

DEBT FINANCING

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Abstract: The budget, as a centralized instrument for the implementation of fiscal policy, usually performs the functions of allocation, stabilization and distribution. Whether it is about national economies or supranational entities like the European Union, the budget represents the most important factor of fiscal cohesion. Market economies are characterized by differences in levels of economic development. Different levels of economic development pose an objective challenge to fiscal policy bearers. The largest fiscal allocations are directed to the public sector, which is not expected to directly fertilize fiscal income, but primarily to fulfill social needs. Obviously, with the development of modern countries and with the increase in standards, expectations regarding the quality of public services also grow. Parliamentary democracies are under constant pressure to satisfy public needs, from a critical public. Enabling the availability of the level of services guaranteed by the Universal Declaration of Human Rights puts the authorities in charge of managing public finances in an unenviable position. Societies at a lower level of economic development strive to reach richer, more developed societies and, due to insufficient fiscal revenues, resort to debt financing of public finances. Developed societies in an effort to maintain the level of development and achieved dominance also multiply expenditures for public finances. For the above reasons, the creators of fiscal policies from local, national to multinational levels are reaching for different forms of debt financing. Global economic crises caused by various causes, which were connected to each other, with deficit financing of the budget in different currencies and debt monetization by the ECB, certainly encouraged a high rate of inflation in the European Union, which spread throughout the European economic area. Due to the largest volume of foreign trade exchange with the countries of the European Union, and the attachment of the domestic currency to the euro, the impact of

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externalities is multiplicative and cannot be stopped only through discretionary fiscal policy measures. For a long time, the professional public has advocated the need to change the course of the monetary policy of Bosnia and Herzegovina, that is, the existing “Currency Board”. It is an indisputable fact that for the effective management of economic policy, it is necessary to use a cocktail of fiscal and monetary instruments.

Keywords: Public debt, budget deficit, inflation, fiscal and monetary policy

1. FINANCIAL CRISES AND INFLATION

The convergence of long-term interest rates, that is, their convergence between the “weak” and “strong” regions of the European Union, was one of the strongest motivations for a certain number of EU countries to renounce their own currency and monetary policy and enter the Euro zone. In the period from 1997 to 2007, their expectations were fulfilled. Before the introduction of the euro, capital flows in the European Union were limited by uncertainty about exchange rates. By entering the Euro zone without currency risk, interest rates are formed based on the credit rating of the debtor countries. In conditions of unrestricted flow of capital, it flows unhindered from one part of the euro zone to another, deepening imbalances. Through cohesion instruments, the European Union seeks to mitigate the differences that exist within the real economic sector. Germany, as the leading power of the European Union, resisted the introduction of Eurobonds, i.e. the financing of European programs through debt instruments (Sinn, 2011).

We distinguish four sources of financing the budget deficit:

1. Borrowing from the Central Bank,
2. Sale of state property,
3. Borrowing on the domestic financial market i
4. Borrowing abroad.

A certain state can borrow from the Central Bank by taking direct loans or by purchasing state securities, such as treasury bills, bonds, etc.

Several securities purchase programs have been implemented since 2009 in order to stimulate growth in the Euro zone and in line with the goal of achieving an inflation rate below, but close to, 2% in the medium term. These programs included the Corporate Sector Securities Purchase

Program (CSPP), the Asset-backed Securities Purchase Program (AB-SPP) and the third covered bond purchase program (CBPP3).

In June 2014, the European Central Bank announced a series of Targeted Longer-term Refinancing Operations (TLTROs) whose purpose was to improve bank lending to credit institutions in the Euro area over an initial period of two years. The second series (TLTRO II) started in March 2016, and the third series (TLTRO III) in March 2019.

In response to the COVID-19 pandemic, the Governing Council of the ECB decided to significantly ease the conditions for the remaining TLTRO III operations, together with a temporary reduction in floating interest rates. In addition, it was decided to carry out eleven additional Longer-term operations refinancing due to the pandemic (PELTRO) in the period from May 2020 to December 2021.

Other already completed programs include the Securities Markets Program (SMP), the Covered Bond Purchase Program (CBPP) and the second Covered Bond Purchase Program (CBPP2). The monthly pace of net asset purchases initially amounted to EUR 60 billion (March 2015 - March 2016), and later this amount increased to EUR 80 billion per month (April 2016 - March 2017).

Net asset purchases were then gradually reduced to EUR 15 billion per month (September 2018 – December 2018).

In December 2018, the Governing Council of the ECB decided to suspend net asset purchases, with the aim of continuing to reinvest in principal repayments for maturing securities and to maintain the total net purchases under each asset purchase program at their respective levels. However, due to unforeseen circumstances, caused by the impact of the “lockdown” caused by the Covid 19 pandemic, the net purchase of assets was restarted in September 2019 with a monthly rhythm of 20 billion euros starting on November 1, 2019, expecting it to last “as long as as long as it takes to strengthen the accommodative effect of the interest rate and that it will end soon after the ECB starts to raise key interest rates”.

