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Reflection of public debt in financing deficit, capital investments and economic growth in Kosovo and level comparison with other countries

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Abstract - *In this paper, we present the processes of public debt development in Kosovo for the period of its functioning, respectively from 2009 until 2018. There is no long history of it, but there is a dynamic constant growth. The methodology used in this paper is based on empirical study analysis, and the scientific literature we have elaborated has found that many thinkers who support public debt with arguments justify this non-fiscal instrument to finance the budget deficit as well as some others who object it. In addition to the international debt with 42% share, in 2012, the domestic debt began to function, with securities issuing at 58%. Along with the country's economic growth, we have also increased budget, and GDP growth. While every year we have an average economic growth of 3.2% to 3.5%. In 2013, compared to 2012, the budget increase is 1.96%, in 2016 compared to 2015 is 7%. In 2017 compared to 2016 we have a growth of 8.31%. In 2009, the debt-to-GDP ratio had a share of 6.12%, in 2014 it reached 10.65%, in 2017 the share of debt to GDP (GDP) was 16.63% and in Q3 of 2018 it was 16.92 %. In the countries of the region and the European Union we have different levels. Most states have a high level of debt to GDP.The study of the literature review was carried out using selected four databases containing publications. Research has been done to find out how much the public debt level is based on the specifics of the economy and fiscal policy in Kosovo. In addition to the dynamics of public finance development, public debt has also been realized.*

Keywords: *Public finances, public debt, deficit, economic growth*

1. INTRODUCTION

Public debt encompasses all the liabilities that are debt instruments owed by governments and public administrations, public companies and other economic subjects of nations (Barro, 1979). Public debt is also a vital instrument for governments to finance public expenses, especially when it is difficult to increase taxes and/or reduce expenditure (Gnegne and Jawadi, 2013; Coccia M. 2018). However, a high public debt is also a critical problem for countries with weak economic system because it may generate economic instability and sovereign debt crisis (Domar, 1944; Hall and Taylor, 1993; Amaral and Jacobson, 2011). A high public debt and a large fiscal deficit are common features among countries in Europe (Tamegawa, 2016). There are many channels through which public debt might affect economic output either positively or negatively. The most frequently cited negative effect is the crowding out of private investments (Elmendorf and Mankiw 1999). A further adverse effect is macroeconomic vulnerability. Two major positive effects of public debt are the Keynesian effect and the hysteresis effect, which refer to the ability of expansionary fiscal policy to mitigate both the actual rate and the natural rate of unemployment during recessions (DeLong, J. B., and L. H. Summers. 2012; Dombi Á. & Dedák I.2018). To sum up, the main message of economic theory is that the debt-growth nexus is country- and time-specific, being conditional on several factors, such as the business cycle and institutional quality (Krugman, P. 2012; Reinhart, Rogoff, and Savastano 2003). This conditionality of the debt-growth nexus is also confirmed by the latest empirical results (Eberhardt, M., and A. F. Presbitero. 2015; Dombi Á. & Dedák I.2018). The argument that accumulation of public debt (fiscal deterioration) has a negative impact on economic growth was made in the studies by Reinhart et al. that concern public debt overhang (Reinhart, Reinhart and Rogoff, 2012, and Reinhart and Rogoff, 2010). Reinhart, Reinhart and Rogoff (2012) reviewed 26 cases of high accumulation of public debt in advanced countries and reported that in 23 of those cases, economic growth remained stagnant for more than a decade. What is notable about their findings is the presence of a non-linear relationship between public debts and economic growth (Kobayashi K.2015). If there is a cause-and-effect relationship of a decline in economic growth increasing public debts but not of a public debt increase lowering economic growth, the correlation between a public debt increase and a decline in economic growth would be observed regardless of the size of the public debt ratio. However, according to the available data, such a correlation is not observed when the public debt ratio is small Kobayashi K. (2015). On the other hand, Bob Rubin and Allen Sinai have pointed out that the major negative consequences of ongoing budget deficits occur suddenly (Orszag, Peter R; Fellow, Pechman, Joseph A. 2004)

