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ANALYSIS OF FISCAL AND MONETARY POLICY MEASURES - MITIGATE THE EFFECTS OF THE COVID-19 PANDEMIC IN THE SERBIAN ORGANIZATIONS

Abstract

Purpose: This study analyzes the fiscal and monetary policy measures implemented by the Republic of Serbia to mitigate the economic effects of the COVID-19 pandemic. This study evaluated their effectiveness in preserving economic stability, employment, and financial liquidity. This study employs a comparative analysis of fiscal and monetary policies using official data from the National Bank of Serbia and Ministry of Finance. A qualitative assessment of policy efficiency was performed along with an evaluation of their macroeconomic impact. This study finds that government interventions, including wage subsidies, tax relief, and monetary easing, play a crucial role in maintaining economic stability. While fiscal stimuli support short-term economic recovery, increased public debt poses long-term sustainability challenges. These findings highlight the importance of well-coordinated fiscal and monetary policies during an economic crisis. This study provides insights into policy effectiveness and offers guidance for future crisis management and financial stabilization strategies. This study contributes to the understanding of the role of policy responses in small economies during global crises. It provides a case study of Serbia, illustrating key takeaways applicable to similar economies that face economic shocks.

Key words: *Fiscal policy, Monetary policy, COVID-19, Economic stability, Public debt, Serbia*

JEL classification: *E52, E58, E62, E63*

АНАЛИЗА МЕРА ФИСКАЛНЕ И МОНЕТАРНЕ ПОЛИТИКЕ - СУЗБИЈАЊЕ ПОСЛЕДИЦА ВИРУСА COVID-19 У СРПСКИМ ОРГАНИЗАЦИЈАМА

Apstrakt

Ovaj rad ima za cilj analizu fiskalnih i monetarnih mera koje je Republika Srbija sprovela kako bi ublažila ekonomske posledice pandemije COVID-19. Studija

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procenjuje njihovu efikasnost u očuvanju ekonomske stabilnosti, zaposlenosti i finansijske likvidnosti. Istraživanje koristi komparativnu analizu fiskalne i monetarne politike, oslanjajući se na zvanične podatke Narodne banke Srbije i Ministarstva finansija. Kvalitativna procena efikasnosti mera je sprovedena zajedno sa analizom njihovog makroekonomskog uticaja. Studija pokazuje da su državne intervencije, uključujući subvencije za plate, poreske olakšice i monetarne podsticaje, imale ključnu ulogu u održavanju ekonomske stabilnosti. Dok su fiskalni stimulansi podržali kratkoročni ekonomski oporavak, povećanje javnog duga predstavlja izazov za dugoročnu održivost. Nalazi istraživanja ističu značaj dobro koordinisane fiskalne i monetarne politike tokom ekonomskih kriza. Studija pruža uvide u efikasnost donetih mera, nudeći smernice za buduće upravljanje kriznim situacijama i strategije finansijske stabilizacije. Ovo istraživanje doprinosi razumevanju uloge ekonomskih politika u malim ekonomijama tokom globalnih kriza. Pruža studiju slučaja Srbije, ističući ključne zaključke primenljive na slične ekonomije suočene sa ekonomskim šokovima.

Ključne reči: *Fiskalna politika, Monetarna politika, COVID-19, Ekonomska stabilnost, Javni dug, Srbija*

Introduction

The most important shift in the global world order was impacted by the Covid-19 virus. National economies were destabilized, financial capital markets were unstable, and the global economy was unstable. The social aspect of mankind, the global economy, and the potential for effective risk management have all been shattered by the fear of sickness. The financial markets and financial management have been subjected to extreme strain. As an economic sector, tourism has also been severely impacted by the virus, which has decreased travel, supply chains, endangered catering operations, decreased consumption and output, increased the negative effects on business, and prioritized safety. Additionally, the epidemic increased financial stress, which was mirrored in the costs of fossil fuels, renewable energy sources, and all other items. In the context of the COVID-19 pandemic, Chang and colleagues (2020) examined financial management risks in the domains of business, economics, and finance. Organizations, like humans, were compelled to adjust their operations as much as possible to the new circumstances in order to survive the crisis.

