Public debt in Southeast Europe

Why to enable public participation?

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BALKAN MONITORING PUBLIC FINANCES

CREDITS

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CSOs as equal partners in monitoring of public finance

"CSOs as equal partners in the monitoring of public finance" started in the beginning of 2016, and is implemented by a consortium of 10 organizations from 7 countries, and will last for four years.

The aim of the project is to improve the transparency ad accountability of policy and decision making in the area of public finances through strengthening the role and voice of NGOs in monitoring the institutions that operate in the area of public finances. In this way, the project will strengthen CSO knowledge of public finance and IFIs and improve CSO capacities for monitoring. Additionally, it will help advocate for transparency, accountability and effectiveness from public institutions in public finance. Moreover, this project will build know-how in advocating for sustainability, transparency and accountability of public finance and IFIs. This project will also increase networking and cooperation of CSOs on monitoring of public finance at regional and EU level. Lastly, it will increase the understanding of the media and wider public of the challenges in public finance and the impacts of IFIs.

Key project activities are research and monitoring, advocacy, capacity building, and the transfer of knowledge/practices and networking in the field of the 4 specific topics: public debt, public-private partnerships, tax justice and public infrastructure.

Additional to this analysis, 3 more analysis will be prepared in line with the other 3 topics of the project: public debt, tax justice and public-private partnerships.

This study is accompanied with a policy brief which will be also available in local languages and will provide a short overview of the key policy recommendations and trends.

More information about the project can be found on http://wings-of-hope.ba/balkan-monitoring-public-finance/ and on the Facebook Page Balkan Monitoring Public Finances

Contents

Introduction

In the face of the European debt crisis, public finance monitoring took center stage in economic discussions. These events have reconfirmed the adverse effects of the rising costs of an ever-growing public debt on economic growth, monetary stability and public finance. The 2008 global economic crisis highlighted the importance of fiscal intervention, and after more than two decades of the neoclassical paradigm and a non-fiscal dominance, brought back fiscal activism and the Keynesian ideas and measures at the top of government agendas. The drastic worsening of many nations' fiscal health, as a result of a decreased economic activity and of various fiscal packages for the financial sector and the economy as a whole, complemented by budgetary pressures from an aging population, activated debates on the size, sustainability and the consequences of budget deficits and public debt. Before the crisis the focus of debates and research on the issue of monitoring of public finance was on developing and emerging market countries. Recent events, however, especially the European debt crisis, when some EU member states faced difficulties in accessing financial markets, proved that fiscal sustainability problems are not typical only of developing countries, but are also a real problem for developed countries with a growing public debt, stagnant economic growth, unfavorable demographic trends and liabilities passed from the financial sector.[1]

Transparency of public finance refers to the extent and ease with which citizens can access information about and provide feedback on government revenues, allocations, expenditures, government's economic priorities in terms of policies and programs. Monitoring of public finance entails using such information to analyze, critique, and track government finances in order to provide this feedback. Transparency is a prerequisite for public participation and accountability, which are instrumental for a democratic and legitimate budget process. Both transparency and monitoring efforts also help remove institutional bottlenecks that result in delayed budget allocations, thereby jeopardizing the delivery of vital services to people. Even though they have a far-reaching impact on the lives of people, opening up public finances beyond the exclusive domain of policy makers and administrators is a relatively recent phenomenon that has gained momentum in the last two decades.[2]

1 Tanner, E., 2013. Fiscal sustainability: A 21st century guide for the perplexed; Working Paper No. 13/89. International Monetary Fund

2 Global stock-take of social accountability initiatives for budget transparency and monitoring: key challenges and lessons learned (English), 2013, available at: http://documents.worldbank.org/curated/en/457241468340847491/Global-stock-take-of-social-accountability-initiatives-for-budget-transparency-and-monitoring-key-challenges-and-lessons-learned

Public officials have a constitutional obligation to account to Parliament. They should be broadly accountable for how they spend public money, how they have achieved the purposes for which the money has been voted and that they have gone about their duties with a high degree of integrity. Monitoring provides the information, in a structured and formalized manner, which allows scrutiny of public service activities at all levels. Despite the concerns that many have that one should not pursue Monitoring only for the purpose of accountability, as it may create suspicion and a culture of fear, when dealing with public funds accountability is critically important. Accountability should be governed by the Constitution and legislation such as the Public Finance Management Act, and failure to adhere to meeting accountability requirements is often met by sanctions.[3]