Thus, the ongoing deficit is a burden for more generations, government spending is not controlled, economic and social problems are repaired. Well-known researchers: Cukiierman and Meltzer (1989) regarding deficit, developed the theory of debt redistribution. They point out that the growth of the deficit and the expected rate of economic growth are based on the distribution of income with a tendency to increase the population's longevity, and consequently, the heirs will lead to large budget deficits (Hung, Derek; Chiat, Chen 2003). Kosovo is granted the authority to "borrow funds, make loan guarantees, and to pay the principal and interest on its debt". The given law, additionally, provides The Ministry of Finance the stated authority, according to which, the Minister is vested as the sole entity to incur State Debt for the designated purposes (RK, 2019). As such, the given Ministry, under the given law, is delegated as the only institutional body to enter into State Debt. Moreover, if the state desires to ensure compliance with the given law to the fullest, the total amount of debt should not exceed the 40% of GDP (Trenovski, B., Tamara M.-S., 2018).

2. LITERATURE REVIEW

In relation to public views on public debt, many sources, many economists, financiers, and theoreticians, who deal with different aspects of this field, have a number of thinkers who support it and some others who oppose it. In the history of economic model studies, the names of the most well-known economists have been associated with this issue in various periods, from Ricardo, Smith, Keynes, and then to Friedman, Samuelson, Blanchard, Hamilton, Krugman, Coorsetti, Rubin and so on. In economics and science of public finances, there is hardly any area to be discussed as much as debating the role of public debt. The deterioration of the debt in many Western countries in the aftermath of the economic recession, over 2007-2008 period, has brought the spot light on the long-term effect of high public debts and economic policy of deficit reductions on the real economy (Coccia, 2013). There are three theories about the effects of budget deficits and public debt: Keynesian, neoclassical and Rikardian School. Their common characteristic is that they mainly discuss the situation of deficit occurrence due to the reduction in tax revenue, and not due to an increase in government spending (although the Keynesian school in the original version sees the effects of the increase in public spending to changes in employment and output, and later the effects of a decrease in tax revenues). In general, differences in attitudes about the deficit and public debt are resulting from different choices of assumptions underlying the models of different schools (Tempelman, 2005). The analysis of the evolution of public debts and of government deficits is important to European policy makers to design economic and financial measures for supporting the stability and growth over the long run (Equiza-Goñi, 2016; Paniagua, Sapena, & Tamarit, 2016). As a matter of fact, public debt is a vital instrument for governments to finance public expenses, especially when it is difficult to increase taxes and/or reduce the public expenditure (Gnegne & Jawadi, 2013). But the two different models have the same argument on the effects of fiscal policy on the level of GDP; whereas they are not the same on the effects of fiscal policy on economic growth. According to the theory of endogenous growth model, government plays a significant role in promoting accumulation of knowledge, research and development, productive public investment, human capital development. Law and order can generate growth both in the short- and long-run. Several attempts at regaining macroeconomic stability through fiscal adjustment achieved uneven success in developing countries, thus raising questions about the macroeconomic consequences of fiscal deficit. Much of the evidence in the literature has strong support for the view that the prior fiscal deficit caused debt crisis in many developing countries. However, the effects of fiscal deficits on debt depend strongly on the adopted financing methods and the country's macroeconomic conditions (Ogunmuyiwa, 2008 and 2011). Boariu and Bilan (2007) also argued that public debt, as all other loans, is costly because government pays interest to their creditors as a price for using the temporary available resources. As a result of its characteristics, public debt can involve several undesired effects. The paper found that debt financing leads to the accumulation of public debt and to the increase in interest payments, which determines an increase in the budgetary expenses that states have to cover. According to Eminer (2015), an increase in a budget deficit will impact economic growth positively if the deficit is geared towards productive spending and negatively if it is geared towards non-productive spending. In any case, the term "productive spending" is relative, and dependent on the discretion of the policy maker. Also, the full realization of the impact of budget deficits is dependent on the duration (short or longrun) of the policy. Carl Dietezel largely supports the state's debt, among other things says that "public borrowing is a factor for strong economic progress(Heinz-Dieter Wenzel, Jörg Lackenbauer, Klaus J. Brösamle. 2005). David Hume in his paper reviewed the financial activity of the state, which devoted the basic care to the public lending activity, but which is a major opponent of public debt. But in practical life, Hjum's opinion falls down because all countries in the world apply public debt with the exception of one of them. The only country in the world that since 1980 does not receive financial resources on behalf of public debt is Singapore that in the public finance science circles is a case study. In this context, repeated debates are held that support it, it is argued that public debt is of great importance in stabilizing the budget, deficit financing and economic development. However, those, who oppose it, say that public debt is a heavy burden on the economy for future generations. In this regard, in the simplest sense, borrowing is provided to provide the means to finance government spending. This implies that in budget deficits, we have low taxes for current citizens but that a large part

