Dragana Gnjatovic[1], Ana Jovancai[2], Nikola Stakic[3]

FISCAL ASPECTS OF APPLYING MAASTRICHT CONVERGENCE CRITERIA IN SERBIA: POSSIBILITIES AND LIMITATIONS[4]

This paper analyzes the fiscal position of Serbia as well as the ratio between its indicators and reference values anticipated by the Maastricht convergence criteria. According to the mentioned criteria, the public debt must not exceed 60% of the GDP, whereas the budgetary deficit must not exceed 3% of the GDP. Although Serbia fulfills the fiscal criteria of convergence rather than the monetary ones, and does so to a greater extent, a deeper analysis is implicative of a serious problem of public finance and the necessity of fiscal consolidation. In that sense, mid-term fiscal measures, whose implementation should ensure macroeconomic stability as well as facilitate Serbia's accession to the European Union, are recommended.

Keywords: *public debt, budgetary deficit, Maastricht fiscal criteria, Serbia.*

Драгана Гнятовіч, Ана Йованчай, Нікола Стакіч

ФІСКАЛЬНІ АСПЕКТИ ВІДПОВІДНОСТІ СЕРБІЇ МААСТРІХТСЬКИМ КРИТЕРІЯМ: МОЖЛИВОСТІ І ОБМЕЖЕННЯ

У статті проаналізовано фінансовий стан Сербії, а також співвідношення між його показниками і контрольними значеннями, які відповідають Маастріхтським критеріям. Згідно з цими критеріями, державний борг не повинен перевищувати 60% від ВВП, а бюджетний дефіцит — 3% від ВВП. Хоча Сербія виконує фіскальні зобов'язання, вона не виконує монетарні, а глибший аналіз виявляє серйозну проблему державних фінансів і необхідність фіскальної консолідації. Представлено середньострокові фіскальні заходи, здійснення яких повинне забезпечити макроекономічну стабільність, а також сприяти вступу Сербії до Європейського союзу.

Ключові слова: *державний борг, бюджетний дефіцит, Маастріхтські критерії, Сербія.*

Таб. 2. Літ. 14.

Драгана Гнятович, Ана Йованчай, Никола Стакич

ФИСКАЛЬНЫЕ АСПЕКТЫ СООТВЕТСТВИЯ СЕРБИИ МААСТРИХТСКИМ КРИТЕРИЯМ: ВОЗМОЖНОСТИ И ОГРАНИЧЕНИЯ

В статье проанализировано финансовое положение Сербии, а также соотношение между его показателями и контрольными значениями, соответствующими Маастрихтским критериям. Согласно этим критериям, государственный долг не должен превышать 60% от ВВП, а бюджетный дефицит — 3% от ВВП. Хотя Сербия выполняет фискальные обязательства, она не выполняет монетарные, а более глубокий анализ выявляет серьезную проблему государственных финансов и необходимость фискальной консолидации. Представлены среднесрочные фискальные меры, осуществление которых должно обеспечить макроэкономическую стабильность, а также способствовать вступлению Сербии в Европейский союз.

[1] PhD, Full Professor, Faculty of Hotel Management and Tourism, University of Kragujevac, Serbia.

[2] PhD, Assistant Professor, Faculty of International Economics, Megatrend University, Belgrade, Serbia.

[3] Assistant, Faculty of Business Studies, Megatrend University, Belgrade, Serbia.

[4] The paper has been prepared within the project of the Ministry of Science and Education of the Republic of Serbia (47004): "The improvement of public policies in Serbia in the improving the social security of citizens and sustainable economic growth".

Ключевые слова: *государственный долг, бюджетный дефицит, Маастрихтские критерии, Сербия.*

1. Introduction. The crisis of public debt, as a typical manifest of the current global financial crisis, has struck numerous countries of the European Union whose macroeconomic indicators are far above the prescribed borders of the Maastricht criteria. With an aim to control fiscal movements and overcome the recession period, many countries have introduced additional, even stricter rules. Extraordinary savings measures are in force and they should ensure sustainability in the management of European economies. The level of public debt prescribed by the Maastricht convergence criteria is 60% of the GDP; once the debt exceeds the limit, legally binding rules for the reduction of public debt come in effect, and there are sanctions for those countries that do not obey them. Certain countries have even determined the successive borders for their respective public debts, at the level lower than the Maastricht one is, due to the expected growth of public debt in the time period of economic crisis.