Negative responses to natural calamities and the invasiveness of viruses did not spare the markets. The global crisis that occurred five years ago served as a warning to investors and managers who are crucial to making strategically significant decisions, as well as to the entire human society, about the potential for significant economic harm and the harm that health factors can do to human lives (Goodell, 2020). According to medical perspective, a single “small virus” on the boundary between living and non-living organisms (since it only requires domestic oxygen for survival) caused confusion in all areas of human life and work, destroying the might of “strong” men and restoring nature’s equilibrium (Ilic & Djukic, 2022). Even while the virus had a greater impact on some facets of human society than others, its powerful impact was most noticeable in domestic consumption when seen internationally. According to Lagoarde-Segot and Leoni (2013), the authors' theoretical model demonstrated that the likelihood of the banking system in industrialized nations collapsing rises with the frequency of big pandemics; in other words, this risk affects banks' optimal reserves (Lagoarde-Segot & Leoni, 2013). It has been demonstrated that nations with stronger institutions, more advanced medical technology, and qualified professionals were unable to effectively combat the COVID-19 pandemic.

According to Petrović et al. (2020), systemic readiness did not equate to a good reaction mechanism to the viral outbreak. Priority and importance were given to government and government-affiliated programs (Ilic et al., 2023). Some authors contend that less developed countries fared better at the onset of the epidemic since there were less health interventions available for general preventative measures because there were no medications at the time and a shortage of vaccines (Adžić et al., 2022). The main defenses were reduced to imposing quarantine and limiting travel, which meant minimizing social contact. Maintaining personal hygiene and cleaning protective gear were also given careful consideration (Mijović, 2020). It can be concluded that the country's "readiness" in the health system was essential to its survival, while the financial system reflected business readiness, which in turn was essential to the social system's survival and, more importantly, its sustainability. Businesses have never been more socially conscious, particularly when it comes to safeguarding the health of their employees.

In an effort to boost sales, businesses have shifted toward new inventions and technology, depending more and more on new forms of communication (Ilić & Ostojić, 2023). In every region of the nation, the idea of sustainable development has taken center stage and become essential to human civilization on a local and global level (Stojanović et al., 2017).

In early March 2020, the first case of coronavirus disease (COVID-19) was reported in the Republic of Serbia. Shortly thereafter, a state of emergency was declared accompanied by a series of measures aimed at protecting public health. The actions taken had a significant impact on economic activities and limited business in most industries, putting in the center the trends of human resource protection (Krušković et al., 2023). To mitigate the adverse effects of the pandemic on the economy, the National Bank of Serbia and Government of the Republic of Serbia introduced a set of appropriate measures. This study conducts a comparative analysis of the fiscal and monetary policies implemented and their impacts on Serbia's economy. To thoroughly examine these issues, it is essential to briefly define public finance, its role in economic stability, and its two main components—fiscal and monetary policy.

Public finance is a critical segment of economic science that focuses on government revenues and expenditures and their effects on the economy. It encompasses financial activities, such as tax collection, public spending, and public debt management. Public finance plays a key role in economic stabilization, income redistribution, and the provision of public goods and services that the private sector cannot deliver efficiently.

Fiscal policy involves government decisions regarding public revenue and expenditure. It serves as a tool to achieve macroeconomic goals such as economic stability, growth, and reduced unemployment. Fiscal policy can be expansionary, involving increased public spending and/or reduced taxes to stimulate economic activity, or restrictive, characterized by reduced spending and/or higher taxes to control inflation and decrease budget deficits (Baumol & Blinder, 2016).

Monetary policy, on the other hand, is the management of money supply and interest rates conducted by the central bank to maintain price stability and support economic growth. Its key instruments include open-market operations, benchmark interest rates, and reserve requirements. Similar to fiscal policy, monetary policy can be expansionary, with reduced interest rates and increased money supply to stimulate the economy, or restrictive, with the aim of controlling inflation through higher interest rates and reduced money supply (Mishkin, 2019).