of tax revenues are paid by future generations to pay off debt interests instead of using them to provide services to governors (Hyman, David, N. 2010).According to this theory, the effects and policy of public debt from migration so far is ignored, this best suits a closed economy (Derek Hung, Chen Chiat). The government, according to them, has to finance a certain amount of spending in each period by taxing current incomes and increasing public debt, based on two factors, but the composition of taxes and the level of government spending influence the exogenous factors (Hung, Derek, Chiat, Chen, 2003). On the other hand, on the question posed by Rosen; borrowing or borrowing reflects the data of debates that if different factors cause increased public spending, be financed by increasing taxes or increasing borrowing. Simultaneously leaving the opportunity to discuss, the choice between debt and taxes is one of the most important problems in the field of public finances ROSEN, Harvay S(2003). For the study of deficit and surplus, D. I. Trotman - Dickinson PhD 1996 presented two ways of their changes(Trotman, D.I: 1996). Regarding the effects on the economy, both the surplus and the high deficit have negative reflections. The high surplus causes the consequences because the assets in the name of taxes are taken for businesses and citizens do not exploit, nor use the government, for a certain period of time, they are removed from circulation and the opposite is when the budget funds are spent more than normal based on the criteria of the Maastricht Treaty. Based on the European Union rules under the Maastricht Treaty (1993), the criteria for assessing fiscal sustainability are set, the reference points tolerate a deficit of up to 3% on the budget and 60% of the debt to GDP, valued at market prices.Many economists in their work spell over the role of public debt in fiscal policy and economy, but also in countries that face huge deficits.The first economist, who supported this idea, was John Maynard Keynes (1923); it was the time when France faced major fiscal deficits (Suggested Citation: Curtaşu, Anca Ruxandra, 2011). In his Guiden, which deals with public sector debt and budget deficit, Buiter (1985) defined fiscal policy as a capability to maintain the net public sector value ratio of output at its current level (Buiter, W.H. 1985). Also, Blanchard and Chouraqui (1990) consider that fiscal policy is stable when public debt is not caused by the factors that represent the dissatisfaction arising from governmental problems, so governments are not obliged to raise taxes, reduce spending, as a surplus the amount of currency in circulation or even deny public debt(Blanchard, O, et al. 1990).In their work, it is proven that US deficits (1962-1984) are in line with the proposal that the government budget should be balanced in terms of current value (Hamilton, J.D. and Flavin, M.A. 1985). Debt has increased sharply, reaching the levels of Central and Eastern European countries. Some countries in the region experienced rising public debt to an extent that their sustainability might become questionable. The significant reduction of the debt burden that took place during the boom years was thus largely undone (Koczan, Z. 2015). In addition to the budget deficit and the public debt level, the authors Corsetti and Rubini also addressed the issue of debt solvency. Corsetti and Rubini (1991) made the study for OECD countries, for the period 1960-1989 for solvency, which found great differences between countries. Until the US, Japan, Germany, France, the UK and Canada are not facing the ability solvency; problems exist in countries such as Belgium, Ireland, the Netherlands and Greece, they owe high in relation to GDP (over 100% Belgium and Ireland) (Corsetti, G. and Roubini, N., 1991). In this sense, according to David N. Hyman, the budget deficit is an excessive burden of government bills on government spending (Hyman, David N. 2010). Factors that could undermine fiscal sustainability are achieved through deficits and high debt stocks, resulting in fiscal instability. In 2009, the UK achieved a budget deficit of 11.5%, Spain with 9.4%, Greece 8.1%, France 7.8%, Ireland 9.9% in relation to GDP. The biggest problem of the deficit is the huge government debts that can cause repercussions. We have the case of Greece and Ireland in 2010, as a result of the high deficit, there were economic and financial crisis. There are major problems when governments face the deficit for a long time, repeating year after year. Repeated deficits can reduce the standard of living of future generations, contributing to lower investment and lower economic growth (Hyman, David N. 2010).The opinion on the budget deficit has been given by David Ricardo, who in the relationship of generating debt financing is equivalent, the form of government funding is unimportant, and this is called the Ricardian model, but he himself was skeptical. It is a known problem that government spending is used for two main purposes; providing public goods and redistributing *income (*Meltzer, Allan H., 2010).This definition is rather a complementary contribution to the work Robert Barro (1979) described, spreading the theory, trying to minimize the excessive tax burden of society over time*(*Barro, Robert J.1979). Alex Cukierman and Allan H. Meltzer have identified the economic factors that lead to the emergence of large debt and deficit for these reasons: due to the distribution of wealth of individuals, high rate of technical progress and return on equity Cukierman, Alex; Meltzer, Allan H. A. (1989).This issue stems from the fact that families tend to increase savings, pending tax increases. Then, the highest deficit does not cause interest rate growth, because savings grow in the same amount, the overall effect is zero, without any negative impact on investment(Krajewski, Piotr; Mackiewic, Michał. 2005). On the other hand, Sheikh et al. (2010) studied the impact of domestic debt on economic growth in Pakistan for the period 1972-2009. Their study showed that the domestic debt stock had a positive impact on Pakistan's economic growth (Sheikh M. et al. 2010).