Civil society organizations engaged in public finance focused work contribute to public expenditure management and oversight in several ways. First, they provide one of the few sources of critical and independent information on the impact of the budget on poor and low-income citizens. Second, they can help build public finance literacy among citizens and facilitate discussions and debates on public finance issues within civil society. Third, by collating, synthesizing, and disseminating information on public finances, adds new data into the budget process. Finally, civil society public finance groups provide training on public finances to citizen groups, the media, and legislatures, thereby strengthening the capacity of all of these groups to exercise oversight over budget process and to demand accountability from government. Although civil society is a relatively new actor in public budgeting, evidence that they are having a positive impact on decision-making and implementation is beginning to emerge.[4]

Public finance monitoring initiatives can contribute to improved transparency and awareness, as well as enhanced resources and efficiency in expenditure utilization. Even more the effect is quite higher with citizen-led monitoring. The main goal here is to increase accountability through independent monitoring, while the main focus of beneficiary collection is on improved responsiveness and beneficiary satisfaction. Some tools in addition to citizen and community monitoring are social audit, public expenditure tracking surveys, participatory auditing, etc. The main results are reduction in corruption, increased transparency and accountability, and openness in government.[5]

Several new standards have also arrived on the global stage, including the OECD's High-Level Principles of Long-term Investment Financing by Institutional Investors, and the

3 Basic concepts in monitoring and evaluation, Public service commission, February 2008, available at: http://www.psc.gov.za/documents/docs/guidelines/PSC%206%20in%20one.pdf

4 Vivek Ramkumar and Warren Krafchik "The Role of Civil Society Organizations in Auditing and Public Finance Management", The International Budget Project, available at: https://www.un-ngls.org/orf/cso/cso10/Ramkumar.pdf

5 Vinay Bhargava "Engaging Citizens and Civil Society to Promote Good Governance and Development Effectiveness", The Governance Brief, ISSUE 23 • 2015, available at:
https://www.adb.org/sites/default/files/publication/172999/governance-brief-23-engaging-citizens-and-civil-society.pdf

United Nations Conference on Trade and Development (UNCTAD) Roadmap on Sovereign Debt Workouts and Principles on Promoting Responsible Lending and Borrowing.[6]

The crisis showed that it is of great importance for fiscal policy makers to balance between short term stabilization goals of fiscal policy and the long-term sustainability. It is a challenge for fiscal policy to stabilize the economy without disturbing the fiscal stability of the system.

When the crisis erupted and banks were under the immediate risk of collapse, private debt was converted into public debt, since the state rushed to take over the liabilities of the overexposed banking system. Thus, in all peripheral countries, government debt exploded despite distinct paths. At the same time austerity is considered as the only way to reduce deficits and repay old and new debt.[7] The consequences of these recurring financial crises in 'advanced' economies included 'austerity', the removal of employment protection, rising housing and education costs, the return of deflationary pressures, high unemployment, falling real wages, low productivity and rising inequality.[8] Austerity adversely affects GDP growth and erodes tax and productive bases while the operation of the multiplier in times of economic contraction creates adverse macroeconomic conditions for it to work. When basic needs are not met because money is flowing to banks instead, it is time to start questioning the legitimacy of these debts and the broader financial system under which they were incurred.[9] We should know what debts the population is paying for. The Audit is the tool that enables us to understand and document the Debt. This is helpful for raising awareness of the need for a new and more equitable (international) financial architecture.[10]

The onset of the crisis in 2008 revealed underlying fiscal vulnerabilities in many emerging European countries. A sharp decline in capital inflows led to economic recessions and modest recoveries thereafter. In this context, part of the revenue surge of the boom years turned out to be temporary, and, together with rising expenditures as part of the countercyclical fiscal policy, set the stage for large deficits across the Balkan countries. The collapse in tax revenues was particularly marked for taxes on goods and services and international trade and transactions, which account for a higher share of revenue in the Western Balkans than in the EU-15 or New Member States. The fiscal balance fell from an average of 1.93% in 2007 to a deficit of -1.45% in 2007 and -3.98% in 2008.[11] In the aftermath of the crisis, the

6 More information available at Eurodad website: http://www.eurodad.org/responsible-finance-standards-state-of-play

7 Elena Papadopoulou and Gabriel Sakellaridis (ed.), 2012, The Political Economy of Public Debt and Austerity in the EU, by Transform! european network for alternative thinking and political dialogue