As an additional response to the crisis caused by the COVID-19 pandemic, the Governing Council decided to increase the existing net purchase of assets by the end of 2020 with an additional package of 120 billion euros. In addition, a new temporary crisis program for the purchase of Public and Private Sector assets (PEPP) was launched with an

initial estimated amount of 750 billion euros, which was supposed to last until the end of 2020.

The Governing Council of the ECB decided in June 2020 to increase the PEPP package from EUR 600 billion to EUR 1,350 billion. The aforementioned PEPP package was additionally increased in December 2020 by EUR 500 billion, to a total of EUR 1,850 billion. It was also decided to extend the PEPP net purchase period until at least the end of March 2022. It was also decided to reinvest the principal payments due within the PEPP at least until the end of 2023. Greater flexibility is built into the PEPP, allowing for “changes in the distribution of purchase flows over time, across asset classes and across jurisdictions.”

The causes of current inflation in the countries of the European Union, as well as in the countries that are directly or indirectly in the Euro system, can certainly be sought in the monetary financing of budget deficits and public debt, that is, intensive debt financing of the private financial and non-financial sectors.

The situation is similar in the United States of America, where inflation rose to the highest level in the last 40 years, when in May 2022 it reached the amount of 8.6% on an annual basis.

The US Federal Reserve (FED) despite recession concerns plans to continue tightening monetary policy in response to rising inflation. The public debt of the United States of America (USA) exceeded 30 trillion dollars for the first time.

The relationship between inflation and public debt may not be explicitly included in the objectives of public debt management itself, but it plays an important role in management decision-making. If the state has not agreed on a currency clause, then inflation works to reduce the public debt. In such a situation, inflation is considered a state income and one of the solutions against the debt.

The indebtedness problem is part of macroeconomic policy, which cannot be effective if the borrowing policy is not conducted in the appropriate direction. Borrowing policy should aim at choosing the optimal combination of risk and income from foreign capital.

The ratio of the total external debt to the gross domestic product indicates the degree of external debt load on current economic activity. If it continues to increase, it will mean possible problems of solvency and

inability to repay the debt for a certain country. If this ratio is less than 48%, the country is less indebted. Between 48% and 80%, it is a medium-indebted country, or if it is above 80%, then it is already a matter of high indebtedness. The export of goods and services is the main source of foreign currency income needed to repay the foreign debt.

According to world experience, if debt repayment in relation to exports is greater than 20%, there may be problems with the country's external liquidity. In the case of debt rescheduling, the interest is not rescheduled, but only the principal of the debt. The consequence of this is a change in the amount of interest due to a change in the amount of the principal when rescheduling the debt.

Greece, Italy, Belgium, Hungary and Malta had excessive public debt before the outbreak of the financial crisis in 2008. The mentioned countries had a high level of public debt because it exceeded the reference value of 60% of GDP. Other member countries had a level of public debt in reference values until 2008.

Greece has the highest public debt calculated as a percent of GDP in 2017, 175%. After Greece, Italy follows with a recorded percentage of 134.7%, and Portugal with a percentage of 132.1%. The member states with the lowest indebtedness are: Estonia 8.9% of GDP, Luxembourg 23.4% and Bulgaria 27.7% of GDP.

The highest nominal amount of public debt in euros in 2017 was recorded by Italy, in the amount of 1,606,200 billion euros. It was followed by France, Germany, Great Britain and Spain. Back in the last 10 years, Italy did not always occupy the first place in debt, Germany and Great Britain alternated. From 2008 until 2014, Germany was the country with the largest nominal public debt in euros, and Great Britain occupied that position during 2015. After 2015, until today, Italy has the highest public debt in euros. It is important to note that the ratio of public debt to GDP also depends on the method of calculation, that is, what is considered public debt. In this context, we cite the example of the German economy, which has the most indebted public companies in the EU, and their debt is 1.2 times higher than the German GDP (Andrašec, 2019).

At the end of 2021, Serbia's public debt amounted to 26.66 billion euros, which was 57.4 percent of GDP. The external debt of Bosnia and Herzegovina in the first quarter of 2022 amounted to 9.67 billion KM,

while the internal debt is about 3.50 billion KM, i.e. over 13 billion KM in total. Taking into account the GDP of 37.34 billion KM, it represents a public debt/GDP ratio of about 1/3 or 35%, which ranks us among less indebted countries. The above data do not include guarantees given to public companies.