3. PURPOSE OF THE PAPER

The purpose of this paper is to address the role of public debt in Kosovo and its reflection on the development of economic and financial processes. As a result, it was decided to deal with the treatment of this financial sphere in order to increase the public's interest in this important and sensitive issue. Transitioning countries tend to control the budget deficit due to their high needs and often face numerous challenges. Public Debt in Kosovo began in 2009, and for that purpose, it is dealt with its impact and its role in economic growth and public goods delivery.

4. METHODOLOGY

The methodology used in this paper is based on empirical study analysis, and the scientific literature we have elaborated has found that many thinkers who support public debt with arguments justify this non-fiscal instrument to finance the budget deficit and some others who object it. Research has been done to find out how much the public debt level is based on the specifics of the economy and fiscal policy in Kosovo. In addition to the dynamics of public finance development, public debt has also been realized. Subsequently, we analyzed the debt structure in relation to the budget and GDP for the period from 2009 to 2018. In this study, we will also compare the level of public debt to GDP of Kosovo with the countries of the region and the European Union.

3.1 Dynamics of budget increase and public debt in Kosovo

The reforms developed in Europe and elsewhere in the 1990s found Kosovo in an unenviable position. As a result of occupation by Serbian aggression, the economy was plundered in succinct forms. In 1999, Kosovo was liberated, its economy was ruined. Although major changes have been made to the economic and political system, despite the consequences, there are positive trends in processes, economic development, construction and reform of the tax and budget system and public debt. Public debt is one of the non-fiscal instruments needed by the government to finance the budget deficit. Immediately after the war, the first four-month budget of 1999, 95% was funded by donors. The first budget of 2000 was financed 47%, in 2001 by 21%, in 2002 by 7%, the 2003 budget by 4.81%, while the 2004 budget by own funds (ME, 2004).

Table No 1.

Dinamics of budget increase, period (2012 - 2019)

Years Budget	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019** project
Budgetory incomes	**1.321,7**	**1.316**	**1.345**	**1.470**	**1.634**	**1.725**	**1.824**	**1.939**
Budgetory expenses	**1.440.7**	**1.469**	**1.480**	**1.564**	**1.672**	**1.811**	**2.092**	**2.297**
Deficit as % of GDP	**- 2.8**	**- 3**	**-2.3**	**-2**	**-1.6**	**-1.5**	**-1.7**	**-1.5**
Stock of debts % of GDP	**8.10**	**8.94**	**10.65**	**13.07**	**14.58**	**16.63**	**17.36**	**18.00**

Source: Law on the Budget of the Republic of Kosovo for 2014, Law No. 05 / L-071 on the Budget of the Republic of Kosovo for 2015, Law on the Budget of the Republic of Kosovo for 2017, Law No.06 / L-020 for the Budget of the Republic of Kosovo for 2018.