8 Ann Pettifor (2017), The neoliberal road to autocracy, in International Politics and Society, available at: http://www.ips-journal.eu/about/about-the-journal/ [accessed on 17.05.2017]

9 Fanny Malinen (2016), The "Golden noose" of global finance, in The rule of Finance, No. 3, ROAR Magazine. available at: https://roarmag.org/magazine/golden-noose-global-finance/

10 Maria Lucia Fattorelli (2014), Citizens public debt audit: experiences and methods. Auditoria Cidadã da Dívida, CADTM and CETIM

11 IMF Country Report No. 16/356, FYROM 2016 ARTICLE IV CONSULTATION—PRESS RELEASE; AND STAFF REPORT, available at: https://www.imf.org/external/pubs/ft/scr/2016/cr16356.pdf, [accessed on April 10, 2017]

Western Balkans experienced difficulties in regaining control of their public finances. 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. [12]

The last debt crisis has been an expression of the systemic crisis rooted in income inequality and the lack of financial regulation as well as macroeconomic imbalances, accentuated by the architecture of the EU and its persistence in the neoliberal project. The consequent loss of legitimacy of political leaders is expressed via massive electoral abstention, the erosion of traditional governing parties and the growing influence of an anti-systemic discourse of radical populist right-wing parties.[13]

Fiscal sustainability can be defined as the ability of a government to sustain its current spending, tax and other policies in the long run without threatening the government's solvency or without defaulting on some of the government's liabilities or promised expenditures.[14] Thus, fiscal policy is sustainable as long as it does not endanger a sovereign's solvency now or any time in the future.[15] This definition can be complemented with the requirement that such a policy can be continuously maintained without a continuous growth and excessive accumulation of public debt. Hence a continuously growing and/or extremely large debt ratio is a practical signal for sustainability problems.[16] "As a prerequisite, a government must satisfy intertemporal solvency: it must raise enough resources (in present value terms) to service its obligations so as to preclude either default or restructuring. In this vein, a "sustainable policy" may be one that, if continued indefinitely and without modification, would keep the government solvent."[17] This means that the present value of future primary surpluses must be at least equal to the initial debt, thus respecting the condition commonly referred to as the no-Ponzi game condition.[18] Notably, this condition does not necessarily rule out large deficits or high and growing debt. Debt is allowed to accumulate as long as it is viable to run large enough primary surpluses in the future to counterbalance the accumulation.[19] In

12 Koczan, Z. 2015. Fiscal Deficit and Public Debt in the Western Balkans: 15 Years of Economic Transition. IMF Working paper, European Department. [accessed July 2017]

13 Elena Papadopoulou and Gabriel Sakellaridis (ed.), 2012, The Political Economy of Public Debt and Austerity in the EU by transform! European network for alternative thinking and political dialogue

14 European Semester Thematic Factsheet: Sustainability of public finances, available at: https://ec.europa.eu/info/sites/info/files/file_import/european-semester_thematic-factsheet_public-finance-sustainability_en.pdf

15 Barta, Z., 2015. Fiscal sustainability and the welfare state in Europe. ACRN Journal of Finance and Risk Perspectives Special Issue of Social and Sustainable Finance, 3, pp.135-147

16 Balassone, F., Cunha, J., Langenus, G., Manzke, B., Pavot, J., Prammer, D. and Tommasino, P., 2009. Fiscal Sustainability and Implications for the Euro Area. ECB Working Paper, pg. 994

17 Tanner, E., 2013. Fiscal sustainability: A 21st century guide for the perplexed.
Working Paper No. 13/89. International monetary Fund

18 Chalk, N. and Hemming, R. 2000. Assessing Fiscal Sustainability in Theory and Practice. *IMF Working Paper* WP/00/81. International Monetary Fund

19 Ibid.

the case of the Stability Pact of the European Union, Balassone and Franco (2000) say that sustainability can be seen a “non-violation of arbitrarily predefined parametric standards.”

Sustainable public debt is a very important category for stable economic growth. Fiscal unsustainability implies that current fiscal policies cannot continue forever and sooner or later, an adjustment will be needed. Otherwise, the debt will explode. A timely detection of unsustainable policies is crucial, because a late detected need for adjustment can cause a loss of confidence in the financial markets and can be very costly. Due to sustainability threats, after the initial fiscal stimulus undertaken as a response to the crisis, the developed countries turned to fiscal consolidation, i.e. “fiscal austerity policy”, trying to regain stability of their public finances. This process was specifically evident in the European Union, where the so called PIIGS countries faced difficulties in accessing the financial markets due to the deteriorated confidence in their credibility.