European monetary unification in the 1990s should have been accompanied by fiscal convergence and harmonization. A similar scenario to the Maastricht Convergence Criteria, through which the budget deficit is limited to 3%, has already been seen in the USA. Namely, in 1985, the American Congress passed the Gram-Rudman Law, which provided for the automatic reduction of consumption in the event of an excessive deficit (James, 2009). It can be stated that there are two groups of factors that determine the direct fiscal consequences of membership in the European Union, namely: the size of Union transfers that are directly directed towards the state sector and the contribution of member states to the Union Budget. With the introduction of the Maastricht criteria and the Stability and Growth Pact, most of the fiscal rules have already been predetermined, while within the Eurozone, the monetary policy of individual member states has almost completely lost its sovereignty. Fiscal criteria are based on the principle of sustainable fiscal policy, i.e. preventing the possibility of increasing the rate of inflation in the future through irrational spending of public finances.

Recognizing the dangers of excessive spending by the general government, which during the 1980s on the example of certain European countries (especially Belgium and Italy) proved to be a very complex issue due to difficulties in stabilizing public finances, the European Commission under the leadership of the then president Jacques Delors, laid the foundations for the establishment of the Economic and Monetary Union. The Maastricht agreement was signed as the crown of the efforts made, which defined the fiscal rules through the five fundamental principles of convergence (Obadić, 2005).

The two most important criteria, the Budget deficit and the Public debt, which were supposed to serve for stabilization, with the introduction of the euro and the temporary equalization of interest rates, have significantly exceeded their limits (Sinn, 2011).

In the world of finding new attractive sources of financing, the idea of issuing Eurobonds has been advocated for a long time. The same would mean replacing the “every man for himself” strategy with the “all for one, one for all” strategy, which would enable joint borrowing (Ferry, 2011). In a certain way, the bonds issued by the European Commission can be considered as Eurobonds, even though they do not officially bear the mentioned name. The issuance of bonds by the European Commission additionally centralizes the fiscal authority at the level of the Union. Member states are required to submit Convergence Programs to the European Commission, upon approval of which funds can be withdrawn from the structural financial funds, which basically serve to stabilize the national economies. In this way, the European Commission directly and completely influences the fiscal policy of the member states.

The monetary stability of Bosnia and Herzegovina, due to the work of the Central Bank of Bosnia and Herzegovina according to the model of the Currency Board, is only apparent, since the Convertible Mark is fixed to the currency anchor, i.e. the euro, and the value of the Euro is effectively objectively decreasing, which multiplies the negative effects on the Bosnia and Herzegovina economy over higher prices of imported inputs and less favorable debt on the foreign market, instead of the domestic Central Bank, whose reserves are held in German and Swiss banks at an interest rate of 0.164% (2021) on an annual basis, and entities from Bosnia and Herzegovina on foreign financial markets they borrow at a rate above 4%, which is unacceptable. So, with this kind of monetary policy, we have come to the absurd situation that a small, underdeveloped country is stimulating the economic growth and employment of Germany and Switzerland with 13.5 billion at a symbolic interest rate (0.164%), and not the domestic economy.

2. FISCAL AND MONETARY POLICY INSTRUMENTS

The importance of sovereignty in the conduct of a unified economic policy, as an example of the Eurozone crisis, with reference to the difficulties that Bosnia and Herzegovina has as a result of the multi-year implementation of the Currency Board system, proves the cause-and-effect relationship between the lack of coordination of monetary and fiscal policy instruments with the efficiency of the economic system.

Due to the inconsistent implementation of the Maastricht Convergence Criteria, i.e. the Fiscal Stabilization Rules by the member states, which are primarily reflected in the obligation to maintain the level of limitation of budget deficits and public debt, and the budget of the European Union which is insufficient to fulfill the macroeconomic functions of allocation, distribution and stabilization, the fiscal system of the European Union has not adequately demonstrated its effectiveness in maintaining the fiscal stability of the European Union.

As a forerunner of the euro, the EKI was created in 1974, which brought the monetary policies of the member countries under partial control. In this way, through the Exchange Rate Mechanism, mutual currency fluctuations were limited to 2.25%. Through the principle of graduation, the Economic and Monetary Union - EMU was gradually created.

The Maastricht Treaty of 1992, which was created in specific internal and foreign political circumstances, marked a turning point in further monetary and political integration. At the moment of the biggest steps towards the unification of European states, the Yugoslav republics experienced collapse and splitting. A bad foreign policy assessment of the timing for entering the transition of the political system with the situation of global imbalance has set us back a long way. The introduction of the euro into the payment system in 2002, as a single currency in nineteen member states, represented a major historical challenge in terms of monetary policy. Its lack arose from economic imbalances between member states, resulting in trade imbalances. In order to correct the aforementioned balances, extensive fiscal redistribution of income between countries via the community level is necessary, however, the aforementioned through the Budget of the European Union, which ranges from about 1% of EU GDP, is not even close to achievable. Until now, the structural reforms of the European Union have been characterized by the acquisition of greater powers in favor of the central countries, which at the same time benefit the most from the monetary union. By introducing a single currency, the European Union assumed the obligation to maintain monetary stability. As the European Central Bank was established on the model of the Deutsche Bundesbank, the minimum level of inflation was one of the most important goals. However, the global financial crisis of 2008, and the rescue of large private banks through public finances, violated the aforemen-

tioned postulates. The crisis caused by Covid-19 has further undermined the fundamental principles of EU monetary policy.

