THE PROBLEMS OF LIQUIDITY AND SOLVENCY OF THE REPUBLIC OF SERBIA

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ABSTRACT

The indebtedness of an economy abroad is today a significant term. Indebtedness of every economy towards foreign countries, as well as, the amount and structure of imported capital are of strategic long-term economic, financial and political significance. Foreign capital has a stimulating role as the initiator of economic growth, but it can suffocates the national economy with high liabilities (repayments and interest). The operation of foreign capital on domestic savings potential can be seen in two ways: positively, through the increase in the accumulation; negative, the high repayment and interest as well as the unfavorable structure of the use of these funds.

The burden of interest burden on national accumulation and contributing to brain a significant part of accumulation abroad. This is evident from year to year. Faster growth of paid interest on external debt of the increase in net national accumulation is especially pronounced in recent years. All of the above are significant and numerous reasons for the selected strategy of economic development must be given much more attention, not only when it comes to the amount of debt, but also its structure and efficiency of use.

This paper analyzes the main indicators used for the evaluation of the debt, known as indicators of overall debt. Some of them are related to the composition of the debt, ie, the amount of external and domestic liabilities, fixed, variable rate of liabilities, the amount of short-term, medium-term and long-term debt, as well as indicators of external liquidity and external solvency. These are useful indicators to define the evolution of the debt and ability to pay, they provide certain signals about the worsening or improvement of the situation.

Key words: *Foreign Capital, Economic Growth, Interest, National Accumulation, Indicators of Overall Debt*

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INTRODUCTION

Debts of the state grow increasingly and more countries sinking into a debt crisis. The most owe the richest and most powerful world economies, which now hard to find a way out of the chasm caused by uncontrolled spending, while a small country makes it into debt crisis. In many countries, public debt grew enormously on road to democracy, as it has conditioned expensive, and often imposed harmful reforms. Public debt of the rich countries has been further increased via financial companies, that have had an impact on the national economy and citizens who have used the maximum availability of all types of loans. The debt crisis, in which the world sinks deeper is not a consequence of the moment, but has been developing for decades because the economy is subordinate to politics. After the crisis of 2008, the growth of debt in the world has accelerated because the country had to rescue its faltered economy and banking system. According to some estimates, saving the world from the effects of a recession is costing about 15 billion euros, which was mainly increased the debts of industrialized countries, but the effects felt by the less developed countries.

Public debt of the Republic of Serbia is covered by issuing bonds, ie. borrowing from financial institutions or foreign governments. Instead of investing in infrastructure, reforms and long-term projects, the government borrows to finance public spending and buy social peace. For the past five years, Serbia's public debt has doubled, and in 2011 was exceeded the statutory limit of 45% of GDP and accounted for 45.4% of GDP, public debt continues to grow at above 70% of GDP . Analysis of the Fiscal Council shows that the growing trajectory of public debt will not reverse prior to 2018, when the public debt will reach around 83% of GDP (http://fiskalnisavet.rs/images/izvestaji/rezime_misljenje_na_nacrt_fs_2015-2017.pdf 08.05.2015).

The Republic of Serbia has the largest public expenditure in the region and a huge budget deficit, but the Serbian economy also characterized by decline in public revenues, the underground economy and tax evasion. Because of these unfavorable fiscal developments Serbian government has decided to implement austerity measures that will lead to real cost reductions:

- limitation of the growth of pensions and salaries in the public sector over the next year and a half, and
- structural reforms - restructuring of SOEs and the turnaround in the management of public enterprises, and reducing unrealistically large subsidies.

What is encouraging is better control of public expenditure, high growth of exports and a slight increase in production.

CAUSES AND REASONS FOR IMPORT OF CAPITAL

There is no a closed economy that is self-sufficient, autarchic. Contemporary economies are more or less open to the world market (goods, money, labor and capital). The presence of foreign capital in each country is bigger or smaller, but inevitable. Excessive caution in borrowing is not good, but neither uncontrolled borrowing has no justification. Where is the limit in the control of foreign capital in the national economy, it is a job of great responsibility of those who devised the concept of growth and development of a country?

In order to function and economy must take into account the growth factors and through their optimization, about the development of the economy and the country in general. In the long run, the goal of economic growth is defined as all components increase of consumption, so the optimum rate of accumulation is expected to contribute to achieving this objective, and that the human and material resources are not overstrain, and this means that the next big economic problem-the problem of optimization of relations: personal consumption- general consumption (Kvrgić, Nikolić, 2013, p. 163).

In addition to addressing these major economic problems, which independently do not contribute much to achieving optimum economic growth, especially in economic development, there remains the problem of technological progress (technological quality).

Investing, in order to achieve competitive advantages, can provide rapid development. Terms of exploiting comparative advantages are limited to the achieved level of economic development of a country. From the history of economic development of the world economy it is well known that developing countries strapped in all production resources, which is why they are forced to import technology that already been developed by other countries. In this way, the effects of investment in developing countries in the initial stage of their development is quite high (comparative advantages problem they usually solve their own exports of raw materials).

The Indebtedness of every economy towards foreign countries as well as the amount and structure of imported capital are of strategic long-term economic, financial and political significance. Foreign capital has a stimulating role as the initiator of economic growth, but it can suffocates the national economy with high liabilities (repayments and interest). Macroeconomic theory suggests that the costs of the public sector should have a positive impact on economic growth if they are productive and if the majority of government expenditure directed towards unproductive expenditures (subsidies, and pensions), it can cause a drop in economic growth (Teles, Mussolini, 2014, p.1-15).

Questions such as: amount of indebtedness, conditions of foreign loans (deadline, interest ...) types of credit (financial, commodities ...) and credit providers (public, private, international financial organizations, ...) are very important, especially are important effects and quality of use of these loans.

