how was that possible that public in Serbia somehow believed that foreign Began to take systematically form in in 2006, when it passed the ***Decree on the Terms and*** [28]***Conditions for Attracting Investments***

Control over subsidies was assigned to the ***Serbia Investments and Export Promotion Agency*** **(SIEPA)**, on the initiative of the Minister of Economy. This very important role implied not only control, but also the creation of many cost-benefit analyses assigned to a marketing agency whose job entailed the worldwide promotion of Serbia to foreign investors.[29]

In order to improve institutional control over subsidies, the **Commission for State Aid Control was formed in 2010**. Its regulatory power stemmed from the Law on State Aid Control passed in 2009 incidentally, didn't predict the possibility of sanctions for the unlawful allocation of subsidies, [30] in same time it is important to highlight that State aid control commission in its decisions is actually giving support to conservative infrastructural developments that do not provide increase of environmentally acceptable investments. Number of complaints was initiated against work of this commission that do not at all provide clear understanding of sustainability of investments thus providing state aid support for destructive (environmentally and financially) programs.

Control over the subsidies is formally impossible since the legal framework didn't offer any sanctions for breaching the law. The Commission couldn't control contracts on subsidies because the Ministry of Economy hadn't sent any contracts to them on which they could give their opinion and official consent in written form. Similar was happening with energy sector investments where this commission is completely passive with regards to the destructive investments in coal sector.

In practice, this means that subsidies have far greater significance for the labor-intensive rather than capital-intensive projects, which does not fit into the officially proclaimed commitment to an economy

[28] Radenkovic 2016, p 75
[29] Ibidem, p.75
[30] Ibidem p.76

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which ought to favor capital intensive investments with modern technologies and the employment of highly qualified labor.

In Decree on terms of attracting foreign investments No 108 of Republic of Serbia[31] Serbian government in 2011 offered two categories of financial incentives, for standard-scale and large-scale projects. For standard-scale projects, non-refundable state funds were offered through SIEPA (now the Development Agency of Serbia) in the range of 4,000-10,000 euros per new job created.

As situation in 2008-2010 have already shown despite heavy investments in infrastructure, heavy support for domestic and foreign companies (prior to 2008) without improved Energy efficiency and without technologies and systems that enable social re distribution of investments, investment in infrastructure carbon intensive, import oriented technologies will lead to situation of captured state that will disable any reasonable inter-generational policy, social cohesion, establishment of new industrial and infrastructural sectors conducive for transition towards socially, environmentally, economically sustainable development.

According to the national reform program for period between 2017-2019 Serbian authorities envision as main focus of fiscal policy and its objective that Serbia maintain:

- Macroeconomic stability coupled with further reduction of the public debt and returning it within sustainable limits;
- continued implementation of structural reforms, particularly in the domain of public enterprises and increasing efficiency of the public sector.

As we can see there is still strong believe that FDI will somehow magically increase efficiency of domestic economy while in same time we see that there is no actual transfer of technologies, knowledges and that also the foreign companies are focusing on

2.5. How FDIs are damaging Serbia economy

In that sense with **largely discriminative tax policy of Serbia that is championing** (for unknown reason) **FDIs** while domestic companies cannot get to good and cheap loans it is practically hardly surprise that domestic companies need to transfer burden of the profit on to the workers that are exposed to massive organized operation of exploitation in multiple forms: a) shadow work, b)minimal wages, c)

[31] http://www.ruma.rs/portal2/jupgrade/dokumenta/ekrazvoj/UREDBA_-_ENGLISH__24.04.2012.pdf

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extra unpaid hours, d) short term contracts, e) non paid social and health obligations, f) refusal of right to unionize etc. Burden of economically restructuring is completely put on to the back of citizens and domestic companies.

Additionally, important **characteristics of domestic debt related policy is that in period of 2008-2012** national Bank of Serbia was leading **rather expansive credit policy** that have led to the focusing of loan activity in the households. Such situation in tandem with high obligatory reserves of banks in Serbia and also fact that most of domestic banks are actually in foreign hands have led to the situation where companies are not able to get to the loans.