Fiscal and Monetary Policy in the Republic of Serbia

The role of fiscal and monetary policies in public finance is crucial for achieving any country's macroeconomic goals. Understanding their functioning and interaction provides the foundation for analyzing economic policies and making informed decisions that contribute to economic development and stability.

In recent years, fiscal policy in the Republic of Serbia has been directed toward achieving fiscal consolidation and stabilizing public finances. Following the 2008 global economic crisis, Serbia faced significant challenges including high budget deficits and rising public debt. In response to these challenges, the Serbian government implemented a series of reforms aimed at reducing budget deficits, including public sector wage cuts, pension system reforms, and tax increases (Ministry of Finance of the Republic of Serbia, 2021).

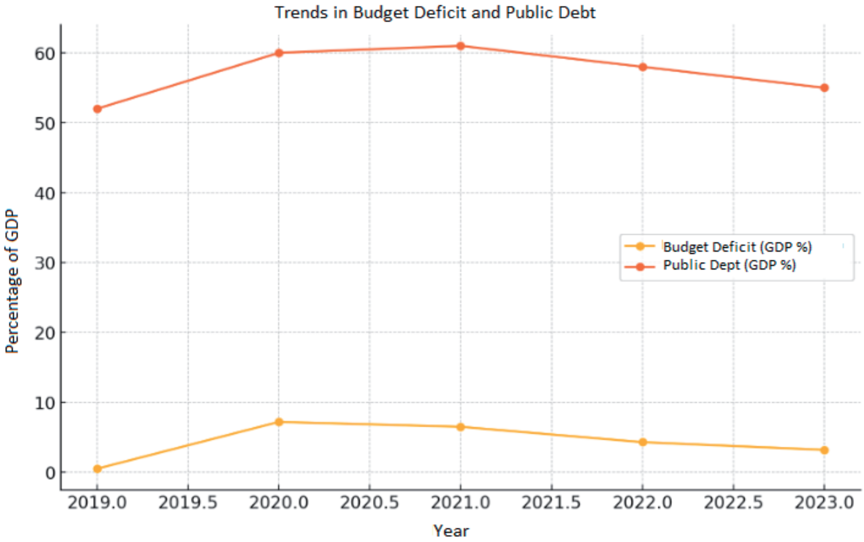
Since 2015, Serbia has made significant progress in fiscal consolidation, resulting in reduced budget deficits and stabilized public debt. These measures have improved the country's credit rating and increased investor confidence. However, the COVID-19 pandemic has posed new challenges, necessitating additional fiscal interventions to support the economy and preserve jobs (Fiscal Council of the Republic of Serbia, 2020).

However, monetary policy in the Republic of Serbia is implemented by the National Bank of Serbia (NBS), which focuses on maintaining price stability and supporting economic activity. The NBS employs various monetary policy instruments, including open market operations, adjustments to the benchmark interest rate, and mandatory reserves to influence the banking system liquidity and interest rates.

Over the past decade, the National Bank of Serbia has successfully maintained relatively low and stable inflation rates, which is a key goal of monetary policy. Additionally, in response to the economic crisis caused by the COVID-19 pandemic, the National Bank of Serbia reduced the benchmark interest rate and implemented measures to ensure liquidity in the financial system to support the economy and maintain banking sector stability (National Bank of Serbia, 2020).

The following graph illustrates how the budget deficit surged in 2020 owing to increased expenditures and reduced revenues caused by the pandemic. Public debt also increased as a result of higher borrowing to finance support measures.

Graph 1. Trends in Budget Deficit and Public Debt



Source: Ministry of Finance of the Republic of Serbia, National Bank of Serbia

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Negative Effects of the COVID-19 Pandemic in the Republic of Serbia

The COVID-19 pandemic has had significant negative impacts on the economy of the Republic of Serbia, affecting various sectors and causing numerous economic and social problems. The key sectors that experienced the greatest losses include tourism, hospitality, retail, manufacturing, and transportation.