The pace and quality of economic growth depends on these issues, also of the possibility of over-indebtedness, cumulating debts and creating debt traps and the crisis of external indebtedness. The economy, which wants to accelerated economic growth and quality usually resorts to deficit in the balance of payments and net capital imports (external debt amounts).

„Accumulation is the basis of self-development of the economy and every business entity in particular (Sokić, 2011. pp. 311.)" Insufficient domestic accumulation, lack of efficient use of domestic accumulation, lack of quality factors of development (especially technology and capital) defines an emerging economy to a stable import of foreign capital due to:

- maintain high rates of economic growth and reduce the development gap in relative to developed countries;
- to cover gaps in the required high investments and domestic accumulation (savings). Also known is the case when the domestic investment higher than saving I> S, imports must be larger than exports M> X according to the equation S –I= X - M,
- technological and developmental dependence on the developed economies (chronic need for new technology, import of equipment, spare parts, raw materials, energy, etc.).

Theoretically it is proved that a certain economy, the greater the degree of underdevelopment, the greater the share of real import and significance of accumulation, which is the level of development achieved higher it is the greater importance of financial resources (capital) in the structure of foreign debts. What is the development of more disproportionate (imports to exports, savings and investments, production and consumption) and the importance of the share capital is growing, because there is the balance of payments barrier that can not be overcome domestic accumulation. Low exports relative to imports creates a hunger for foreign accumulation.

The rapid and balanced growth at the same time allow larger share of real accumulation and a higher degree of technological integration of the country with the world, then the need for a high rate of accumulation significantly reduced. The need to import accumulation can be created through economic and development policy in which the primary meaning gives the rate of growth, full employment and stability but at the sacrifice of balance of payments equilibrium and chronically high external debt. Both of these ways of creating additional accumulation are politically possible, but it depends on several factors:

- the the achieved development level and possibilities of compression of domestic consumption,
- the political and social situation in the country,
- high rates of inflation and overall economic instability,
- the existing relations in the balance of payments,
- relations and developments on the international capital market

In the economy which forces the growth rate along with satisfying stability and high levels of employment at some point comes the next phase, when the accumulated problems of balance of payments (high external debt, lagging development and weak exports, a growing balance of trade deficit, high and accumulated obligations under debt) , interest and repayment, melting of foreign currency reserves, followed by interventionism in the economy, this leads to the fact that the economy is entering into new debts to repay old debt into new debt for the formation of foreign exchange reserves and the preservation of any such external liquidity of the economy. The debt now becomes an impediment to development, it becomes a contradiction in relation to the beneficiary country. External debt is increasingly taking the form of financially, has to balance the economy, but only to be immediately drawn off. It makes their way to the recipient country and back, leaving behind only the interest and repayment obligations. Creates a debt due to the debt but with the constant expansion of such formed circles.

In this way, obligations under debt absorb the increase in GDP, leading to bankruptcy of debtor of the country. The main objective of capital imports is not increase in personal and general consumption and increase in living standards, but enhancing and maintaining high rates of investment, increase in income and employment, and increase in savings and investment spending. The economy of a country requires a certain level of capital to generate production in order to sustain economic growth (Mankiw, 2013. p. 87). Economic theory suggests that a reasonable level of indebtedness of the country is likely to increase economic growth, because it accelerates the pace of infrastructure development. Therefore, it is essential height imports of capital and its structure and efficiency of use.

“The main purpose of import of capital is to be in the national economy ensuring such process of economic growth, which will continue to be able to be maintained without external financial support, meaning that changed the economic structure should provide the domestic economy such capability (Mrkušić, 1974, p. 8).”

Development can not be imported from abroadbecause foreign funds only the initial, will enable the growth and then they need their own power that will accept and ensure the continued growth and that based on domestic factors. Imports of capital has the function of rapid change in production structure, the structure of imports and exports by delaying the payment of the required imports of goods and equipment (payment on the loan for example.), As it will do later when with the help of foreign capital change its economic structure and exchange relations.

From all of this raises the question of how the national economy is, at a certain level of development, able to achieve such savings and development structure that will ensure combined self-sustaining growth with only additional funding, as required by technology and international connections of its economy.

FUNCTIONING OF IMPORT CAPITAL TO FINANCE POTENTIAL OF SERBIAN ECONOMY

Functioning of foreign capital on domestic savings potential can be seen in two ways: positively, through the increase in the accumulation; negative, the high repayment and interest, as well as the unfavorable structure of the use of these funds.

The burden of interest burden on national accumulation and contributing to brain a significant part of accumulation abroad. This is evident from year to year. Faster growth of paid interest on external debt of the increase in net national accumulation is especially pronounced in recent years. Through the interest, a significant part of the income and internal accumulation is poured abroad instead of increasing the funds available to accumulation and investment. This tendency is due to the following factors:

- Carelessly borrowing abroad;
- sudden increase in the cost of capital in the financial markets;
- irrational and unproductive use of foreign funds;
- uncontrolled implemented policy appreciation of the dinar exchange rate;
- deteriorated conditions and caution in the financial markets (financial crisis, the collapse of the banks' liquidity, the crisis on the stock markets), but also a great caution in granting new loans.

All of the above are significant and numerous reasons for the chosen strategy of economic development must be given much more attention, not only when it comes to the amount of debt, but also its structure and efficiency of use. The negative consequences are manifested through the accumulation of foreign debt, inefficient use of resources and numerous long-term negative effects that will be rectified for years, because it is not a crisis of liquidity in the economy, but about fundamental disturbances in the economic development of our country.