As a state in which economy depends on economic flows in the European Union to a great extent, Serbia is undergoing the identical pattern of the deterioration of fiscal parameters. In Serbia, there has also been a reduction in budgetary incomes, increase in expenses, and simultaneously a fiscal deficit which has further impacted the public debt. Although it is too early to speak about the membership in the EU, and especially in the European Monetary Union, the movements of budgetary deficit and the public debt have been analyzed so as to assess the condition of fiscal indicators and confirm the significance of necessary structural reforms in the sphere of public finance.

2. Maastricht Convergence Criteria. The establishment and functioning of the European Monetary Union has been one of the most complicated segments in the process of the deepening European integration. What has made this process so much a complex one has been the readiness on the part of the European Union's countries to establish an economic and monetary union as well as a big difference in the economic and social development of the member countries. At that moment, after the successful formation of the internal market, the next step — in the form of establishment of the European Monetary Union — was expected. In order to conduct a successful monetary integration, it was necessary to reduce the differences into tolerable frameworks through the measures of economic policy, and, at the same time, to ensure approximately the same starting position towards a higher phase of integration. According to the Maastricht agreement, the European economic and monetary union members were supposed to satisfy the following criteria according to the monetary and fiscal policies until 1997 or 1998:

1. Price stability, i.e. a sustainably low growth of prices and an average inflation rate not exceeding 1.5 percentage points above the average inflation of the 3 most successful member countries. Actually, inflation is measured on the basis of the comparative consumer price index — CPI.

2. Long-term interest rate — the average nominal long-term interest rate must not exceed 2% above the average of the 3 most successful member countries. The

guideline for the determination of the interest rate is interest rates on long-term government bonds or comparative securities;

3. The amount of budgetary deficit is determined in such a manner that the rate of the planned or achieved budgetary deficit does not exceed 3% of the gross social product;

4. The public debt criterion anticipates that the amount of public debt does not exceed an amount of 60% of the gross social product;

5. The stability of the foreign-exchange rate and the participation in the Exchange Rate Mechanisms II (ERM II). This criterion relates to respecting the stipulated margins of the foreign-exchange rate fluctuation, which were ± 2.25%, without any more significant deviations in the time period of at least two years prior to the introduction of the common European currency. It is important to point out that — in the stated time period, when its currency is included in the Exchange Rate Mechanism — a potential member country has no possibility of self-initiatively devaluating its own currency against a currency of another EU member country with an aim of improving the competitiveness of its economy.

The obligation of fulfilling the convergence criteria is related to all the potential member countries of the Euro zone. These countries were expected to comply with the standards of budget-conscious living so as to create stable economic conditions for the introduction of European currency. Amongst these conditions, budgetary deficit was determined to have a share in GDP not exceeding 3%. If we take into consideration the fact that not one country fulfilled this particulat criterion in 1993, and that some countries had a deficit 3 and even 4 times higher (Greece, 15.4%; Sweden, 14.5%; Italy, 10.1%), as well as the fact that each of these countries successfully satisfied the criterion until the year 1997, then a big success of the restrictive budgetary policy and the maintenance of budgetary discipline is evident (Jovanovic Gavrilovic, 2001). After "soft budgeting" which lasted for a number of years, it was necessary that modifications in the manner of conducting the fiscal and budgetary policy should be made if we wanted to create conditions for the introduction of a uniform currency. This is what the member countries noticed, too, and the Maastricht agreement established the fiscal convergence criteria with a clear goal to, inter alia, use tight budgetary discipline to enable the original introduction and, after that, keeping the common Euro currency stable, too.

The European Union opted for the application of a stabilization budget which was greeted with approval after many years of deficient financing of the budget within the EU. Although, according to the opinions expressed by many people, the fiscal convergence criteria were set at a demanding level, they represent a strong foundation of a uniform restrictive budgetary policy. The European Union understood that it was necessary that the budgetary consumption should be reduced to reasonable frameworks if they wanted price stability and the national currency stability, and they adapted their macroeconomic policy to achieve the goal. Although the fulfillment of the Maastricht criteria does not represent a condition for full membership in the European Union, for many new member countries, it represents the next strategic goal. Croatia, which will become the 28th EU member country on the first of July 2013, has already been making it clear that they will not be rushing with introducing Euro and that it will have to wait for one decade to happen (NikoliC, 2011). There are 17 countries within the Union at the moment, while — according to the latest report issued by the European Committee — Bulgaria, Czech Republic, Letonia (i.e. Latvia), Lithuania, Hungary, Poland, Romania and Sweden still do not fulfill the preconditions for the adoption of Euro at this stage.