Over 140.000 companies were insolvent in 2013, of which more than 100.000 companies were so for over six months. Every third company had their bank account blocked. Around 59.000 companies have their accounts permanently blocked, and owe 207 billion dinars. Around 32.000 companies are faced with the prospect of bankruptcy. 19.400 companies are already operating under the regime of automatic bankruptcy. **Only 26% of private companies pay taxes regularly**, while 18% of employers pay wages on time.[32] In same time policy without vision is actually focused exclusively on to the low quality FDIs, importer sector, low inflation that are directly undermining development of domestic companies.

Most of FDIs is concentrated in financial services, retail trade, and telecommunications. This implies that FDIs are not contributing to transfer of technology and *know-how to the Serbia*, and also, that FDIs might increase imports more than exports through creating a trade deficit rather than a trade surplus, consequently seriously opening up the window of growth of debt.[33]

"The prevalence of the service sector and small labor-intensive manufacturing means that there were/are no major inputs in terms of modern technology transfer, equipment and production management."[34]

Goal of fiscal savings that are most important goal of the **overall national restructuring program is to create fiscal space could be open for investments** in both infrastructure and also in supporting productive activities. There is however one rather big problem in structure of such support provided by Serbia. Not transparency of decision making, prevalence of corporate and politically interest in decision making, Lack of clear climate change related and environmentally criteria for investments, and

[32] See: http://www.magazin-tabloid.com/casopis/?id=06&br=375&cl=15. , www.rosalux.rs/sites/default/files/publications/6_Radenkovic_engl_web.pdf, *p.42*
[33] Similar *Valerija Botrić:* Foreign direct investment in the Western Balkans, page 14
[34] www.rosalux.rs/sites/default/files/publications/6_Radenkovic_engl_web.pdf , *p.31*

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moreover criteria that are providing social distribution and political and territorial decentralization of investments. Without such mainstreamed criteria it is hard to expect sustainability of spending of hardly earned budgetary resources.

Case of "Fiat Serbia" is showing,[35] such support is in one hand reducing income of Serbia due to whole system of tax holidays, tax discounts etc for foreign companies while in same time it is actually increasing debt of Serbia that is providing massive financial support for those companies thus excluding practically domestically companies from cheaper financial support. Same un even approach is not only characteristics of the so called industrial sector BUT it is moreover becoming factor of importance in agribusiness and other sectors where foreign companies are enjoying seriously better position than domestic counterparts.
Contract with Fiat is still years after investment not published and it is not clear how much financial, and infrastructural investments was actually provided and it is still provided to the Fiat. Notorious argument that Fiat is providing much more in taxes than what Serbia is investing in it is actually even without complete financial and contractual overview available is simply not correct.

Most of FDIs in Serbia are benefiting from serious tax and other forms of supports. In same time big problem for macro economically stability of country presents so called **Tax free zones (custom freed zones)** that are providing enormous number of tax and customs exemptions to foreign companies that are establishing their operation in such zones. **The benefits of free zones** are: (1) exemption from value-added tax (VAT) on entry of goods into a free zone, as well as providing transportation and other services in connection with the import of goods; (2) exemption from VAT on goods and services in a free zone; (3) exemption from VAT on goods between two users of a free zone; (4) the release of manufacturing users paying VAT on energy consumption; (5) The release of individual tax burdens for foreign direct investment. In addition, within free zones companies enjoy exemption from customs duties and other import duties for goods intended for the performance of activities and the construction of facilities in the free-zone (materials, equipment, construction materials). Yet another benefit is that in free economic zones, companies enjoy so-called 'home clearance'. This implies a customs system available twenty-four hour a day (even during weekends), the import of semi products and raw materials inside the factory premises as well as their export from the factory premises. Users of free zones have the following logistics services made available at preferential prices: transportation, handling, loading, shipping services, agency services, insurance and reinsurance, banking transactions etc. However, the most important benefits are financial ones. This implies the free flow of capital, profits and dividends, along

[35] https://insajder.net/sr/sajt/tema/4886/ , https://insajder.net/sr/sajt/tema/959/ ,

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with funds available from the budget of the Republic of Serbia for financing investment projects in the manufacturing and service sectors.[36]