For countries in the eurozone periphery, already deeply indebted after years of weakening competitiveness relative to the eurozone core, fiscal deficits led to restricted access to international bond markets. Peripheral states were threatened with insolvency, posing a risk to the European banks that were among the major lenders to the periphery. To rescue the banks, the eurozone had to bail out peripheral states. But bailouts were accompanied by austerity that induced deep recessions and rendered it hard to remain in the monetary union.[20]

When we are researching public finance the role of rating agencies is crucial when talking about public debt. In the mainstream discourse they are presented as the institutions designed to solve the asymmetric information problems of modern finance, caused by the disintermediation of capital markets, the internationalization of finance and financial innovations. The focus on their technical character is important in order to maintain their scientific prestige, which enables them to enforce their policy recommendations and judgment in an allegedly objective manner. The downgrading of economy evinces the imperative for restricting policy options. Any divergence from mainstream prescriptions is excluded under the threat of another downgrade. Moreover, the management of the crisis does not only deploy economic, but also political tools. One of them is widening the democratic deficit in the European Union.[21]

Recent decades have witnessed dramatic changes in the structure of the global political economy and the nature of the state that have in turn caused the international balance of power to shift decisively in favor of finance and the main creditor states, and the domestic balance of power decisively in favor of local elites whose interests and ideas are broadly aligned with those of

20 Costas Lapavitsas (2012), Crisis in the Eurozone. London and New York, Verso

21 Elena Papadopoulou and Gabriel Sakellaridis (ed.), 2012, The Political Economy of Public Debt and Austerity in the EU by transform! european network for alternative thinking and political dialogue

foreign creditors.[22] Or as it is captured in W. Streeck's (2014:72) conceptualization of the debt state as "a state which covers a large, possibly rising part of its expenditure through borrowing rather than taxation, thereby accumulating a debt mountain that it has to finance with an ever greater share of its revenue."[23]

Purpose of the analysis

The objective of the study is to analyze various policies, regulation and legislation regarding public debt and processes of the situation in the public finance field, to recognize key problems, propose solutions and advocate for change, with a special focus on monitoring of public finance. Often debt does not serve the needs of the citizens and puts limitations on democracy in a sense that does not imply involvement of citizens and NGOs in the process of decision making in the area of public finances and at the same time is characterized by a low level of transparency. Hence, the study will identify problems in implementation of the existing legislation or identify lack of necessary legislation. This will be the basis for proposing policy recommendations regarding monitoring of public finance for the covered countries and advocating for them.

The study analyzes the recent debt trends in Bosnia and Herzegovina, Bulgaria, Kosovo, Macedonia, Montenegro, Serbia, and Slovenia with the aim of warning about possible problems with long-term debt sustainability. It is very important to detect debt vulnerabilities and to react in a timely manner.

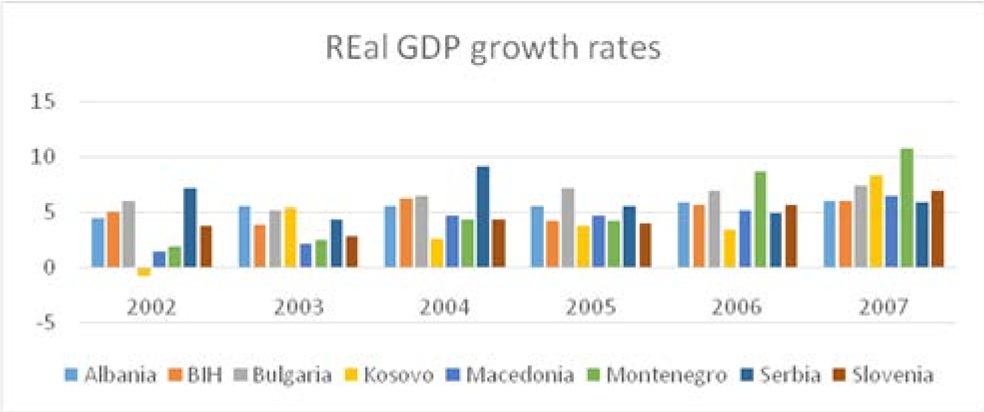
Quick glance at the region

The pre-crisis years were favorable for the Bosnia and Herzegovina, Bulgaria, Kosovo, Macedonia, Montenegro, Serbia, and Slovenia in the fiscal area. Positive global expectations and developments, as well as solid economic growth in the region (the average growth in the pre-crisis period 2002-2007 was around 5% - see chart no.1) led to a stable period and positive budget outcomes, resulting in periods of balanced budgets and even surpluses in some of the countries (Chart 2.).