3. Fiscal Movements in Serbia in the Time Period between 2000 and 2011. After the political changes in Serbia in late 2000, there was an increase in the GDP which lasted until the second half of 2008, when, due to the financial and economic crisis, it recorded a fall. The current financial and economic crisis will undoubtedly change the manner of economic behavior at both micro- and macro levels. The so-far effects of the crisis and the forthcoming many-year challenges at the global level confirm the fact that it is not just an ephemeral phenomenon (Stakic, 2010). Due to the degradation of the situation at the world financial markets, there has been a significant decrease in the flow of foreign capital, the domestic currency has depreciated and there have been inflationary blows, only to have been followed by a decline in the aggregate demand, and, simultaneously, consumption as well, which has first led to slowing down then to a fall in economic activities.

In the same time period from 2000 to 2008, there was a significant fall in the absolute level of public debt as well as the share of public debt in the budgetary deficit. Thanks to the writing-off of a portion of the debt to the Paris and London Creditors Clubs, the external debt of the public sector of Serbia was reduced by 1/3 after 2000 (Gnjatovic, Jovancai, 2009). Apart from the writing-off of the debt, incomes generated by privatization of enterprises also had an impact on the reduction of the level of public debt to a significant extent. During this time period, there was an increasing improvement of the degree of Serbian public sector's indebtedness measured by the ratio between the external debt of the public sector and GDP. Starting in 2008, however, these favorable movements were stopped because the Republic of Serbia began to intensively indebt itself abroad, primarily to finance its state budget's growing deficit which no longer could have been financed by the privatization-generated incomes.

In the time period between 2008 and 2011, the state became indebted 6 bln euros in total. The structure of indebtedness in that time period is such that bonds (both domestic and foreign) make 3.7 bln euros, while 2.3 bln euros referred to credit indebtedness. Out of 3.7 bln in bonds, 700 mln were the Eurobonds issued in the month of September 2011, which are tied to dollar, and the remaining ones were "domestic" securities.

Table 1. **Public debt (in mln Euro)**

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Public debt - total	**13,431**	**11,382**	**10,800**	**10,803**	**9,331**	**9,619**	**8,582**	**7,850**	**8,456**	**10,444**	**12,357**
External	**9,561**	**7,230**	**6,563**	**5,266**	**5,364**	**4,745**	**4,615**	**4,691**	**4,406**	**5,872**	**7,238**
Internal	**3,870**	**4,151**	**4,239**	**4,064**	**4,255**	**3,837**	**3,413**	**3,161**	**4,050**	**4,571**	**5,118**

Source: Ministry of Finance of the Republic of Serbia, *Public Finance Bulleting, March 2012*, Belgrade, 2012.

At the end of 2011, the public debt was 12.3 bln euros, in which amount — due to the different methodologies of the Ministry of Finance and the IMF — only direct liabilities of the state at the central level of authorities were included (Table 1). Taking into consideration the indirect liabilities as well, both related to internal and external debts, the total amount of public debt was 14.46 bln euros. Only in 2011 did the public debt increase by almost 2.5 bln euros. The last indebtedness in 2011 was the one made in September, when the state sold bonds worth one billion dollars at the international market. The very dynamics of an increased indebting has been increasingly more alarming as the fact came out that a larger portion of the amount has not been directed towards investments, capital projects and new employments, but rather primarily towards consumption and covering the budgetary deficit.

The real size of the public debt probably exceeds 46% of the GDP because the analysis of the Fiscal Council has shown that there are accumulated delays on the part of certain budgetary beneficiaries (RFZO) exceeding a possibility of their servicing from the current business operations. Given the fact that indebtedness will be needed for repaying those delays, too, the actual public debt at the end of 2011 already and the most probably exceeded 47% of the GDP (NBS, 2011).