- Fiscal benefits (exemptions from any tax burden for FDI, VAT and specific local taxes)
- Free of custom duties on import of goods, equipment and raw material used in exporting production and construction material for building of infrastructure
- Financial benefits (free cash flow)
- Efficient administration (one stop shop)
- Simple and fast customs procedures (each zone has a Customs Administration Office)
- Local subsidies for using free zone infrastructure (Community offers low prices and service cost)
- A set of services is available to users under preferential terms (transportation, loading, reloading, freight forwarding services, insurance and banking services)[37]

The **relative success of the Western Balkan countries in attracting FDI during the 2000s** was probably more related to the fact that the large privatization processes in the new EU member states had already been completed, and based on the positive experienced the foreign investors had with those countries, they turned their focus to the new markets that were being privatized.[38]

The inability of the manufacturing sector to be more efficient in attracting FDI has also influenced the relative competitiveness of the economies in terms of the lack of new product creation and new market attainment. When taken individually trade diversification indices for most of the countries throughout the transition period were actually falling.[39]

Main measure of macro-economic policy that according to national authorities have helped country to put its macro economically position back on track of low budgetary disbalance and reduction of public debt was: "structural adjustment was given by expenditure (wage and pension) reduction, while the favorable macroeconomic environment, with the strengthening of tax and financial discipline, enabled

[36] https://www.ilo.org/dyn/natlex/docs/ELECTRONIC/74694/119555/F838981147/SRB74694%20Eng.pdf, page 55
[37] http://www.usz.gov.rs/eng/pogodnosti.php
[38] Similar *Valerija Botrić:* Foreign direct investment in the Western Balkans, page 15
[39] Ibidem, page 16

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a strong revenue increase. The goal of the fiscal consolidation program was a structural adjustment of 4% of GDP, with the public debt trend reversal."[40] Together with deflation policies, strong savings in all the sectors, freeze of employment in public sector that is directly damaging Serbia ability to regulate quality and sustainability of life it is not able to establish sustainable economically policy. Lack of enforcement is one among main reasons for proliferation of polluting industrial practices, lack of positive signals for introduction of new technologies and also one of reasons for enormous spending on health and also desperate health condition of nation.

According to numerous analysis of Serbian macro economically situation, most noticeably those by IMF in framework of Stand By arrangement of Serbia with this institution Serbia is highly exposed to **considerable external imbalances and rely on external financing, exposing country to sudden changes in investor sentiment. In same time despite strict legal definition Serbia has levels of debt per GDP much higher than 45%.**

Such levels of public debt first started to occur in period after 2008. Despite strong increase of growth from 2000-2008, despite privatization, increase in investments in infrastructure Serbia as over exposed to imports and also imports of capital was not prepared for shock of global crisis. Since 2012 Serbia involved in **structurally reforms in line with IMF and World Bank advises** have implemented significant fiscal adjustments in recent years and achieved debt stabilization.

Looking at the real sector economically indicators and structure of economy of Serbia, especially its overwhelming reliance on imported primary energy, reproduction products (heavy machinery, process equipment, raw chemicals, semi products, transport vehicles etc.), labor intensive industrial activities with low value added ratio it is clear that Serbia by all the restructuring and debt balancing fiscal measures is not actually tackling its main problem and it is technologically obsolete and non-competitive tradable industries that are heavily reliant on import of resources and technologies. Similar pattern was already used during most of period of industrialization since 1970 where Serbia (within Yugoslavia) was exposed to external volatility of high prices for new technologies, resources (especially oil and gas but moreover also to prices of other raw or semi processed resources).

Since 2000 Serbia have lost most of its technologically achievements and all of the newly established industries heavily supported by domestic fiscal and economically (and politically) measures are actually not at all increasing competitiveness of domestic tradable sector that is lagging behind and whose only

[40] Page 25, ERP 2017-2019, www.mfin.gov.rs/UserFiles/File/.../ERP%202017%20-%202019%20final_Eng.pdf

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competitive edge is actually high subsidies for FDI (that are heavily increasing domestic debt), one of lowest wages in Europe

Such tendencies aren't tackled by heavily subsidized FDIs that have actually brought in to Serbia high levels of precarious labor conditions (in official IMF, WB, EC and governmental programs defined as flexible work), low added value industrial activities that aren't actually brining serious

The positive contribution of multifactor productivity completely was reduced. The labor factor also negatively contributed to the growth of potential GDP, as a consequence of lower employment levels, and, to a lesser extent, an upward unemployment rate trend.[41]

On the output side, in the period 2017–2019, the greatest contribution to GDP growth is expected from the service sector and industrial production. Increased investment activity in the private sector, and intensified implementation of infrastructural projects will result in a positive contribution of the construction sector, while the contribution of agriculture should be mildly positive. It is however in long term impossible to defend structure of infrastructural investments since those are not increasing opportunities for new significant high value employment, increase of energy independency, reduction of environmentally pollution and moreover macro economically stability.