As seen in Table No.1, in 2013, compared to 2012, the budget increase is 1.96%, in 2016 compared to 2015 the growth rate is 6.9%. In 2017, compared with 2016, the increase is 8.31%. The budget deficit as a % of GDP calculated according to fiscal rules in 2012 is (-2.8%) in 2017 (-1.5%) and in the third quarter Q3 (Q3) of 2018 is (-1.7%). Sources of funds from the types of taxes, customs, excise, taxes, and non-tax revenues are not abundant, it is a necessity for the government to provide means through debt, which are transformed into tangible public goods.

3.2 Public development policy as a non-fiscal istrument

With the development and the state's role in the economy, public debt functions also grow. To carry out these functions, the government borrows internally as well as from international financial institutions and organizations. In Kosovo for the first time, the State Debt portfolio started in 2009, consisted only of a loan called the Consolidated Credit C by the World Bank, the total amount of this loan was in the amount of 381.21 million € (MF, 2018). External debt was realized in 2012 against the International Monetary Fund (IMF), with a stand-by agreement of € 22.1 million, it was expected to be returned by 2015, whereas (AZHN) is worth € 5.1 million, the return starts from 2020 until 2030 (Kryeziu, R. 2014). International debt sources are from these institutions: the European Bank for Reconstruction and Development, the International Development Association, the International Monetary Fund, the UniCredit Bank in Austria, the German Bank for Development and the Islamic Development Bank. Whereas, in 2012, domestic debt began with the issuance of securities.

Table No 2.

Dinamics of budget increase, period (2009 - 2016)

Years	2009	2010	2011	2012	2013	2014	2015	2016
Internat-debt	249	260.1	253.7	336.6	323.76	326.35	371.17	373.77

Inner debt				73.4	152.51	256.52	377.78	478.97
Total debt	249	260.1	253.7	410	476.27	582.87	748.95	852.74
Public warra	0.00	0.00	0.00	0.00	0.00	0.00	10.00	20.00
% Debt/GDP	**6.12**	**5.91**	**5.27**	**8.1**	**8.94**	**10.65**	**13.07**	**14.58**
GDP	**4.07**	**4.402**	**4,815**	**5.509**	**5,327**	**5.567**	**5.807**	**5,985**

Source: MF, (2018). Annual Bulletin 2017 on Public Debt, https://mf.rks-gov.net/desk/inc/media/DBC0F3C8-589E-4612-A290-BD1DE2F8900A.pdf

As can be seen in Table no. 2, General Debt in Kosovo has an upward trend in nominal values over the years. In 2010 it increased, in 2011 it was reduced because the amortization was higher than the withdrawals from the contracted loans. In 2012, there was an increase due to the receipt of three tranches from the IMF Program of € 93.6 million and issuance of securities. By the end of 2014, public debt is € 582.87 million, compared to 2016, we have an increase of 22%, compared to GDP by 10.65%. In 2016, the debt amounted to € 852.74 million, compared to 2015, it increased by 14%, against GDP of 14.58%. By the end of 2017 the debt amounted to € 996.42 million, compared with the GDP of 16.63% compared to 2016, it increased by 16.85%, due to the withdrawal of two tranches of € 100.37 million from the Program with IMF and new securities issue of € 95.30 million.

Table No 3.