22 Jerome Roos (2016), Why Not Default? The Structural Power of Finance in Sovereign Debt Crises. The European University Institute, Florence

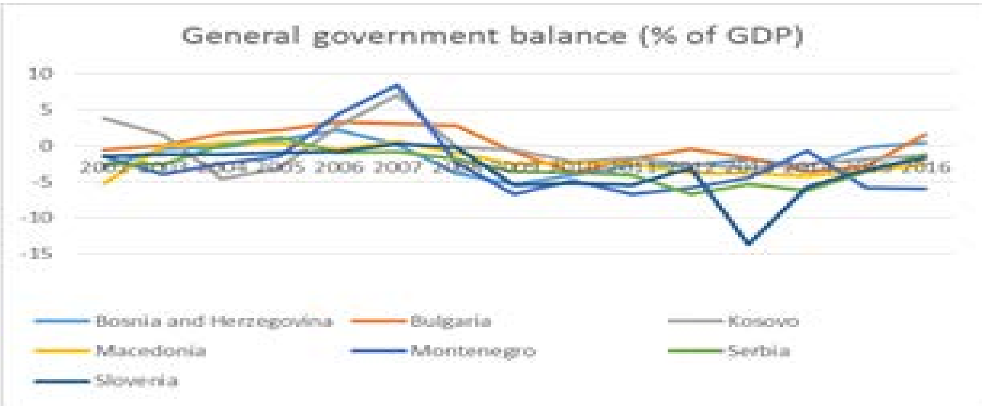
23 Wolfgang Streeck (2014), Buying Time: The Delayed Crisis of Democratic Capitalism. London and New York: Verso

Graph 1: Pre-crisis Real GDP growth rates in SEE



Source: WEO database

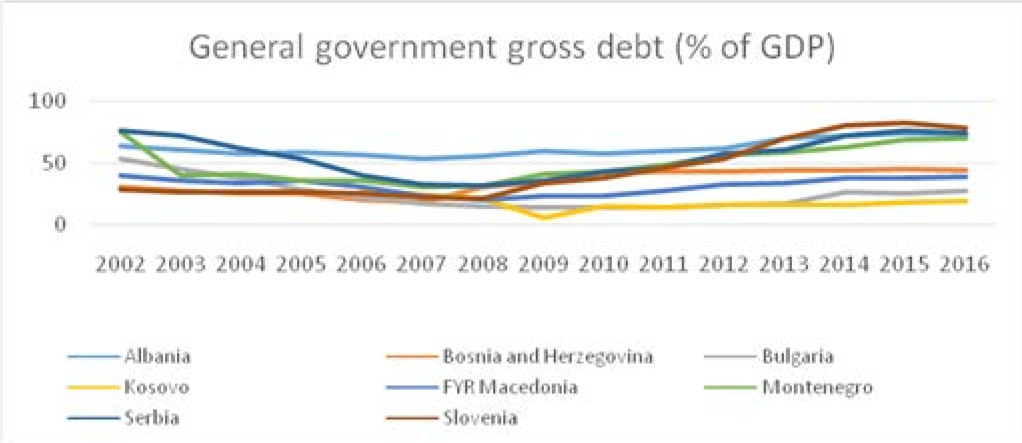
Graph 2: General government balance in the SEE



Source: WEO database

As we can notice form the Chart 3, the general government gross debt had a general downward trend, falling from an average of 52.8% of GDP in 2002 to an average of 28.2% of GDP in 2007 (lowest – Bulgaria 17.6%).