Due to increasingly more and more unfavorable sources of becoming indebted, Serbia's fiscal deficit is the leading problem in running the country's sustainable macroeconomic policy. In the RS's budget, that problem was not so much evident due to the privatization of a large number of enterprises, out of which — in terms of their respective incomes — the leading ones were the sale of Mobtel to Telenor — a Norwegian company, and the privatization of several banks where the state had major ownership. The incomes generated from privatizations were partly used for covering the fiscal deficit; however, since those are one-off funds, this source of financing soon ran dry. At the same time, there appeared the first manifestations of the global economic crisis and, pursuant to the postulates of an anti-cyclical policy, the needs for financing from the budget rose. The fiscal policy had a task to mitigate the consequences of the crisis by growing social transfers as well as the stimulation for the economy and the population. Incomes from direct taxes recorded a fall due to a significant growth of unemployment as well as a fall in economic activities, whereas indirect incomes also reduced because of the similar reasons of unemployment and lower salaries, which reduced the population's consumption. The deficit was being financed through an increased indebtedness of the public sector by both loans issued by international financial institutions and indebting at the domestic market.

The fiscal deficit of the consolidated state in 2011 was 158.3 bln dinars, i.e. 4.7% of the GDP, which is a deficit bigger by 5 bln dinars than 153.4 bln (4.5% of the GDP) which had been planned in compliance with the fiscal rules. Such a deficit, bigger to a certain extent than the planned one, resulted from the fact that the achieved public incomes were by around 10 bln dinars less than the ones planned in the month of September, when the rebalance of the Republic's budget had been adopted and the fiscal framework for 2011 had been defined. Exactly the fiscal deficit is the main driving force of a growing public debt. In the first two years of the crisis, Serbian fiscal deficit was even slightly lower than the one in the EU. However, starting in 2010 or 2011, the majority of the EU member countries abruptly declined their respective deficits, mainly through increasing taxes, whereas Serbian deficit remained at an almost unchanged level of 2009, ranging between 4.5% and 5% of the GDP. The problem of the fiscal deficit in 2012 and the forthcoming years is assuming alarming proportions which, due to bad macroeconomic indicators, can make it impossible for the country to service its own obligations and the public debt crisis, which will further be discussed in the following chapters.

4. Current Fiscal Movements. For the first time in early 2012, the statistical data of the fiscal movements in Serbia openly highlight the dramatic situation in the sphere of public finance. Although for different methodological scopes and legal regulation the assessment of the public debt differed between the relevant institutions (namely the NBS and the Ministry of Finance), in that time period, the exceeding of the fiscal limit of 45% of the public debt compared with the GDP was openly spoken about.

At the end of June 2012, the public debt amounted to 15.3 bln euros, and, compared with the end of March 2012, it was increased by 674 mln euros. Its share in the estimated GDP in the second quarter was increased by 4%, thus reaching 54.7%. During the second quarter, the internal and the external public debts were also increased, partly due to the Euro currency depreciation against the other currencies present in the structure of the debt. Although the repayment of this year's installment of bonds of the old savings in foreign currencies has reduced the state's debt on this basis by 213.2 mln euros, the public internal debt was increased by 291.3 mln euros according to the net sale of state securities at the domestic financial market. The public external debt is by 382.8 mln euros bigger at the end of the second quarter than it was in the previous one not only because of the state's higher direct (by 255.3 mln euros) but indirect liabilities (by 190.5 mln euros), too (NBS, 2012). In order to gain an insight into the absolute values of the public debt in a right way, they need to be compared with other relevant macroeconomic data so as to make their sustainability precisely stated. The traditional measures of sustainability of the public debt encompass the share of the balance and repayment of public debt in the GDP, exports and budgetary incomes. Because of the balance of the public debt for the duration of the second quarter, all the measures of its sustainability have deteriorated: apart from the growth of the share of the public debt in the GDP, the share of the public debt in goods and services export has also increased by 4.2%, thus reaching 132.4%. The indicator expressing the budgetary incomes increased during the second quarter from 113.7% to 119.9% (Table 2).

Table 2. **An overview of the measures of sustainability of public debt (in %)**

	2010	2011	I 2012	II 2012
Public debt/GDP	44.0	47.7	50.7	54.7
Public debt/Goods & services export	119.4	126.1	128.2	132.4
Public debt/Export of goods and services, and remittances	91.6	100.7	102.7	106.8
Public debt/ Budgetary incomes	101.3	113.2	113.7	119.9
Public debt repayment/ GDP	10.1	11.0	11.6	11.1
Public debt repayment/Export of goods and services, and remittances	21.5	23.8	26.6	21.2
Public debt repayment/Export of goods and services, and remittances	21.5	23.8	26.6	21.2

Source: Ministry of Finance of the Republic of Serbia and the National Bank of Serbia.