- **Tourism and Hospitality:** Tourism and hospitality were among the hardest-hit sectors. Border closures, travel restrictions, and reduced consumer spending have led to a drastic decline in tourist numbers and revenues in these sectors. Many travel agencies, hotels, restaurants, and other hospitality establishments face revenue losses or complete shutdowns, resulting in job losses and reduced employment in these industries (Ministry of Trade, Tourism, and Telecommunications, 2021).
- **Retail and Manufacturing:** Retail experienced significant declines due to reduced consumer demand and restrictive measures aimed at curbing the spread of the virus. The closure of shopping centers, stores, and markets affected the revenues of traders and manufacturers, while supply chain disruptions added further challenges. The manufacturing sector has faced issues such as reduced production, raw material shortages, and decreased exports (Chamber of Commerce and Industry of Serbia, 2020).

• **Transportation:** The transportation sector also suffered severe losses due to reduced population mobility and declining international transport activity. Airlines, railways, bus operators, and transport companies face reductions in passenger numbers and cargo volumes, leading to revenue losses and increased costs (Ministry of Construction, Transport and Infrastructure, 2021).

In addition to the aforementioned issues and consequences affecting key sectors in Serbia, the pandemic exposed and exacerbated several critical problems and risks that had a direct impact on the entire economy. These problems primarily affected unemployment and social insecurity, public debt and budget deficits, the healthcare system, and education.

• **Unemployment and Social Insecurity:** Reduced economic activity led to increased unemployment and decreased household incomes, further heightening social insecurity and poverty. The COVID-19 pandemic has caused significant increases in unemployment in Serbia. Owing to restrictive measures and reduced economic activity, many companies were forced to lay off workers or close their businesses entirely. The most affected sectors included tourism, hospitality, retail, and transportation, leaving a large number of workers unemployed. Increased unemployment further worsened social insecurity, particularly for vulnerable groups such as young people, women, and low-skilled workers (World Bank, 2021).

• **Public Debt and Budget Deficits:** To mitigate the negative economic effects of the pandemic, the Government of the Republic of Serbia implemented a series of fiscal measures, including subsidies, direct support to businesses and citizens, and increased public spending on the healthcare sector. These measures significantly increased the country's budget deficit and public debt. According to the Ministry of Finance, Serbia's public debt rose from 52% of GDP before the pandemic to over 60% of GDP during 2020. The increase in public debt could hinder fiscal stability in the long term and reduce the fiscal space for future investments and economic growth (Ministry of Finance of the Republic of Serbia, 2020).

• **Healthcare System:** The COVID-19 pandemic has placed immense pressure on Serbia's healthcare system. Hospitals faced capacity shortages, a lack of medical equipment, and insufficient personnel, making it difficult to provide adequate healthcare for COVID-19 patients and those with other medical needs. Additionally, the pandemic revealed structural weaknesses in the healthcare system, including insufficient investment in infrastructure, technology, and workforce training. These issues highlighted the need for urgent improvements to make the healthcare system more resilient to future crises (Institute of Public Health of Serbia, 2021).

• **Education Sector:** The closure of schools and the transition to online learning posed significant challenges for Serbia's education system. Many students, particularly those from rural areas and low-income families, lacked access to the necessary technological resources for online learning, increasing educational inequalities. Furthermore, the lack of interaction between students and teachers and the absence of practical learning negatively affected the quality of education. These issues underscored the need for improving digital infrastructure and ensuring equal access to education for all students (UNICEF Serbia, 2020).

The observed negative effects and challenges highlight the need to strengthen the economy and society's resilience to crises, improve the healthcare system, diversify the economy, and enhance social protection. Appropriate measures were needed to mitigate the pandemic's negative impacts in response to the emerging crisis.

Implemented Monetary and Fiscal Policy Measures

The negative consequences of the COVID-19 pandemic created severe economic challenges in the Republic of Serbia, necessitating urgent and comprehensive monetary and fiscal policy measures. The goal of these measures was to stabilize the economy, protect jobs, and support the healthcare system. The Government of the Republic of Serbia, together with the National Bank of Serbia, implemented a series of fiscal and monetary measures to support the economy and mitigate the negative effects of the pandemic.