THE EFFECTS OF CAPITAL IMPORTS ON BALANCE OF PAYMENTS AND FOREIGN TRADE DEFICIT

The deficit of the balance of payments occurs most often under the influence of a number of factors caused by the movement of the national economy. Constantly high import demand is one of the basic characteristics of the modern economy and is linked to three factors in the local economy:

- high inflation rate (above the world price);
- strong growth of in demand for products for the current reproduction, and other forms

- of consumption (in relation to the production and supply of the commodity funds); a high income elasticity of imports (import dependency).

All three factors have led to discrepancy of import and exports and a deficit of the trade balance. The imbalance of the balance of payment is due not only lagging exports to imports, but also unfavorable long-term flows and short-term capital. Indebtedness of an economy abroad is today an important notion if one looks at the form and manner of use of funds, routing directions (allocations), the effects of which are obtained using these resources, time availability (deadlines), the dynamics of maturity of liabilities, connectivity and quality of resources, conditions of use and more.

Today, all countries are trying to take a conscious policy of deficit in the current account, in particular developing countries. Imports of capital and deficit allow you to maintain a higher current rate of economic growth. These imports means indirect increase in national disposable income and consumption in the period of borrowing. Imports of capital temporarily pushed in the second plan necessary corrective moves of economic policy, and change the parity of the national currency (devaluation).

Question, what can be the maximum current-account deficit, and that does not negatively affect on stability, economic growth and employment in the country. Maximum deficit must be seen in the development and faster structural changes of production, economic and social structure, which is present in all countries, especially in developing countries. Maximum deficit must be put into function:

- achieved level of external indebtedness;
- structure of the debt and its maturity;
- the possibilities for faster or slower change of production structure and creating greater
- independence from foreign capital;
- the production or non-productive use of capital;
- the supply of raw materials and energy (structural characteristics of the economy);
- The structure of exports and imports and its importance on the world market etc.

Balance of payments deficit is the result primarily of the current situation and trends in the national economy, relations between national income and consumption, and the involvement of the economy in the world economic developments and activity of crisis processes in the world economy on export restrictions. The flow of domestic expenditure is functionally linked to the trends in mutual economic relations of each country in particular in developing countries.

ANALYSIS OF THE PUBLIC DEBT OF THE REPUBLIC OF SERBIA

Serbia is one of the countries in transition and has a budget deficit in recent decades. When there is a budget deficit, the government can borrow in the domestic and international markets to finance government expenditures and domestic investment, and therefore the accumulation of past borrowing becomes debt, the burden of government.

Greater inequality in income and expenditures will increase pressure on politicians to shift the fiscal burden from present to future generations, i.e. this pressure will result in a portion of government spending financed by issuing public debt, which can lead to a higher debt-to-gross domestic product in the long run (Arawatar,Tetsuo, 2015, p. 2).

Public debt management requires a risk analysis of public debt or public debt structure. Portfolio of public debt is exposed to numerous risks, of which the most important are highlighted in the following table.

Table 1: The risks in public debt management

Risk	Description
Market risk	Refers to the risk of increases in the cost of the debt arising from changes in market variables, such as interest rates and exchange rates. The most common types of market risk are the interest rate risk and exchange rate risk.
Interest rate risk	Refers to the risk of increases in the cost of the debt arising from changes in interest rates.
Exchange Rate Risk	Refers to the risk of increases in the cost of the debt arising from changes in exchange rates.
Refinancing Risk	Refers to the risk that debt will have to be refinanced at an unusually high cost or, in extreme cases, cannot be refinanced at all.
Liquidity risk	Refers (in the context of debt management) to a situation where the volume of liquid assets diminishes quickly as a result of unanticipated cash flow obligations and/or a possible difficulty in raising cash through borrowing in a short period of time.
Credit risk	Refers to the risk of non-performance by borrowers on loans or other financial assets, or by a counterparty on financial contracts. This risk is particularly relevant in cases where debt management includes the management of liquid assets.
Settelment	Refers to the risk that a counterparty doesnot deliver a security as agreed in a contract, after the country (other counterparty) has already made the payment according to the agreement.
Operational risk	Refers to a range of different types of risks, including transaction errors in the various stages of executing and recording transactions; inadequacies or failures in internal controls, or in systems and services; reputation risk; legal risk; security breaches; or natural disasters.

Sourse: http://www.imf.org/external/np/pp/eng/2014/040114.pdf pp. 12-13.

The main risks faced by the portfolio of public debt refers to market risk, which includes interest rate risk and exchange rate risk, refinancing risk, liquidity risk, credit risk and operational risk. The risk exposure of a portfolio of public debt determine the composition of the debt portfolio, including the share of short-term debt to long term debt in the portfolio, variable rate debt to fixed rate debt and debt denominated in foreign currency.

SUSTAINABILITY OF THE PUBLIC DEBT OF SERBIA

During the recession around the world, nearly all countries lend huge sums of money for public spending and social programs. However, according to the IMF, the reason why the state fall into the growing indebtedness is a rapid decline in public revenues.

The largest public debt for years has Japan, even 226,10% of GDP at the end of 2013, followed by Zimbabwe, Greece, Italy, and in the place number 47 is the Republic of Serbia, and the lowest public debt among developed countries has Estonia with 6% of GDP (https://www.cia.gov/library/publications/the-world, 20.05.2015.).

The main guidelines for the management of the public debt policy, defined by the Public Debt Management Strategy, which is an integral part of the economic and fiscal program of the Republic of Serbia. According to the Strategy, the primary objective of the borrowing and public debt management is to provide the funds needed to finance the budget, with minimal financing costs in the medium and long term, with an acceptable level of risk (http://mfin.gov.rs/UserFiles/File/dokumenti/2015/Fiskalna%20strategija%202015-2017.pdf p. 72.).