Dinamics of budget increase, period (2012 - 2019)

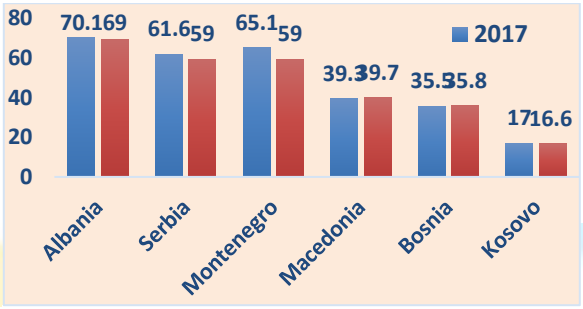
Types of Sectors	**The amount of funds invested from 2009 to 2018**	**Breakdown by %**
Education Sector	14.52	2.38%
Financial Sector	5.22	0.86%
Financial Sector	36.34	5.96%
Financial Sector	14.30	2.35%
Financial Sector	67.45	11.06%
Financial Sector	81.90	13.43%
Water Infrastructure Sector	114.00	18.70%
Central Heating Sector	5.00	0.82%
Public Sector	28.91	4.74%
Road Infrastructure Sector	226.83	37.21%
Total	**609.67**	**100.00%**

Source: PUBLIC DEBT BULLETIN 2018, Debt Management Division April 2019, https://mf.rks-gov. net/ desk/inc/media/0D71E1B8-28E2-4AC5-9CDE-1634D4D0C97A.pdf.

In Table No. 3 we have presented the data on international debt contracted during 2009-2018 for the financing of projects belonging to the above sectors. The loans contracted during 2018 belong to the road infrastructure sector 65%, 18% to water infrastructure sector and the public sector 17%. While, it is quite differently in the countries of the region that continuously, year after year, have high debt in absolute and relative value as well as GDP. In Graph no. 2 below, we present the public debt in the countries of the region as a percentage of GDP (2017-2018).

Graph *No*. 2.

Public Debt in the Countries of the Region, % to GDP (2017-2018)



Source: Eurepean Commission // raw data by Monitor

As it can be seen on graph Nr. 2, it is proved that in 2017 the countries of the region have a high level of debt to GDP. Albania reaches the debt with a level of 70.1% of GDP, Serbia with 61.6%, Montenegro with 65.1%, North Macedonia with 39.3%, Bosnia with 35.9%, and Kosovo with 17%. European Union and euro area countries have a high level of public debt. According to Eurostat's report EUROSTAT, (2019), confirms that by the end of the third quarter of 2018, the ratio of government debt to GDP in the euro area (EA-19) was 86.1% compared to 86.3% at the end of the second quarter of 2018. In the EU-28 member states, the debt ratio dropped from 81.0% to 80.8%, compared to the third quarter of 2017, the government debt to GDP ratio in the euro area fell (from 88.2% to 86.1%) to EU-28 countries (from 82.5% to 80.8%). The highest levels of government debt to GDP at the end of the third quarter of 2018 were recorded in Greece (182.2%), Italy (133.0%), Portugal (125.0%), Cyprus (110.9%) and Belgium 105.4%), and the lowest in Estonia (8.0%), Luxembourg (21.7%) and Bulgaria (23.1%). According to Eurostat's report (EUROSTAT, 2019),compared to the third quarter of 2017, four EU member states recorded an increase of their debt to GDP at the end of the third quarter of 2018, an increase registered in Cyprus (+9.7%), Greece (+7.4 %), Great Britain (+ 0.4%) compared to the third quarter of 2017, four EU member states recorded an increase of their debt to GDP at the end of the third quarter of 2018, an increase registered in Cyprus (+9.7%), Greece (+7.4 (-8.0%), Malta (-6.8%), Portugal (-4.6%), Slovenia (-8.0%), Great Britain (+ 0.4%) and Slovakia (+ 0.1%),), Austria (-4.3%), Lithuania (-4.2%), Netherlands (-4.1%), Ireland and Croatia (both -4.0%).

5. CONCLUSIONS

This study concludes that Kosovo has a low level of public debt relative to GDP and compared with the countries of the region and the member states of the European Union, and as a result of this policy, the Kosovo government has room and opportunity to increase its external and internal debt. Moreover, the financial means received from the government on behalf of the public debt have a positive impact on the overall economic growth and the completion of public goods in particular. Realization of new loans as a target should have the financing of projects in the fields of education, agriculture, energy, health, water, district heating, rehabilitation of roads of different levels, railways and budget support for the realization of public goods and economic development of the country. It can be concluded that if the means of debt are used well, they have positive effects on the economy, welfare growth, public goods, otherwise, if not properly managed, the government and the state in general will feel the consequences.

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