Key Fiscal Measures

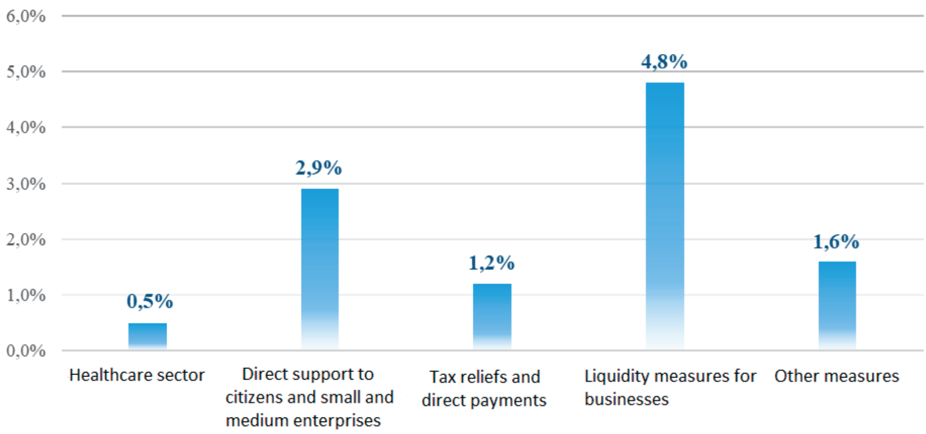
- **Direct Support to Businesses and Citizens:** The government introduced direct support programs to mitigate the economic consequences of the pandemic. These measures are aimed to preserve jobs and increase the purchasing power of the population and include the following:
  - **Wage Subsidies:** The Government of Serbia provided payments equivalent to the minimum wage for private sector employees over three months (April, May, and June 2020). This measure directly contributed to reducing layoffs and increasing employee security. The cost of this measure amounted to approximately 3% of the GDP.
  - **One-Time Payments to Citizens:** All adult citizens received one-time financial assistance of 100 euros (in dinar equivalents) in May and June 2020. The estimated cost of this measure was approximately 1% of the GDP.
  - **Support for Small and Medium Enterprises (SMEs):** The SME sector was granted non-repayable subsidies and favorable loans to ease operations and maintain liquidity. Programs of non-repayable subsidies and favorable loans for SMEs contributed to maintaining liquidity and business activity. The cost of these programs is estimated to be approximately 2% of the GDP.
  - **Tax Reliefs and Deferrals:** Businesses were provided with relief in the form of deferred payment of taxes and contributions, as well as temporary exemption from certain fiscal obligations, to reduce liquidity pressures. The deferral of income tax and social security contributions helped preserve liquidity and business continuity, while temporary tax exemptions most benefited sectors such as hospitality and tourism, significantly alleviating the negative effects of the pandemic on these sectors. The cost of deferrals and exemptions is estimated to be around 1.5% of GDP, with most funds planned for collection in subsequent years. Exemptions for the most affected sectors reduced fiscal revenue by approximately 0.5% of GDP but significantly helped sustain operations in these sectors.
- **Increased Public Investments:** The government increased public investments in the healthcare sector, prioritizing the procurement of medical equipment, construction of new hospitals, and expansion of existing healthcare facilities. Additional funds

were allocated to healthcare worker salaries and other costs related to the fight against COVID-19. Increased investments in healthcare infrastructure and equipment had a direct positive impact on the capacity of the healthcare system to respond to the pandemic. The total cost of these investments is estimated to be approximately 2% of GDP. Additionally, investments in infrastructure were increased to stimulate economic growth. These investments included road construction, railways, and energy facilities, aimed at boosting economic activity and creating new jobs. Public infrastructure investments have contributed to job creation and economic growth. The cost of these projects is estimated to be approximately 1% of the GDP.

- **Financial Support for the Most Vulnerable:** Programs of social assistance were introduced for the most vulnerable groups, including additional support for pensioners and socially disadvantaged citizens. Pensioners received one-time bonuses, and regular pensions for the most vulnerable categories were increased. This measure helped maintain the standard of living for pensioners, with a cost estimated at around 0.5% of the GDP. Additionally, social assistance programs were expanded to cover all citizens in need of support during the pandemic. The expansion of social assistance programs positively impacted the most vulnerable population groups, with a total cost of around 0.5% of the GDP.