5. Fiscal Consolidation. In the circumstances of the current macroeconomic position of the country and the condition of the public finance in it, a question of the time when it is possible to expect the most dramatic epilogues which would discredit the state with the international political and financial institutions comes to surface. Namely, the projection of economic indicators is indicative of the crisis of public debt in the Republic of Serbia and the creation of the country's insolvent position towards different categories of creditors, both foreign and domestic ones, which threatens the settlement of obligations towards certain budgetary beneficiaries. Given the fact that public debt has exceeded the legally established border of 45% of the GDP, the Law on the Budgetary System stipulates that the government of the Republic of Serbia must adopt a credible plan of the mid-term consolidation of the public finance when reaching a new budget or making a rebalance of the existing one, which — in the years to come — will enable public debt to return to its sustainable, legally prescribed frameworks, and by this a potential debt crisis will be avoided.

Under current circumstances, conducting a restrictive budgetary policy represents one of the fundamental pillars which can fix the current situation in public finance in the short- and later in the long-run as well. In order to recover and overcome the structural problems of Serbian economy, the Fiscal Council has prepared a comprehensive and consistent report on the Proposal for the measures of fiscal consolidation for the time period 2012-2016. In the report, the current balance of public finance in Serbia has been analyzed, the necessary amount of savings in the short- and mid-term has been quantified and a list of possible savings in different segments of public sector in Serbia has been made a proposal for. It has been estimated that, unless urgent measures of fiscal consolidation were not introduced, the fiscal deficit in 2012 would exceed 200 bln dinars, which is by over 50 bln dinars above the amount anticipated by the fiscal policy. Those estimates have also been confirmed by the Ministry of Finance, highlighting that, at the end of 2012, in the case of the prolongation of the tendencies of the first half of the year, the fiscal deficit of the sector of the state will reach 235.4 bln dinars, i.e. 7.1% of the GDP, while the public debt would reach around 65% of the GDP. This unsustainable fiscal position would lead to the endangering of budget liquidity and would be an introduction into the crisis of public debt (Ministry of Finance and Economy, 2012).

In order to avoid a debt crisis and a liquidity crisis in the short run, the Fiscal Council have estimated that it is necessary to have savings of around 1 bln euros until the end of 2013. Also, in the mid-term (2014 to 2016), in order to ensure the solvency of public finance and stabilize the level of public debt, it is necessary that the budgetary deficit should be reduced by additional 1.2 bln euros — all this to reach a balanced budget in 2016, and to have the public debt return to the legally prescribed framework by that particular year.

Depending on the scope and the time of action, the following 3 categories of measures have been proposed: (Fiscal Council, 2012):

- A short-term package of measures for fiscal adaptation, which means the combination of an increase in certain incomes from tax (VAT and part of excise) and the freezing of pensions and salaries in the public sector. Due to the structure of public consumption, the accent must be put on the expenditure side of the budget, where the biggest savings are possible to make, primarily through salaries and pensions, then through the creation of a sustainable model of fiscal decentralization, change in the policy of subsidies and making savings at other levels. The value of short-term reforms would be around 1 billion euros, out of which 70% would be on the expenditure side, whereas a tax reform would bring additional 300 mln euros.

- Mid-term reforms in the time period between 2014 and 2016 must solve the problem of the structural deficit of the country which would exist even without the negative consequences of the global economic crisis. Again, the accent would be on the expenditure side and primarily on the reform of the pension system, because it is the most significant item generating 30% of all public expenditures. To establish an even higher percentage of public investments in the structure of public consumption (up to 5% of the GDP in 2016, instead of the existing 3.5%) is an important task to do. Investments in the infrastructure are of key importance for the promotion of further, private investments and the stimulation of economic growth. Almost always when the public sector is capable of ensuring efficient infrastructural projects, an increase in the stimulation and the possibilities of making private investments emerge as a consequence (Jovancai, 2011).