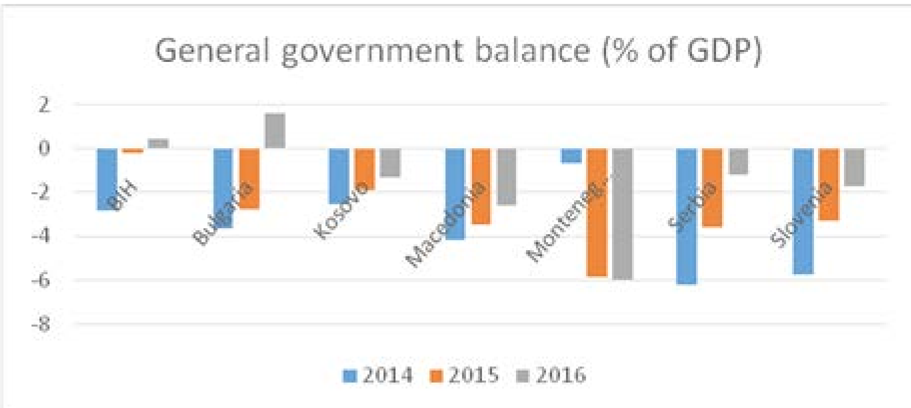
Graph 3: General Government Gross Debt



Source: WEO database

The public debt reduction in the pre-crisis period expresses the limited borrowing needs, as a result of privatization revenues, smaller budget deficits and settling the debt toward the Paris and London creditors.[24] Compared to the EU-15, in 2004 the SEE countries had an average debt lower by 13 percentage points (51.2% as to 64.7%). However, the WB/SEE countries were not immune to the global financial and economic crisis. All of them felt consequences.[25] The positive growth rates fell drastically, reaching a bottom in 2009. The economies were struggling for a few years, but they have recovered, although not to their pre-crisis level of growth.

Graph 4: General government balance in the post-crisis period



Source: WEO database

24 Izvorski, I. and Kahkonen, S. 2008. Public Expenditure Policies in Southeast Europe. *World Bank Working Paper* No.134 . Washington, DC: The International Bank for Reconstruction and Development / The World Bank

25 Thanks in large to privatization campaigns before 2009, a significant share of the large current account deficits in the countries of the region were financed through FDI inflow, thus preventing the occurrence of dangerously high levels of external debt. (Slay, 2010)

Having lower debt than the Euro area (average of 91.3% of GDP in 2016), they also had a larger fiscal maneuver space to respond. But, the crisis eroded fiscal buffers, increased public debt, and exposed structural weaknesses, notably the contingent liabilities generated by state-owned enterprises and other public entities.[26] The average debt in the region went up from 30% of GDP in 2007 to 54% in 2016. Kosovo is the only country that has managed to keep debt lower than its pre-crisis level. All other countries are struggling to get their fiscal positions back on track. Slovenia experienced the largest jump in indebtedness by 61 p.p. from 2008 to 2015 (from 22% to 83% of GDP).[27]

The rising trend triggered alarm about the long term sustainability of their public finances, especially if we consider that the debt tolerance level is lower for lower income economies.[28] This makes a unique analysis even more desirable and significant, since it offers significant insights regarding debt trends, debt management, and public finances institutions in SEE countries, which are especially vulnerable at higher levels of public debt, and the price to preserve fiscal sustainability is continuously growing.

Last year, though, there were signs of fiscal tightening that helped manage the debt level in some of the countries and prevent its continuous rapid growth.[29] The fiscal deficits narrowed in the Western Balkan countries (except in Montenegro) and Bosnia and Herzegovina and Bulgaria even registered surpluses.[30]

Overview of the content of the analysis

The first section provides an overview of the existing national legislation on public debt in order to identify pros and cons of the current legal framework as one of the objectives of this opening part of the study. At the same time, an analysis of public debt related policy documents (if there are such on the country level) and assessment of their alignment with the respected laws is undertaken.

26 World Bank. 2017. Western Balkans - Regular Economic Report No.11: Faster Growth, More Jobs, World Bank Group, Spring

27 World economic outlook database

28 Reinhart, C.M., Rogoff, K.S. and Savastano, M.A. 2003. Debt Intolerance. Brookings Papers on Economic Activity. Vol. 2003, No. 1, The Brookings Institution, pp. 1-62, available at: http://www.jstor.org/stable/1209144 [accessed on 10. 5. 2017]