Significantly both IMF, WB, EU and Serbian authorities do not at all in their reform programs consider few seriously important factors:

a) Loss of trust of population with regards to the past solidarity investment programs have led to complete stop of solidarity investments in local and national level. Such programs in past were one among most important factors of local investments un local communal infrastructure but moreover also in national level in constructing some of critical infrastructural objects in Serbia.
b) Sustainable and reliable introduction of more than 3billion EUR of remittances in to the equation of domestic investment while in same time heavily supporting in both direct subsidies, strong fiscal support measures and guarantees for loans necessary for the investment.

[41] ERP 2017-2019, page 14

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3. INDEPENDENT REGULATORY AND OVERSIGHT BODIES/ ACCOUNTABILITY

Parliament of Serbia and Government of Serbia are the institutions that are taking decision related to the management of debt. The Government, on the proposal of the Ministry, determines proposal of platform for issuing guaranties.

It is clear that Parliament is deciding about the guaranteed loans however problematic is transparency of decision making about the securities that are completely in the hands of government. The Government regulates general terms for issuance and sale of government securities on the primary market and other elements of government securities primary market.

Competent local government bodies are making decision on local government borrowing, after it has obtained opinion of the Ministry. Local government can borrow in country and abroad, i.e. on domestic and foreign market. Local government can borrow in domestic currency and foreign currency, in accordance with this Law. Local government cannot issue guarantees. State of Serbia is the instance that can provide guarantees for the local communities. Problem of financing local communities is being repeatedly highlighted by IMF within article IV reports as one of important macro economically problems. Public debt report for May 2017 shows that 5 local authorities have 80% of overall debt of local authorities and that 10 local authorities are liable for more than 90% of overall debt of local authorities. In same time overall debt of local authorities is at level of about 1,8% of GDP as of May 2017.[42] Important fact about loans of local authorities is that 99,5% of loans are actually for the investment purposes. Autonomous province of Vojvodina is considered as local community.

The Ministry keeps public debt record about the public debt. The record, its obligatory to contain data about the outstanding amounts, interest rates of guarantees and counter- guarantees. Once a year, the Ministry shall submit to the Government a report with information from the record.

The Public Debt Administration is an administrative authority within the Ministry of Finance of the Republic of Serbia, having the role in the public finance system of ensuring liquidity of the state and

42 http://www.javnidug.gov.rs/upload/Stanje%20i%20struktura%20za%20mesecni%20izvestaj%20o%20stanju/Web%20site%20debt%20report%20-%20ENG.pdf, page 11

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supporting governmental bodies, public enterprises and other state institutions in financing projects having the public importance.

The Public Debt Administration is the holder of public debt policy, presenting one of the most important branches of macroeconomic policy and having stabilization and development function.

The activities of Public Debt Administration have been regulated by the Law on Budget System, Law on Budget of the Republic of Serbia and other laws and by-laws.

The Public Debt Administration performs tasks related to: borrowing on the financial market aimed at covering budget deficit of the Republic of Serbia and financing projects having the public importance, through the issuance of government securities and contracting loan agreements, issuing guarantees in favour of public enterprises, governmental agencies and local self-government units, public debt proceeds management, execution of public debt service, recording and reporting, preparing public debt management strategy, as well as other obligations in accordance with the Law.

The Public Debt Administration was established on 1 October 2009, in accordance with the recommendations of the World Bank. [43]

According to law on budgetary system[44] that is regulating external audit in article 92 annual financial statement of the Republic of Serbia and annual financial statements of the organizations for mandatory social insurance shall be subject to external audit, pursuant to the provisions of the law regulating the jurisdiction the Supreme Audit Institution. Annual financial statements of local government budgets shall also be subject to external audit. The audit referred to in paragraph 2 of this Article shall be performed by the **Supreme Audit Institution** in line with the law regulating the jurisdiction of the Supreme Audit Institution.