The indicator, which is mainly used in the literature is an indicator of share of debt in GDP. This indicator measures the level of indebtedness that relates to economic activity in the country. It implicitly assumes that all GDP resources are available to finance the debt burden, which is not necessarily true. However, this indicator is recognized as one of the most important for measuring the level of indebtedness, highlighting the ability of government solvency. Also, several other indicators have been established using the criterion of debt to GDP. The main indicators of using this concept for debt assessment are known as indicators of overall debt. Some of them are related to the composition of the debt, that is, the amount of external and domestic liabilities, fixed, variable rate liabilities, the amount of short-term, medium-term and long-term debt (Tagkalakis, Athanasios, 2014. p. 163.).

These are useful indicators to define the evolution of the debt and ability to pay, they provide certain signals about the worsening or improvement of the position of the government.

According to the Public Debt Law, public debt is: (Zakon o javnom dugu, Zakon je objavljen u "Službenom glasniku RS", br. 61/2005,107/2009 i 78/2011, Član 2.)

1. debt of Republic arising under the contract concluded by the Republic,
2. debt of Republic on the basis of securities,
3. debt of Republic based on contracts and agreements are reprogrammed obligations took
4. over by the Republic, under previously signed contracts, as well as securities issued by special laws,
5. debt of Republic arising on the basis of given guarantees of the Republic, or on the basis of of direct undertaking in the capacity of the debtor to pay the debt on the basis of assurances given, or on the basis of counter guarantee, which gives the Republic,
6. debt of local authorities, as well as legal entities referred to in Article 1 of this law for which the Republic has given its guarantee.

Public debt of the Republic of Serbia is divided into direct liabilities (loans) and indirect liabilities are obligations arising from the issued guarantees. Depending on the lenders they are classified as internal debt and external debt.

1. Domestic debt consists of obligations from the previous period and obligation on base of emissions of short-term treasury bills. The largest part of the internal debt refers to the old foreign currency savings, which represents the largest individual debt in the total public debt of Serbia.
2. External debt consists of rescheduled old debt and new borrowings. Rescheduled debts are:

- Debt to the International Bank for Reconstruction and Development (IBRD A, B, C)
- Debt to Paris Club creditors,
- Debt to the London Club of creditors,
- Debt to the Development Bank of the Council of Europe (CEB).

Serbia's public debt at the end of 2014 amounted to 23 billion of EUR. The amount shown is the sum of the total balance of external and internal debt and non-guaranteed debt of local authorities shown in the following table.

Table 2: Public Debt of the Republic of Serbia on 31.12.2014.

	In thousands		In millions	BDP%
A. Direct liabilities	EUR	USD	RSD	
Internal debt	8.225.160	10.002.618	994.901	25,6
External debt	11.986.805	14.577.155	1.449.904	37,3
Direct liabilities-total	20.211.965	24.579.773	2.444.805	62,9
B. Indirect liabilities	EUR	USD	RSD	
Internal debt	703.819	855.914	85.133	2,2
External debt	1.841.154	2.239.028	222.703	5,7
Indirect liabilities-total	2.544.973	3.094.941	307.836	7,9
C. Unguaranteed debt of local authorities	EUR	USD	RSD	
Internal debt	320.616	389.901	38.781	1,0
External debt	115.324	140.245	13.949	0,4
Unguaranteed debt of local authorities-total	435.940	530.146	52.731	1,4
Total public debt of central level of government (A + B)	22.756.938	27.674.714	2.752.641	70,9
Total public debt of the general government level (A + B + C)	23.192.878	28.204.860	2.805.371	72,2

Sourse: Ministry of Finance of the Republic of Serbia - Public Debt Administration, December2014.http://www.javnidug.gov.rs/upload/Bilteni/Bilten%20CIR/2014/Mesecni%20izvestaj%20Uprave%20za%20javni%20dug%20CIR-%20DECEMBAR.pdf

The Republic of Serbia has a specific debt, because it includes the old foreign currency savings, social liabilities, public and private companies and banks, borrowing to the current liquidity. The most important reason for the existence and financing of public debt in most countries in the world is usually only the last one.

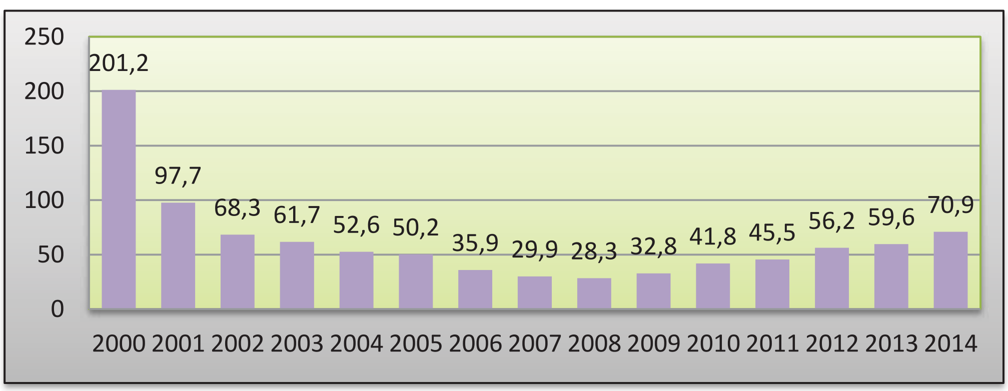
Table 3: Public debt of Serbia (central level of authority) for a period 2004- 2014. in millions of €

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
DIRECT LIABILITIES											
INTERNAL DEBT	4.064	4.255	3.837	3.413	3.162	4.050	4.572	5.441	6.496	7.055	8.225
EXTERNAL DEBT	5.267	5.364	4.746	4.616	4.691	4.409	5.873	7.239	8.621	10.245	11.987
TOTAL	9.331	9.620	8.583	8.029	7.853	8.459	10.444	12.679	15.117	17.299	20.212
INDIRECT LIABILITIES											
INTERNAL DEBT						135	340	536	723	857	704
EXTERNAL DEBT	344	663	769	846	929	1.257	1.372	1.574	1.878	1.985	1.841
TOTAL	344	663	769	846	929	1.392	1.712	2.110	2.600	2.842	2.545
PUBLIC DEBT OF SERBIA	9.676	10.283	9.352	8.875	8.781	9.851	12.157	14.789	17.717	20.141	22.757