Also, the European Commission, due to insufficient sources of financing, resorted to debt financing. A fundraising model was introduced through the issuance of bonds with high solvency. The collected funds are further distributed in the form of loans and grants to member countries. The aforementioned method created the possibility of cheap borrowing for less solvent countries, which would borrow independently at significantly higher interest rates.

The Economic and Monetary Union (EMU) represents a unique model in the world in which, in the conduct of economic policy, a single monetary and decentralized other macroeconomic and structural policies are combined, of which fiscal policy stands out in particular. With the entry into force of the Pact on Stability and Growth, as a continuation of the Maastricht Convergence Criteria, a model of decentralized fiscal policy of the European Union was defined.

By supervising the implementation of the rules defined by the Stability and Growth Pact, countries are obliged to bring their medium-term budget balances to balance or even surplus, so that in the event of cyclical pressures, they could deal with them without exceeding the reference limit of 3% of GDP. The supervision mechanism is carried out through the so-called double anchor, that is, through two Convergence Criteria, namely, the level of the General Government Deficit and the National Debt.

The shortcomings of the Pact on Stability and Growth were first manifested in 2002, when there was a slowdown in growth in the majority of Eurozone member countries, and in that situation most countries were obliged to bear the stipulated penalties. In the mentioned situation, decisions were made on reformulating the rules of the Pact in terms of greater flexibility towards countries and considering each case separately, taking into account the business cycles of individual countries.

The institutional crisis in the functioning of the Pact arose in 2003 when the Council for Economic and Financial Affairs (ECOFIN) did not apply punitive provisions to France and Germany when they violated the budget deficit limits. On that occasion, the Council made a decision to give these countries until 2005 to return the deficit level to the permitted limits. The aforementioned decision showed the inconsistency of institu-

tions when it comes to deciding on the interests of “big countries”. They justified their decision with the reason of the slowdown in the general level of growth at the beginning of the new millennium.

However, when in the case of Portugal in 2001 the budget deficit line of 3% of GDP was crossed, under strong pressure from the European Commission, Portugal had to cut public spending. This is why the Portuguese economy went into recession the very next year, while already in 2005, the budget deficit rose to the level of 5% of GDP.

The above example showed that a rigid approach to the rules of the Pact, without respecting the individual circumstances in which the country is located, cannot achieve a quality long-term effect.

The rules of the Pact have been repeatedly challenged by member states due to the annual cycle of implementation. Proposals for changes went in the direction of applying the Pact in economic cycles, because limiting public spending during recessionary periods can slow economic growth. The alleged problems resulted in changes to the rules of the Pact, i.e. loosening and introducing greater flexibility in the application of sanctions for countries that exceed the Pact's limits. Countries where the budget deficit exceeds 3%, and in the event that they can justify the above with extraordinary circumstances, penal provisions would not be applied. Under them, it can be taken into account if the drop in GDP is above 2%, in the case of a constant decline in the economy or if structural reforms are involved, such as the reform of the pension system, etc. Also, the time of adaptation to the rules of the Pact has been extended.

Implementation of common stabilization fiscal policy through coordination of individual fiscal policies of member countries is primarily subordinated to the objectives of the Economic and Monetary Union. If such differential shocks occur within the Economic and Monetary Union that affect a certain country, and if the Union has a restrictive monetary policy aimed at preserving prices, the only instrument for mitigating economic shocks remains fiscal policy. The effects of fiscal policy are significant and strong to the extent of the size of the budget. The above applies both to the budget of the European Union and to national budgets. In the past 12 years, the EU budget has grown by about 20% from 141 to 169.5 billion euros, which with the accompanying inflation rate does not represent a significant increase. However, it has changed significantly in terms

of expenditure structures. In the 1970s, almost 80% of the budget went to expenditures in the field of agriculture and fisheries, but now this form of financing is represented by twice the amount of about 40%.