The fiscal measures taken by the Republic of Serbia include direct support to citizens and businesses, tax relief, and investments in the healthcare sector. According to Ministry of Finance estimates, the total value of these measures amounted to 608.3 billion dinars, representing approximately 11% of the gross domestic product (GDP). Of this, 28.4 billion dinars (0.5% of GDP) were invested in the healthcare sector, while 161 billion dinars (2.9% of GDP) were allocated for direct support to citizens and small and medium enterprises. Tax relief and direct payments amounted to 68 billion dinars (1.2% of GDP), while liquidity measures for businesses amounted to 264 billion dinars (4.8% of GDP). Other measures accounted for 86 billion dinars (1.6% of GDP) (Ministry of Finance of the Republic of Serbia, 2021).

Graph 2. Costs of Fiscal Policy Measures as a Percentage of GDP



Source: Ministry of Finance of the Republic of Serbia

In addition to the fiscal measures undertaken by the Government of the Republic of Serbia, the National Bank of Serbia (NBS) also implemented a series of monetary measures to support economic recovery and maintain financial stability.

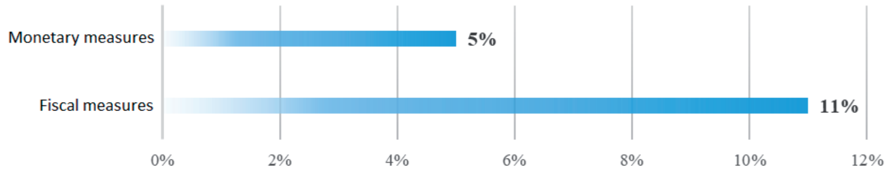
Key Monetary Measures

- **Reduction of the Benchmark Interest Rate:** The National Bank of Serbia reduced the benchmark interest rate to a historically low level, from 2.25% to 1.0% in 2020. These measures aimed to lower borrowing costs for businesses and households, stimulate credit activity, and support liquidity in the financial system. While the effects of this measure are difficult to quantify in terms of GDP percentage, they significantly contributed to the recovery of the economy.
- **Open Market Operations:** The National Bank of Serbia conducted open market operations, including the purchase of government bonds in the secondary market, to increase bank liquidity, reduce interest rates, and support the stability of the financial system. The cost of open-market operations is estimated to be approximately 2% of the GDP. Additionally, the NBS temporarily repurchased securities from banks with an obligation to repurchase them, thereby increasing the short-term liquidity in the banking sector. The effects of these operations are estimated at approximately 1% of GDP.
- **Credit Facilitation Measures:** To ease credit availability for businesses and households, the National Bank of Serbia introduced a reduction in mandatory reserves that banks are required to hold with the central bank, thereby freeing up additional funds for lending. Although the cost of this measure is difficult to quantify precisely, it contributed to increased credit activity. Additionally, government-backed guarantee programs for loans to businesses, particularly small and medium enterprises (SMEs), were introduced to reduce risks for banks and facilitate loan approvals. The total cost of guarantee programs is estimated to be approximately 1% of the GDP.
- **Exchange Rate Stabilization:** The National Bank of Serbia implemented measures to stabilize the exchange rate, including interventions in the foreign exchange market to maintain investor confidence and prevent excessive dinar volatility. Exchange rate stabilization was achieved through foreign exchange market interventions by buying and selling foreign currencies to stabilize the dinar's value, thereby maintaining the financial system's stability. The cost of foreign exchange market interventions for exchange rate stabilization is estimated to be approximately 1% of the GDP.

The total monetary measures undertaken during the pandemic are estimated to be approximately 5% of GDP (National Bank of Serbia, 2020).