Sourse: Ministry of Finance of the Republic of Serbia - Public Debt Administration, December2014.http://www.javnidug.gov.rs/upload/Stanje%20i%20struktura/Stanje%20i%20struktur%20-%20SRB%20LATINICA.pdf

Serbia is at the end of 2000 had a debt of 14,167 million euros, which consisted of the inner part, amounting to 4,108 million and external of 10.059 million, there was no indirect liabilities. Both debts represented the socialization of debts of enterprises and banks in the nineties, because the state was not in a position to borrow at home or abroad (http://www.makroekonomija.org/0-miroslav-zdravkovic/javni-dug-republike-srbije 08.03.2015.).

Debt decreased to the outbreak of the economic crisis in 2008, partly because of write-off of debts, and due to regular repayments. Domestic debt is largely represented obligations under the old foreign currency savings, including savings in private banks, while the external debt represented liabilities to the clubs of creditors and other debts that the government has taken on himself. Obligations to the London and Paris Club creditors have been reduced, while the debt to the World Bank recognized in its entirety. Total debt to all creditors included the interest and penalty interest loans since 1992, despite the fact that Serbia was prevented to service its obligations. From 2000 to 2008, and the outbreak of the crisis, Serbia's public debt was reduced by 5,386 million euros. During the first decade of the 21st century, our country had a relatively low share of public debt in GDP, which in 2008 amounted to 28.3%. The financial crisis that erupted in 2008 in the US and Western Europe, has not missed Serbia. To maintain economic activity and prevent a decline in gross domestic product, the government decided to increase the budget deficit and public debt since 2009 begins to grow rapidly (http://www.javnidug.gov.rs/upload/bilteni/bilten%20lat/2014/mesecni%20izvestaj%20uprave%20za%20javni%20dug%20-%20avgust %20lat.pdf)



Graph 1: Percentage share of public debt in GDP of the Republic of Serbia: central level of authority

Source: Ministry of Finance - Public Debt Monthly Report Analysis of public debt and debt of the general government, 2014

Besides the high level of debt, must be analyzed and its structure. "In order to finance the budget deficit in 2011 intensified the issue of local currency securities, which increased the share of public debt in dinars from 16.4% at end-2011 to 19.5% at the end of 2012. yr., And the end of 2013 . the dinar debt accounted for 20.5% of the public debt of the Republic of Serbia. Striving to reduce exposure to currency risk, extending the maturity and development of new borrowing instruments in the domestic financial market during 2014 continued the trend of growth of the national currency in the portfolio of public debt (http://www.javnidug.gov.rs/upload/Strategija/Strategija%20cir/20152017/Strategija%20upravljanja%20javnim%20dugom%202015%20-2017.pdf.)."

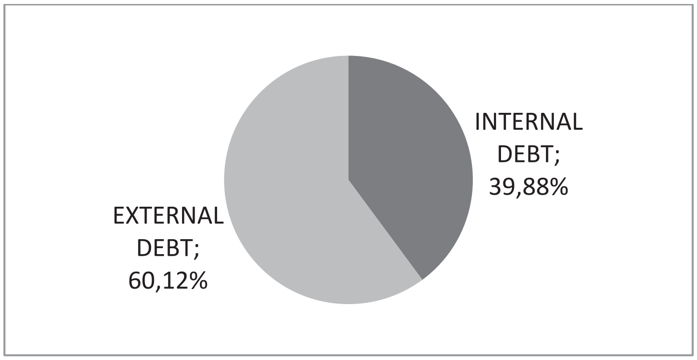
Table 4: Currency structure of public debt (central level of authority and general government debt)

Central level of authority		
Currency	By the middle exchange rate	Share
RSD	588.567.193.663	21,38%
EUR	1.148.230.448.621	41,71%
USD	866.628.236.381	31,48%
CHF	20.021.229.969	0,73%
SDR	115.416.956.322	4,19%
Others	13.776.452.305	0,50%
Total	2.752.640.517.261	100%
General government debt		
Currency	By the middle exchange rate	Share
RSD	605.977.661.282	21,60%
EUR	1.183.283.258.006	42,18%
USD	866.628.236.381	30,89%
CHF	20.288.484.348	0,72%
SDR	115.416.956.322	4,11%
Others	13.776.452.305	0,49%
Total	2.805.371.048.645	100%

Source: Ministry of Finance - Public Debt Monthly Report Analysis of public debt and debt of the general government, 2014

Currency structure of our debt is unfavorable because it is only 21.60% in local currency (RSD). The largest part of the public debt of Serbia is still in foreign currencies, of which the majority are EUR 42.18%, 26.47% US Dollars (USD), special drawing rights 4.11% (SDR), CHF 0.72% (CHF) and other currencies 0.49%.

"The currency structure of public debt, as a share of external public debt in total, show the extent to which the exchange rate affects the size of the public debt (Đorđević, Stoiljković, 2012., p. 252.).



Graph 2: The share of external and internal debt in the public debt of the Republic of Serbia

This analysis clearly shows that the public debt (total) is sensitive to exchange rate risk, as well as to the amount of debt affects the mood of investors, with the knowledge that non-residents hold a significant portion of the debt.

Interest structure of public debt of the Republic of Serbia towards interest rates is favorable, because most of debt tied to fixed interest rates.