3. NEW FINANCIAL INSTRUMENTS OF THE DUAL REFORM

Most of the funds from the NextGenerationEU instrument amounting to EUR 723.8 billion in current prices will be spent under the Recovery and Resilience Mechanism. The recovery and resilience mechanism includes extensive financial support for public investments and areas such as green and digital projects. The aforementioned will be distributed in the form of grants of 338 billion euros and loans of 385.8 billion euros.² The Brexit adjustment reserve of five billion euros will serve as support for the countries and economic sectors most affected by Great Britain's exit from the European Union. The European Union is facing a slowdown in real GDP growth due to supply disruptions and reduced demand. Increasing wages above productivity can keep inflation high for a long time. The current ratio of total public debt has reached its maximum and in 2021 it amounted to 92% of GDP. Differences in the level of public debt between member states are significant. It is expected that the debt ratio above 100% of GDP will be maintained in six countries, while half of the member states will remain below 60%. It is estimated that a too sudden consolidation of public debt would undermine the solvency of the six states mentioned, and in this context it was decided to temporarily freeze the mechanism used in case of excessive debt within the Stability and Growth Pact (SGP). The challenges of the double transition are facing all member states. Climate and digital goals require additional investments through which growth is expected to be stimulated. It is planned that in the period from 2021 to 2030, about 520 billion euros will be spent for the aforementioned purposes on an annual basis. The investment gap for achieving digital transformation is estimated at 125 billion euros. However, the determination of European actors to make a new step towards a higher degree of digitization with the aim of increasing efficiency in all sectors, and an accelerated transition to green energy additionally condi-

2 <https://ec.europa.eu/info/strategy/eu-budget/long-term-eu-budget/2021-2027/>

tioned by the war in Ukraine, is visible. Through the NextGeneration EU instrument, it is planned to provide 338 billion euros in grants and up to 386 billion euros in loans until 2026. The European Commission evaluates the programs submitted by the member states for their Recovery Plans. So far, they have been approved by twenty-two countries. The priorities of European economic policy and employment policy are structured around the following priorities:

- Environmental,
- Life expectancy,
- Productivity,
- Fairness and
- Macroeconomic stability (European Commission, 2021).

In the near future, the green agenda will represent not only investment potential for the development of the European Union, but also an important political mechanism at the internal, and especially at the foreign trade level. “Green measures” will certainly be one of the main obstacles for the import of “unsuitable” products to the European Union market. It is also planned to make decisions on a new fiscal consensus on the basis of ensuring debt sustainability, which implies a gradual reduction of the coefficients of highly indebted countries and the promotion of sustainable growth through investments and reforms.

It is planned to make decisions on a new fiscal consensus on the basis of ensuring debt sustainability, which implies a gradual reduction of the coefficients of highly indebted countries and the promotion of sustainable growth through investments and reforms. In this context, the statement of the Commission’s Executive Vice President and Commissioner for Trade, Valdis Dombrovskis, can be interpreted: “We promised to make trade sustainable, and we are fulfilling that promise today. Our trade agreements have enabled us to influence the world stage and encourage economic growth and sustainable development, however, in the future, we want them to have an even stronger impact on positive changes. In order to achieve this, we will cooperate with our partners and provide them with support. We will strengthen the implementation of the agreement, but also resort to sanctions if key obligations in the field of labor and climate are not met.”

4. EU INSOLVENCY RISKS

The level of the budget deficit of 3% of GDP does not represent the same parameter for a country with a low level of public debt, compared to a country whose public debt exceeds the amount of over 100% of GDP. From the point of view of conducting an active countercyclical fiscal policy, the level of restrictions prescribed by the EU Stability and Growth Pact (GSP) does not leave the country with sufficient opportunity for automatic fiscal stabilizers to operate. In growing economies, a balanced budget does not play a significant role. A limited deficit prevents state investments, through which it is possible to contribute to higher growth rates in the future, and therefore easier debt repayment, by reducing the ratio of deficit to GDP. If the growth rate is higher than the deficit level, the public debt is considered to be solvent.

The greater part of the budget expenditures of European over-indebted countries is allocated to cover interest on the national debt, while less than half of the budget is directed to “state expenditures”. This tells us in favor of the fact that the state is “cheap”, but that the burden of over-indebtedness is too great and left to the next generations.

If interest rates on public debt exceed the growth rate of the economy, the debt is set dynamically, so the ratio of public debt to GDP worsens. By itself, the same is unsustainable in the long term and requires corrective action.

If one wants to continue with the implementation of the Pact, that is, limiting the borrowing of the budgets of the member states, it is necessary to increase the role Budget of the European Union. Strengthening financing from the central level by adding the new financial instrument NewGeneration to the budget of the European Union will certainly strengthen macroeconomic stability in the medium term. What should not be overlooked is the fact that the new financial instrument is financed for the most part from bonds issued by the European Commission. In this way, the debt burden is transferred from the already medium and heavily indebted countries of the European Union to the European Commission as a supranational body, and it assumes the risk of repaying this debt.

In national states with fiscal federalism, the powers of local communities, that is, regional authorities, are regulated in relation to the central

national authorities (Škreb, 2009). Part of the authority in the collection of fiscal revenues depends on the level of centralization in an individual state, that is, how much central authorities are ready to hand over fiscal authority for tax collection to lower authorities (Oates, 1972).