National Bank of Serbia is preparing monthly reports about status of national debt since 2012.[45]

In same time **strategy for management of public debt** is being formulated since 2012/2013. These strategies are being formulated for the periods of two years**.**

[43] http://www.javnidug.gov.rs/eng/default.asp?P=32&MenuItem=2
[44] http://www1.worldbank.org/publicsector/pe/BudgetLaws/SerbiaBudgetSystemLawJuly162009EnglishFINAL.pdf
[45] http://www.javnidug.gov.rs/lat/default.asp?P=27

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Main goals of strategy are to a) reduce Debt to GDP ratio, At the end of 2015 the balance of the central government's debt reached 74.7% of GDP and the general government's debt reached 76% of GDP. Ratio of public debt to GDP for the central government level was 70.8% of GDP at the end of September 2016 and for the general government this ratio stood at 72%. A slight increase is expected until the end of 2016 and the share will reach approx. 73.5% of GDP on the central level and 74.6% of GDP on the general government level,[46]

b) reduce exposure to foreign currencies denominated loans. The key strategic goals that we should strive for in the upcoming long-term period, in order to minimize the risk of increasing the indebtedness and the cost of servicing public debt are:

- that the share of debt denominated in dinars amounts to approx. 20-25% of the total public debt in the medium run;
- that the share of debt denominated in euros in the public debt amount to no less than 60% of the debt in foreign currency, including future borrowings and transactions,

c) to extend maturity of loans, At the end of 2013 the share of long-term dinar instruments at original maturity of three and more years amounted to 37% in the balance of dinar securities and 67% at the end of September of 2016. In 2014, ten-year bonds were issued for the first time, which completed the development of maturity in the yield curve for both dinar and euro denominated government securities

d) reduce number of loans with variable interest rates.

[46] http://www.javnidug.gov.rs/upload/Strategija/2016/Public%20Debt%20Management%20Strategy%202017%20-%202019%20eng.pdf. Page 15, 16, 17

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4. PUBLIC DEBT MANAGEMENT

Beside national strategy for public debt it is possible to state that Serbia as number of strategies and program which are actually part of the overall debt management strategy or are functioning as its supplement. In that sense economic reform program for period 2017-2019 is as main goal having reform of all the sectors of society and economy with goal to reduce pressure on budget and reduce fiscal risks. In same time real sector strategies serve to the end to attract as much as possible investments that should (in most of cases MAGICALLY) serve for improvement of infrastructural, employment and environmentally conditions.

Serbia is having program with IMF since 2015 in form of Stand By Agreement.

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RECOMMENDATIONS

- More transparency needed with regards to investment of Republic of Serbia in to the private sector especially thorough tax free zones.
- Detailed data should be provided about the tax subsidies thorough business support mechanisms that have a large impact on the BUDGET and PUBLIC DEBT of Serbia.
- Strategy for management of debt should be discussed in wider circle of interested public.
- Decisions about the main projects that are expected to reduce in middle and long term Serbian exposure to not sustainable debt should be taken in widest possible circle of interested public, reflecting as much as possible all the clusters of public.
- Mechanism for proclamation of ILLICIT LOANS should be foreseen.
- Support to foreign companies should be revised in light of real costs and benefits of supportive mechanisms provided to such investments with regards to public debt management.
- Fiscal measures should not damage social sustainability and responsibility of republic of Serbia. In these light overall investments in FDIs and infrastructure should be revised. Best investments are those that are providing multi-level positive impacts. From this stand point infrastructural investments should be reconsidered. Focus for policy makers should be on raising the efficiency (in every sense) and effectiveness of public spending.
- IFIs and Serbia to start detailed and concrete estimating of negative environmentally and climate change impacts that should serve as important adittion to the GDP estimations thus showing how much Serbia looses due to limited and not sufficient investment in environmentally protection systems in Serbia. Such estimations would bring strong signals to the decision making process deciding of new infrastructure.
- It is necessary to start estimations in fossil fuels subsidies with same methodology already used by IMF.
- State aid should be strictly used only for advancement of environmentally and socially important sectors with positive impacts for transition towards low carbon, low resource, energy efficient, socially just and equitable project and program proposals.

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