Table 5: The structure of interest rates debt of general government in the period 2011 – 2014

	2011	2012	2013	2014
Variable interest rate	31,8%	29,0%	26,9%	23,7%
Fixed interest rate	68,2%	71,0%	73,14%	76,3%

Source: Ministry of Finance - Public Debt Monthly Report, Analysis of public debt and debt of the general government, December 2014. "Public Debt Management Strategy from 2015 to 2017."

Table 6: Structure variable interest rates debt of general government in the period 2011 – 2014

	2011	2012	2013	2014
EURIBOR and LIBOR - EUR	73,1%	72,9%	70,3%	64,1%
LIBOR - USD	11,4%	11,0%	9,7%	10,3%
LIBOR - CHF	2,1%	1,9%	1,7%	1,7%
Others	13,5%	14,2%	18,3%	23,9%

Source: Same as above table.

"Most of the public debt of the Republic of Serbia 76.3% is at fixed interest rates, while the public debt with variable interest rates of 23.7% of total public debt. Among the variable interest rates are in most cases Euribor and Libor on euro representing a total of 64.1% of the total public debt at variable interest rates, while 12.9% refers to the obligations related to the NBS reference interest rate, 10.3% were the obligations related to the US dollar Libor, while other liabilities related to other types of floating rate applies 12,7% (mostly the variable interest rate for special drawing rights) (http://www.javnidug.gov.rs/upload/Strategija/Strategija%20cir/20152017/Strategija%20upravljanja%20javnim%20dugom%202015%20-2017.pdf)."

Table 7: Indicators of Serbia's external position from 2005 to 2014

	2005.	2006.	2007.	2008.	2009.	2010.	2011.	2012.	2013.	2014.
The indicator of external liquidity (in%)										
Foreign exchange reserves / imports of goods and services	6,1	9,0	7,5	5,4	9,7	8,4	8,8	7,7	7,5	6,6[2)]
Foreign exchange reserves / short-term debt	177,0	265,1	250,6	162,6	220,6	193,0	299,6	242,6	289,8	285,7
Foreign exchange reserves / GDP	23,3	36,9	32,7	24,2	34,6	33,6	36,1	34,5	32,7	29,8
Repayment of the debt / GDP	5,0	10,3	10,3	10,7	12,8	12,0	12,5	13,1	13,4	17,5
Debt service / exports of goods and services	19,8	36,2	37,5	37,5	48,8	37,4	37,5	36,2	32,9	41,1
External solvency indicator (in%)										
External debt / GDP	59,3	58,5	59,0	62,3	72,7	79,0	72,2	80,9	75,2	78,3
Short-term debt / GDP	13,2	13,9	13,1	14,9	15,7	17,4	12,0	14,2	11,3	10,4
External debt / exports of goods and services	234,9	205,7	214,2	219,1	277,0	246,9	216,4	223,0	184,5	180,2

Source: National Bank of Serbia, statistics, http://www.nbs.rs/internet/latinica/80/index.html,19.02.2015.

External solvency indicators have improved compared to last year .. The most important is the improvement of external debt to exports of goods and services for which it is often said that the most important among the indicators. "Export is the basis of sustainable servicing of external debt (Vaggi, Gianni, Prizzon, 2014, p. 1159).

This indicator is reduced not only by reducing the external debt but also by increasing exports. From the year 2005. brought down by 54.7 percentage points to 180.2%, which is below the limit of sustainability, according to criteria of the World Bank (up 220%)(Herzberg, Angélique, 2015, pp. 235-289.). Compared to the 2012 year. continued reduction of foreign debt to GDP ratio to 78.3%. In addition to the indicators of external solvency indicators are favorable external liquidity compared to the previous period. The indicators of public debt sustainability are exacerbated, in addition to indicators that it considered in relation to exports.

Bad debt management and high debt levels could increase inflation expectations and affect the increase in the level of interest rates and / or currency depreciation. Exchange rate and interest rates policy, limits the amount of foreign currency debt and debt that can be emitted by the variable interest rate. The bad debt structure could jeopardize the ability of central banks to keep interest rates under control (Kvrgić, Čolić, Vujović, 2011, p. 36).

Public debt will continue to grow and is estimated by the end of 2017. to 76.8% of GDP. Due to the recession the population consumes less, foreign investors and the state does not invest, so that economic growth can be stimulated only instrument of monetary policy, ie reducing the reference interest rate and encouraging consumption and investment. The National Bank of Serbia emphasizes the stability of prices and the exchange rate of the domestic currency to its target, but the Central Bank of the leading economic powers have announced a shift in its monetary policy. Instead of the focus on the inflation rate, emphasis is placed on efforts to increase employment and stimulate economic growth. In line with the global and Serbian monetary policy should be changed as soon as possible and to react, rather than in emergency situations recession economy Serbian market left to self-regulation. It is more than obvious that the stable dinar exchange rate means a high price for the increased current account deficit, and the effect that has on exports and production.

METHODS OF FINANCING PUBLIC DEBT

Public debt can be financed using a variety of sources: domestic and foreign, official and commercial. The difference between domestic and foreign sources based on their origin, in the country or outside its borders, and this classification can be used as a basis to identify the source of financing public debt (Dabrowski, Marek, 2015, p. 21).

Unlike companies when they can not service their debts or go bankrupt, extinguish and be with them and their obligations, states can not cease to exist as a result of their indebtedness. Their capacity to repay debts is unlimited, regardless of the consequences for them and their inhabitants. State's unlimited duration, have many different types of assets, from those who have companies, and most importantly, have a tax mechanisms which may force their citizens to (indirectly) to help restore the state debts (http://www.makroekonomija.org/1-nebojsa-katic/pravo-pravda-i-drzavni-dugovi/ 20.01.2015.). Also, the budgeted crisis affects many more people and affects them much harder than the crisis may hit corporations and its employees.