From the point of view of the fiscal position of the European Union, it would be more favorable if a new, more significant source of financing was introduced in the form of a certain type of tax at the level of the European Union, through which the automatic redistribution of wealth would be carried out, i.e. mitigated economic imbalances between the economically and industrially highly developed countries of the center and less developed ones, the so-called peripheral countries.

The principle of budget balance (The Principle of Equilibrium) means that the revenue and expenditure side must be in balance, that is, that financing the budget by borrowing is not allowed.

However, the European Union introduced a system of debt financing from the level of the European Union through various funds that are financed on the basis of issuing bonds since 2012. Through the latest multi-year financial framework 2021-2027, a new financial instrument with the futuristic name NextGenerationEU is also promoted, which also indirectly represents a debt form of financing budgetary needs, which is guaranteed by the European Commission.

Two years ago, the Decision adopted by the European Commission on “Freezing procedures in case of excessive deficit” was in force. In addition, the decision was made due to extraordinary pressures on the budget caused by the pandemic, however, it was extended due to newly emerging crisis circumstances resulting from the war in Ukraine.

Based on the above, it is obvious that the European Union is going through an economic crisis conditioned by the factors of over-indebtedness and inflation. The creators of monetary and fiscal policy decided to resort to monetary debt financing through the policy of cheap money and financial funds. It is to be expected that a high inflation rate could “eat up” a significant amount of debt, thus relieving over-indebted countries. However, inflation will eat up savings in the same way, which could affect a significant drop in the standard of living of the population of the European Union, as well as the countries that are in its sphere of influence.

The main priority of the fiscal system of the European Union is the goal of preserving fiscal stability and stabilization policy, with the special task of maintaining prices as the main goal of a unified anti-inflationary monetary policy. The fiscal position of the member states is regulated primarily by the Maastricht convergence criteria, which were later supplemented through the Stability and Growth Pact, and later with the Euro-Plus Pact, which additionally defined the so-called procedure for excessive deficits.

Although the bodies of the Union, and primarily the Commission, approve and supervise the stabilization programs of the member states, most of the responsibility lies with the authorities at the national level, because ultimately they are responsible to their citizens.

Since the introduction of the single currency in 2002, based on the examined financial and fiscal indicators of the ratio of GDP to public debt, GDP and budget deficit, and the level of long-term interest rates on government debt instruments, we have determined that there has been a significant deterioration of the fiscal position of the majority of Eurozone member countries.

One of the reasons for the current crisis is the unevenness of the economies that have joined the monetary union, that is, that have exchanged their currencies for the euro, which has led to less developed countries moving in the direction of budgetary financing of consumption. The initial convergence of interest rates, which lasted until the beginning of 2009, due to the global crisis and the inconsistent implementation of fiscal stabilization rules, along with inadequate structural reforms, primarily of the labor market and the pension and social insurance system, led to the “periphery” countries reaching on the verge of bankruptcy.

The model of fiscal federalism applied in the European Union, with an insufficient budget framework that does not recognize the possibility of stopping anticyclical processes through built-in automatic fiscal stabilizers, contributes insufficiently to the convergence of member states in recessionary periods.

By applying the new financial-fiscal architecture, which is reflected in the European Fund for Financial Stability, and the European Stabilization Mechanism in the spirit of the Europe 2020 Strategy, and the new

financial instrument NextGenerationEU, the financial position of European countries has been strengthened in the medium term.

The main goal of the mentioned mechanisms is to prevent the financial collapse of the Eurozone, through the threatening insolvency of banks, due to the potential insolvency of “peripheral countries”, which could spread through the Eurozone with a domino effect.

The largest creditors of potentially insolvent countries are banks from the central countries of the Eurozone, that is, from the strongest European economies, Germany and France. The aforementioned banks were primarily interested in strengthening the capacity of the Financial Stability Fund and the European Stabilization Mechanism, as well as their issuance of debt instruments, which are even issued at a negative interest rate.

Through bond issues of the European Fund for Financial Stability, the liquidity of crisis countries is financed to repay debts to large European banks.

The processes taking place in the European Union and the Eurozone in recent years indicated that dissolution could occur due to the abandonment of the fundamental principles of solidarity and convergence.

Based on the above, it can be concluded that the instruments of the fiscal system of the European Union did not sufficiently satisfy the set goals with their functioning, and that they had a bad effect on the efficiency of the fiscal system of the European Union.

5. FISCAL POSITION OF BOSNIA AND HERZEGOVINA

According to the analysis of macroeconomic parameters, which concern the ratio of GDP to public debt, that is, the ratio of GDP to the budget deficit, Bosnia and Herzegovina meets the Maastricht convergence criteria. Given that in Bosnia and Herzegovina the exchange rate of the convertible mark is fixed to the euro, from the above-mentioned aspect, the conditions for entering the Eurozone are potentially met, considering that the stability of the exchange rate is required when entering the monetary union. According to all economic and formal parameters, the fiscal system of Bosnia and Herzegovina fully converges with the fiscal system of the European Union.