- The establishment of the foundations for a high and sustainable economic growth. The passing of reforms of public consumption is not only needed for the sake of expected fiscal effects. The majority of the anticipated reforms would doubtlessly have a positive impact on the economic growth and quality of living in Serbia. Fiscal consolidation will enable the more favorable financing of the economy, because the reduction in the public debt will have an influence on the reduction in the country's risk premium, and the change of the structure of public consumption towards a bigger share of investments will directly influence a faster economic growth, because public investments have a multiplier bigger than the current consumption. The reduction of the fiscal deficit and the public debt will also have an impact on the reduction of the foreign-trade deficit and the stabilization of the dinar exchange rate. The passing of the proposed reforms will positively impact economic growth — by fixing the business ambience, stimulating the development of the private sector, rebalancing the economy from consumption towards export, increasing competitiveness due to the effects of a fiscal devaluation, establishing a predictable business environment and so forth (Fiscal Council, 2012)

6. Turning Point in Fiscal Policy: 2013-2015 Fiscal Strategy. In the context of the unfavorable macroeconomic indicators and an increasingly more unfavorable position of the current economic policy in Serbia, the Fiscal Strategy which should introduce order in the sphere of public finance and initiate the economic recovery of the country. The Strategy emphasizes the application of a responsible and predictable fiscal policy which is complied with the principles of fiscal liability and legal fiscal rules. In the coming mid-term time period, the fiscal policy as a whole will be directed towards the accomplishment of the following objectives:

- Lower shares of public expenditures and fiscal deficit in GDP;
- A relative reduction in public consumption to the greatest possible extent through the reduction of current public expenses, together with an increase in the level of capital investments;
- The maintenance of a stable tax incidence upon the economy, simultaneously strengthening tax discipline;
- Strengthening the financial discipline of public enterprises at the Republic and local levels.

The state's common sector's public debt in 2012 has grown to 65% of the GDP, and every failure to apply the fiscal consolidation measures would lead to a debt crisis and the repetition of Greek scenario. The reduction of debt in the midterm will be carried out through the reduction of the consolidated deficit and by the measures of the tax and expenditure policies. The application of the largest number of the measures of fiscal consolidation is started in the final quarter of 2012, which exactly is the reason why the effects estimated in this year are so small. The full effects of the measures will be visible in 2013, when the deficit should be halved as compared to 2012. Through fiscal consolidation on the side of incomes, an increase in tax rates of certain categories of incomes is anticipated, whereas the expenditure policy will be directed towards the reduction of the relative share of the current public consumption.

According to the fiscal strategy, the share of public debt in the GDP in the time period between 2013 and 2015 begins to decline and, at the end of the period, reaches 58.4%, above all as a consequence of the measures of fiscal consolidation and reduction of fiscal deficit, and also operations at the financial market, to a certain extent. On public tenders, the state plans to offer for sale certain state-owned enterprises which are doing business in competitive conditions as well as a part of the state-owned property currently out of use. The funds generated by such a sale will partly be used for the repayment of obligations in a foreign currency and partly for the repayment of the securities issued at the domestic market. Given the fact that the level of public debt does not reach the target value of 45%, in the time period after 2015 the program of fiscal consolidation and the reduction of the fiscal deficit should be continued for a longer period of time in the future.

7. Conclusion. Given the most important strategic goal set by the Republic of Serbia — its membership in the European Union — and apart from the numerous structural and administrative adaptations, it is important that the ratio between the basic economic indicators and the values anticipated by the Maastricht criteria should be kept an eye on. Although the fulfillment of the convergence criteria is not a condition for being granted membership in the Union, it certainly represents a goal towards the accomplishment of which we should direct the conducting of economic policy. The analysis of the so-far fiscal movements in Serbia as well as the projections of those movements present a clear picture of the extent to which we are far away from the fulfillment of the Maastricht criteria. However, the improvement of all the aforementioned fiscal elements must primarily have as a goal the improvement of the efficiency of the domestic economy, the reduction in unemployment as well as the stability of the domestic currency. What is important is to change the course of the overall economic policy and especially the fiscal policy. To avoid the crisis of public debt, which realistically threatens, it is necessary for public finance to be consolidated. The additional problem is the one represented by the weak efficiency of the economy which should be improved so as to generate a wider scope of the GDP and exports. Just as it is the case with a number of countries within the EU when the creation of a monetary policy is concerned, Serbia must obey a thrifty life style and use a restrictive fiscal policy to try to resume the weary economy. Big public consumption and its unfavorable structure are the consequences of conducting an inadequate economic policy based on the inflow of foreign capital according to privatization activities and speculative possibilities. When, due to the effectualization of the economic crisis, such a policy has proved to be impossible to sustain, it has become clear that Serbia must approach a new model of conducting a fiscal policy, which is inclusive of responding to the question of a structural deficit, a tax reform and an overall reform of the public sector.

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