Public debt returns of the funds that are generated from public funds, and to the key role played by the fiscal policy of the state (http://www.investopedia.com/articles/economics/11/successful-ways-government-reduces-debt.asp 7.12.2014.).

Fiscal policy is one area where everyone has an opinion, but few economists can agree on any single idea. While a smaller public debt and stimulating the economy overall objectives of most governments in the developed economies, the achievement of these goals often involves tactics that appear to be mutually exclusive and sometimes very contradictory.

In the case of servicing the public debt the state has several options: (Beslać, 2014, pp. 153-158.).

1. **To increase the fiscal burden -** The first action of the Government in the context of fiscal consolidation was increasing the rate of most buoyant taxes - VAT

from 18 to 20%, from 1 October 2012. It is planned progressive taxation on the model of developed countries, as well as the introduction of a solidarity tax on earnings most favored in the state administration. The effects of this measure would be more symbolic than they would be able to influence the level of public debt. Options that Serbian government is still considering raising and special VAT rate, from 8 to 9%, and the taxation of certain types of goods that have so far had less income, the general rate of 20%. After first raising the general VAT rate, there has been a reduction in economic activity and the fall in trade turnover.

2. **To increase the level of public revenue -** to reduce the the informal economy by developing the fiscal awareness, change the way the fiscal payments and fiscal burden. Not paying taxes leads to socially entropy, encourages corruption and disruptive market relations. Were announced decisive action Serbian Tax Administration in the fight against the gray economy and improving of tax discipline, but this action can not in the short term to provide sufficient revenues to increase significantly assist the public debt. Translation of the black market in legal businesses would still for Serbia was the biggest chance and impetus for overcoming the crisis, because it is estimated that the informal economy comprises around 30% of gross domestic product.

3. **To reduce expenses to the level of income -** is a complex process because the budget revision brings the same procedures as the budget itself. Reducing expenses is also realized by reducing public spending. Canada in 1990 was faced with an almost double-digit budget deficit. The introduction of deep budget cuts (20% or more within a period of four years), the government reduced the budget deficit to zero within three years and reduce the public debt by a third within five years. They did it without raising taxes. In theory, other countries may follow her example. But in reality, state assistance in basic sectors of the economy, especially in the sector of investment, employment and the social sector, especially in times of crisis is essential. Options for reducing costs, which are available to the government are small and rare.

Adopting the savings program will unload Serbian budget deficit reduction, which increases public debt, abolishing subsidies and quenching incompetent firms. Restructuring of former social enterprises that can generate annual cost of up to one billion euros, would prevent further spending of the state about their maintenance and loss of their suppliers and customers because these companies do not meet their liabilities.

4. **To provide funds from other sources -** borrowing from domestic and foreign creditors. By increasing taxes, the debt burden borne by the present generation, thus reducing the economic power and the borrowing burden shifted to future generations that will feel the consequences of the past.

The indebtedness due to investment is good, because in the future the money come back and make more profit. Indebtedness for the construction of infrastructural facilities is also economically justified because they bring general benefit. But the indebtedness due to expenditure - public spending, which will bring income in the future is harmful.

Indebtedness can be done with short-term bank loans and short-term borrowings, loans of commercial banks from savings funds, foreign loans and credits, funds of new public borrowing funds from the primary issue.

Eventually borrowing from foreign creditors usually goes with some major political or economic conditions, which would make this option should be used carefully. Therefore, in Serbia occurs issuance of government debt (Kvrgić, Nikolić, 2014, p. 261)

The central bank often issues bonds to generate income. This allows to avoid tax increases and provides money to stimulate the economy. For debt securities issued by the government, the risk is very small. For this reason, the interest rate on government securities tends to be relatively low. This approach is often used during the last ten years, but at some point the borrowed money must be repaid and the government must pay interest to its creditors. In this year will, for the financing of public debt and deficit, the budget need to be five billion euros, and only the interest goes to 100 billion dinars from the budget.

At the time of the sale of government bonds, moves to household savings, which instead of investing in real estate, stocks or bonds of companies, goes into government bonds. In this way, the public debt of the lowering of production, wages and income.

Manipulation of interest rates - the maintenance of low interest rates is another way that the government is trying to stimulate the economy by increasing consumption, and thus tax revenues and ultimately reduce public debt. Low interest rates make it easier for individuals and businesses to obtain loans that they will continue to spend on goods, services, or further investment, which creates jobs and tax revenues. Low interest rates have introduced the United States of America (interest rate since 2008 is 0.25%)(„Central banks - summary of current interest rates“ http://www.global-rates.com/interest-rates/central-banks/central-banks.aspx, 03.07.2013), European Union (since 05.02.2013. Amounted to 0.5%, before that, was 0.75% from 2005) Great Britain (from 2009's 0.5%) and other nations with a certain amount of success. The National Bank of Serbia obviously does not implement this measure because it is 2013 years. reference interest rate was 11.25%.

Then it decreased from 11.75%, explaining that thanks to the measures taken of the monetary policy significantly weaken inflationary pressures (Jovović, http://www.danas.rs/dodaci/biznis/kuda_ide_precenjeni_dinar.27.html?news_id=26180, 2.6.2014.). And since 13/11/2014. is 8%.

1) **Forgiveness of debt -** States that were not able to regularly pay off the debts were allowed to be partially write off or reprogrammed. These unwritten rules are adopted and apply to the global economic scene last three decades. Reprogram has never been easy, had its own hidden political dimension, but the country managed to after the write-off of debts again function normally. The strategy that the country that owes other wealthy creditors forgive the debts or provide irrevocably the money is used only in certain severe cases - for example, many countries in Africa are beneficiaries of debt forgiveness. Unfortunately, even this strategy has its

flaws. In the late 80's indebtedness of Ghana significantly reduced debt forgiveness. But in 2011 the country was again deep in debt. Greece, which has received billions of dollars in resources to get out of the crisis in the period 2010-2011.godine, was not much better after the initial round of cash infusions.