Due to the lack of consensus regarding the future direction of monetary policy, the existing system of the “Currency Board” increasingly represents a limiting factor in the economic development of Bosnia and Herzegovina. If we take into account that as a condition in the pre-accession negotiations, Bosnia and Herzegovina had to completely liberalize its customs policy towards the European Union, therefore in the past years domestic businessmen were in a disadvantageous position compared to businessmen from neighboring countries due to the overvalued exchange rate of the convertible mark.

Given that the “Currency Board” system does not allow the use of instruments of active monetary policy, i.e. monetary regulation (except for the mandatory reserve instrument), Bosnia and Herzegovina in a certain way shares the fate of the peripheral countries of the Eurozone (Muratović, 2022). The current state of the world, and the changes that will rapidly follow, will determine the way of life for this and future generations. In this light, Bosnia and Herzegovina should join the processes led by the European Union in the field of digitization and green energy. The strategic importance of the European Union largely determines our policies in all spheres. Adaptation to European standards is a technical-legal issue and the legislation of Bosnia and Herzegovina converges to the greatest extent to the European legal heritage. A bigger problem is the lack of internal political consensus around important strategic goals and methods of economic policy.

With about three and a half million inhabitants, Bosnia and Herzegovina is one of the smallest European countries. Its economic and political importance in the geopolitical framework is therefore minimal. The positive economic trends of recent years provide a chance for economic progress, enabling a decent life for its residents in the future. We can conclude that it is necessary to make all the necessary reforms, which, in addition to meeting the standards, also include the adjustment of policies, in order to catch up in time with the new processes that are happening rapidly.

The world as we know it today will already be different in ten years, if the reform goals of the European Union are met. The Green Agenda, which is not a political marketing pamphlet as it sometimes seems from

our position, is additionally conditioned by the existing firm geopolitical positions, will significantly open up space for the use of new technologies.

Achieving an internal consensus in Bosnia and Herzegovina is of key importance in the time to come, primarily for the reason that there would be no delay in making important decisions regarding adaptation to the double agenda of the European Union, which refers to digitization and green policy. Our comparative advantages in the energy sector provide us with an additional development opportunity for a new investment cycle that would ensure macroeconomic stability and continuous growth in the medium term. The transition to green energy, with the inevitable creation of disincentive taxes and duties on CO₂, should be recognized as a reality as soon as possible, and they should direct their capacities in the direction of monitoring the decisions of European institutions and seeking more favorable sources of financing for improving energy efficiency and gradual transition to green energy.

Also, the area of digitization represents no less a development opportunity. Given that we have unfavorable demographic trends, it is evident that we need to develop our capacities by improving excellence. Additional digitization in the field of education will certainly contribute to this, which would open up the possibility for young people to develop competences for a commercial, and not just consumer, approach to cyber space in an institutional and planned manner. The world we live in is changing rapidly, so we should change accordingly.

Bosnia and Herzegovina implemented the provisions of the Sixth European VAT directive on tax harmonization in its legislation and harmonized the rates of indirect taxes and the rate of corporate profit tax, as a direct tax, but not contributions and other fiscal and parafiscalities. Bosnia and Herzegovina has a single VAT rate of 17%. Although in some countries of the European Union there are both preferential and zero rates, Bosnia and Herzegovina decided for a single rate, mostly for reasons of preventing tax evasion. Standard VAT rates in the Union range from 17% to 25%.

It can be seen that Bosnia and Herzegovina shares the lowest standard VAT rate with Luxembourg. Within the European Union, only Denmark applies a single VAT rate of 25%, which is also the maximum pos-

sible rate according to European Union regulations. However, the fact is that the single rate of VAT stands as an aspiration of the European fiscal legislation, so that the single-rate system of VAT, present in Bosnia and Herzegovina, fully meets the framework of the prescribed rates of VAT in the European Union. Types of financial and monetary services that are exempt from VAT in Bosnia and Herzegovina are³:

- insurance and reinsurance services,
- sale of immovable property, except for the first transfer of ownership rights or the right to dispose of newly constructed immovable property,
- leasing and sub-leasing of residential buildings for a period longer than 60 days,
- financial services (approval and management of loans; services related to the management of deposits, savings and bank accounts, management of payment transactions; trading of stocks/shares or other types of participation in companies; management of investment funds)
- valid postage stamps, tax stamps, administrative and court fees, and
- lottery games.