Fiscal and monetary measures significantly contributed to stabilizing the economy and mitigating the negative effects of the pandemic. The total fiscal measures are estimated at around 11% of GDP, while monetary measures account for approximately 5% of GDP. Combined, these measures represented about 16% of the GDP, showcasing a substantial effort by the state to address the economic crisis caused by the pandemic (Ministry of Finance of the Republic of Serbia, 2021; National Bank of Serbia, 2020).

Graph 3. Comparison of Fiscal and Monetary Measures as a Percentage of GDP



Source: Ministry of Finance of the Republic of Serbia, National Bank of Serbia

Fiscal and monetary measures significantly contributed to stabilizing the economy and mitigating the negative effects of the pandemic. However, the increase in budget deficit and public debt presents a long-term challenge to the country's fiscal stability. During the pandemic, Serbia's budget deficit rose from 1.8% of its GDP in 2019 to approximately 8% of its GDP in 2020 (Ministry of Finance of the Republic of Serbia, 2021).

Serbia's public debt increased from 52.0% of GDP by the end of 2019 to approximately 57.4% of GDP by the end of 2020, which represents a significant increase but remains below the Maastricht criterion of 60% of GDP (Ministry of Finance of the Republic of Serbia, 2021). These changes highlight the need for careful fiscal policy planning in the coming years to ensure the long-term sustainability of public finance.

Conclusion

The COVID-19 pandemic represented one of the most significant challenges for the global economy in recent decades, and the Republic of Serbia was no exception. The economic and health impacts of the pandemic necessitated urgent and extensive fiscal and monetary policy measures to mitigate its negative effects. Serbia responded with a comprehensive package of measures aimed at preserving jobs, supporting the economy, stabilizing the financial system, and protecting the most vulnerable groups.

Some of the implemented measures proved effective and yielded significant results. These included wage subsidies and one-time payments to citizens, which were key to preserving jobs and boosting the aggregate demand. Wage subsidies directly prevented mass layoffs and helped businesses survive the crisis. One-time payments to citizens stimulated consumption, thus benefiting the retail sector. Additionally, support for small and medium enterprises (SMEs) through grants and favorable loans enabled businesses to maintain liquidity and continue operations, preventing bankruptcy. Investments in the healthcare sector increased the capacity of the healthcare system, facilitated the procurement of medical equipment, and allowed for a better response to the pandemic, reducing pressure on hospitals and healthcare workers.

Regarding monetary measures, the reduction of the benchmark interest rate yielded positive results, encouraging credit activity and reducing borrowing costs, which supported the liquidity of businesses and households. Increased credit availability helped enterprises navigate crises. Significant results were also achieved through open-market operations, where the purchase of government bonds and repo operations provided additional liquidity to banks, enabling them to continue lending to businesses and households under favorable conditions. Furthermore, guarantee programs for loans reduced banks' risks and facilitated loan approvals for SMEs, helping maintain business activity and liquidity.

However, not all the measures yielded equally significant results. For example, tax reliefs and deferrals, although reducing financial pressure on businesses, had limited effectiveness because of the uncertainty of the crisis duration and the need for long-term solutions. Deferred taxes had to be paid later, creating additional pressure on businesses when economic activities recovered. Temporary tax exemptions for the most affected sectors provided limited relief because of their narrow scope, leaving some industries unaddressed. Exchange rate stabilization measures aimed at supporting dinar's stability were costly and could not completely prevent volatility caused by global economic disruptions. Pressure on foreign exchange reserves increased the risk of long-term stability.

The implemented fiscal and monetary measures had a significant positive effect on mitigating the negative consequences of the pandemic, preserving jobs, supporting the economy, and stabilizing the financial system. However, these measures led to an increase in budget deficit and public debt, posing a long-term challenge to the country's fiscal stability. In the future, careful fiscal policy planning and structural reforms will be necessary to ensure the sustainability of public finances and to support economic growth. The success in preserving jobs, increasing liquidity, and supporting the most vulnerable groups demonstrates the effectiveness of the measures in addressing the crisis. However, the need for further adjustments and additional reforms remains crucial to ensuring long-term economic recovery and stability through careful fiscal policy planning, supporting private sector innovation, and strengthening healthcare and social protection systems.

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