2) **The debt crisis (default) -** when the state is unable to repay the debt, may declare bankruptcy or restructure debt to creditors. This is a common and often successful strategy to reduce debt. North Korea, Russia and Argentina have successfully used this strategy.

There are controversies for each method, the arguments for and against. Although the different methods used in different times and with varying degrees of success, there is no magic formula that works equally well for each state in each instance.

CONSLUSION

Theoretically it is proved that a certain economy, the greater the degree of underdevelopment, the greater the share of real import and significance of accumulation, which is the level of development achieved higher it is the greater importance of financial resources (capital) in the structure of foreign debts. What is the development of more disproportionate (imports to exports, savings and investments, production and consumption) and the importance of the share capital is growing, because there is the balance of payments barrier that can not be overcome domestic accumulation. Low exports relative to imports creates a hunger for foreign accumulation.

In the economy which forces the growth rate along with satisfying stability and high levels of employment at some point comes the next phase, when the accumulated problems of balance of payments (high external debt, lagging development and weak exports, a growing balance of trade deficit, high and accumulated obligations under debt) , interest and repayment, melting of foreign currency reserves, followed by interventionism in the economy, this leads to the fact that the economy is entering into new debts to repay old debt into new debt for the formation of foreign exchange reserves and the preservation of any such external liquidity of the economy. The debt now becomes an impediment to development, it becomes a contradiction in relation to the beneficiary country. External debt is increasingly taking the form of financially, has to balance the economy, but only to be immediately drawn off. It makes their way to the recipient country and back, leaving behind only the interest and repayment obligations. Creates a debt due to the debt but with the constant expansion of such formed circles.

In this way, obligations under debt absorb the increase in GDP, leading to bankruptcy of debtor of the country. The main objective of capital imports is not increase in personal and general consumption and increase in living standards, but enhancing and maintaining high rates of investment, increase in income and employment, and increase in savings and investment spending. Economic theory suggests that a reasonable level of indebtedness of the country is likely to increase economic growth, because it accelerates the pace of infrastructure development. Therefore, it is essential height imports of capital and its structure and efficiency of use.

From all of this raises the question of how the national economy is, at a certain level of development, able to achieve such savings and development structure that will ensure combined self-sustaining growth with only additional funding, as required by technology and international connections of its economy.

The Republic of Serbia has a specific debt, because it includes the old foreign currency savings, social liabilities, public and private companies and banks, borrowing to the current liquidity. The most important reason for the existence and financing of public debt in most countries in the world is usually only the last one.

Currency structure of our debt is unfavorable because it is only 21.60% in local currency (RSD). The largest part of the public debt of Serbia is still in foreign currencies, of which the majority are EUR 42.18%, 26.47% US Dollars (USD), special drawing rights 4.11% (SDR), CHF 0.72% (CHF) and other currencies 0.49%.

Interest structure of public debt of the Republic of Serbia towards interest rates is favorable, because most of debt tied to fixed interest rates. Most of the public debt of the Republic of Serbia 76.3% is at fixed interest rates, while the public debt with variable interest rates of 23.7% of total public debt.

External solvency indicators have improved compared to last year .. The most important is the improvement of external debt to exports of goods and services for which it is often said that the most important among the indicators. This indicator is reduced not only by reducing the external debt but also by increasing exports. From the year 2005. brought down by 54.7 percentage points to 180.2%, which is below the limit of sustainability, according to criteria of the World Bank (up 220%). Compared to the 2012 year. continued reduction of foreign debt to GDP ratio to 78.3%. In addition to the indicators of external solvency indicators are favorable external liquidity compared to the previous period. The indicators of public debt sustainability are exacerbated, in addition to indicators that it considered in relation to exports.

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EFFECTS OF FISCAL SYSTEM CONSOLIDATION AND INFLATION AS A MONETARY PHENOMENON ON THE DEVELOPMENT OF BOSNIA AND HERZEGOVINA

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APSTRACT

Successful functioning of monetary and fiscal policies is a prerequisite for economic growth of any economy. This paper is designed in a way that, among other things, analyzes two very important points of these policies, namely the budget on the one hand and inflation on the other. Also, the adoption of economic reform agenda, and the entry into force of the Stabilization and Association Agreement, Bosnia and Herzegovina (B&H) show serious intention to join the European Union. We determine the directions which must guide the consolidation of B&H fiscal system in order to create conditions for economic growth. Emphasis is placed on the importance of fiscal consolidation in B&H, and the consequences that may result if the implementation of fiscal consolidation is not done. This paper includes a comparison of the Croatian example as a neighbouring country in the period when it was a candidate for the membership in the EU, before the accession on 1 July 2013, because the reforms that Croatia had to undertake as a candidate country will also await B&H as a potential candidate for EU membership. The comparison established that the fiscal situation on the territory of B&H is identical to the status of neighbouring countries, so equal fiscal consolidation could be done. It indicates the reforms that authorities would need to undertake in the area of consolidation of the fiscal system. On the other hand, inflation is a monetary phenomenon that has preoccupied economists for decades. In this paper we analyze the inflation as a monetary phenomenon, and point out results of inflation and economic growth correlation. Due to the negative correlation between high inflation and economic growth, driven by these postulates, we analyze the level of inflation in B&H and the region to assess the success of the Central bank of Bosnia and Herzegovina. Also, this paper analyzes the fulfilment of Maastricht criteria relating to inflation, and the result obtained confirms that at this aspect Bosnia and Herzegovina fulfils this criterion.

Key words: *Fiscal Consolidation, Economic Growth, Inflation, Economic Reform Agenda, The Stabilization and Association Agreement*

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