Council Directive No. 2006/112/EC of November 28, 2006 on the Common Value Added Tax System as amended, in Chapter 3, Article 135, Paragraph 1, prescribes which financial and monetary services are exempt from taxation, which is fully taken over in our legislation.⁴

The debate that is being conducted in Bosnia and Herzegovina on the subject of the introduction of a differentiated VAT rate finds its foothold in the domain of social policy because it is considered that the same tax rates should not be applied to basic foodstuffs, humanitarian services, medicines, etc. with luxury products and services. However, taking into account the danger of tax evasion, which would be increased by the application of a differentiated VAT rate, we believe that any possible risk to macroeconomic stability, which has been extremely favor-

³ <http://www.new.uino.gov.ba>

⁴ <https://eur-lex.europa.eu/legal-content>

able trends in VAT collection since its introduction until today, would become questionable. Social reasons, which are strongly argued through the reduction of the standard of living due to the increase in the prices of all products, cannot be solved only through discretionary fiscal policy measures.

In the aforementioned context, it is important to consider the role of monetary policy in Bosnia and Herzegovina. The monetary policy of Bosnia and Herzegovina, as the second pillar of the economic policy, did not evolve in time. Due to the mentioned fact, due to the drop in the value of the Euro as the currency anchor of the convertible mark, Bosnia and Herzegovina loses millions of monetary assets linked to the euro every day. With a more active monetary policy that certainly requires expert involvement, Bosnia and Herzegovina would improve its macroeconomic position and open the possibility of leaving the group of underdeveloped countries, which in itself would contribute to an increase in living standards and an improvement in the position of socially sensitive categories of the population.

Excise duties in Bosnia and Herzegovina were introduced on oil and oil derivatives, tobacco and tobacco products, beverages and coffee. Therefore, the structure of products subject to excise taxes is reduced to four groups of products and it is within the structure of excise products that exist in the European Union. Although the rates of excise taxes are within the limits that exist in the Union, the problem lies in the fact that the population of Bosnia and Herzegovina has incomparably lower incomes than the population of the Union, so it is unreasonable to compare them from a social aspect.

By joining the monetary union, the member countries renounced the exchange rate as an important instrument of monetary policy. The exchange rate represents the price at which the currency of one country is exchanged for the currency of another country. With the help of the exchange rate, countries can develop their economic doctrine, encouraging the competitiveness of their products abroad. The exchange rate is a way of defining prices in international exchange in the absence of a single monetary instrument (Jotanović, 1999:199).

6. CONCLUSION

The European Union is faced with a decreasing in GDP growth due to various reasons (interruptions in the supply of certain inputs or high increases in their prices, as is now the case with energy products). An increase in wages above productivity can keep inflation high for a longer period. In addition to them, cost inflation was also generated by the enormous increase in energy prices, which occurred as a result of the introduction of sanctions against Russia. The ratio of the total public debt of the EU reached 92% of GDP, which is the maximum. The differences in the level of debt are significant because six member states have a public debt between 60-100% (Germany, Croatia, Hungary, Slovenia, Slovakia, Finland), seven member states have a public debt above 100% (Belgium, Greece, Italy, Spain, France, Cyprus, Portugal), while the other member states are below the 60% level (Bulgaria, Czech Republic, Denmark, Estonia, Ireland, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Romania, Sweden). The European Union is faced with the challenges of double transitions (climatic and digital), the financing of which is expected to spend 520 billion euros annually in the period from 2021 to 2030. Through the NexGeneration EU instrument, it is planned to provide 338 billion euros in the form of grants and 386 billion euros in the form of loans until 2026.

What are the implications for Bosnia and Herzegovina? Given that most of the foreign currency assets of the Central Bank of Bosnia and Herzegovina are in securities denominated in the Euro currency, due to externalities in the form of rising prices of imported products and high inflation rates, Bosnia and Herzegovina is on the way to losing significant capital. The monetary policy of Bosnia and Herzegovina is not proactive. Certain monetary stability is provided by the Currency Board system, however, it finds its center of gravity in the currency anchor, i.e. the Euro. Taking into account the fact that the European Union has decided on monetary debt financing, which consciously leads to a fall in the value of the Euro, in the future, through this constant rate of inflation, a devaluation of the euro can certainly be expected. It is obvious that in such a scenario, Bosnia and Herzegovina would lose a significant part of its national wealth due to its monetary policy. Maintaining the gold exchange

standard at any cost (which essentially represents the fixed exchange rate of KM for the euro, but not according to the market value, but according to a predetermined value), which all developed countries abandoned in the 1970s and avoiding monetary-credit multiplication, is completely disincentive for the economy of Bosnia and Herzegovina. Borrowing on foreign markets is always less favorable than it is the case with the active monetary policy of the domestic central bank, which places money to financial institutions and economic entities through operations on the open market.

Looking at our financial sector, we can notice that most of the capital is in the hands of foreign banks. The above has the consequence that most loans are bound by a “currency clause” for the currency of the home country. With that, the host country is deprived of a significant part of its monetary sovereignty, for the reason that in case the country decides to devalue the domestic currency, the same measure would not be able to help reduce the level of debt.

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