29 World Bank. 2017. Western Balkans - Regular Economic Report No.11: Faster Growth, More Jobs, World Bank Group, Spring

30 However, the way in which fiscal deficits fell varied by country. In Albania and Serbia both revenue gains and a reduction of current spending supported the narrowing of the fiscal deficit. Revenues also rose in Kosovo and Montenegro, but recent amendments to regulations have steeply increased the cost of their untargeted entitlement programs. Moreover, capital investment budgets were under-executed and the share of current spending increased. FYR Macedonia's revenues dropped as a share of GDP and its overall spending fell as the economy felt the effects of a severe political crisis. Hence, although fiscal deficits narrowed in 2016 in FYR Macedonia (to 2.6 %) and Montenegro (to 3.9 %), and remained low in Kosovo (1.3 %), the composition of their spending shifted to less productive and equitable areas. (World Bank, 2017)

The second part brings closer the concept of public debt and explains its economic purpose. Public debt must be managed very carefully, because its excessive use can lead to liquidity problems of public finances, especially the central and local budgets of the states. This section provides an overview of the public debt developments in the countries of the region, presenting the growth since the outburst of the crisis and the main reasons behind this growth. Additionally, the public debt structure is presented in terms of external and internal share of debt. The transparency of data is highlighted in this section, together with an overview of the practice in these countries in making the data available to the public.

The objective of the third section is to assess whether independent regulatory bodies exist, whether they present realistic auditing reports, whether the latter are implemented in practice, and if not, whether there are any sanctions imposed on the responsible institutions/persons in charge. Democratic government requires that public debt and its medium and long-term effects be made transparent. This is only possible if public debt is regularly audited by independent audit bodies which operate autonomously.

The fourth part analyzes the effectiveness of the public debt management. When it comes to effective public debt management one should have in consideration the public debt management strategy and strategy for risk management. The most significant risk is the one that is determined by the structure of public debt. To achieve effective public debt management, a continuous monitoring and periodic evaluation of risks that may have significant reflection on the structure of the debt portfolio is necessary. One of the measures of sustainability of debt is the debt/GDP ratio. A constantly rising debt ratio implies a risk to the long-term sustainability of public finances. Namely, if a country realizes a budget deficit, it should have a much higher growth rate of GDP than the interest rate on debt in order to have public debt sustainability. Unsustainable public finances and rising public debt are a threat to some of these countries, considering the numerous adverse effects they can cause. Thus, closely monitoring the debt movements is necessary and a timely response to unsustainable developments is of crucial importance for maintaining macro-economic stability.

The last part of the study presents conclusions and recommendations for decision-makers, both in the region and in international institutions.

Legal framework on public debt

Sound public debt management (PDM) helps to support sustainable debt objectives. Guidelines for effective PDM have been provided over the years by international organizations such as the IMF, the World Bank, the OECD, etc. The IMF and WB (2000) define PDM as "the process of establishing and executing a strategy for managing the government's debt in order to raise the required amount of funding at the lowest possible cost over the medium to long run, consistent with a prudent degree of risk". A robust legal framework is critical for effective PDM, given the centrality of law to public debt. "While political and economic factors tend to influence debt policies and the quality of debt management practices, a good legal framework helps to promote discipline, transparency, and accountability, all of which is critical to achieving sustainable debt."[31]

A soft law mechanism for sovereign debt restructuring based on the UN principles. The UN took the lead in the efforts to create a statutory mechanism for sovereign debt restructuring, as first reflected in the UN GA Resolution 68/304 passed in September 2014 and later in UN GA Resolution 69/319 passed in September 2015. The latter resolution approved a set of nine principles that should serve as the basis for restructuring processes—sovereignty, good faith, transparency, impartiality, equitable treatment of creditors, sovereign immunity, legitimacy, sustainability, and majority restructuring.[32]

The scope of the domestic legal framework governing public debt management may vary from country to country. Constitutions and primary legislation (Acts of Parliament, Laws, Decrees and similar), provide the broad legislative architecture within which public debt is contracted and managed. This is usually supplemented by a secondary legal framework (regulations, rules, guidelines, and circulars, among others) to elaborate on operational aspects of the framework.

31 More information available in Awadzi, E.A., 2015. Designing Legal Frameworks for Public Debt Management (No. 15-147). International Monetary Fund

32 Martin Guzman and Joseph E. Stiglitz (2017), A soft law mechanism for sovereign debt restructuring based on the UN principles. The Institute for New Economic Thinking

Sources of PDM Legal Framework[33]

- *Supranational*
  - Treaties of Monetary Union Members
- *Constitutions*
  - Distribute political and fiscal powers and basic institutional arrangements, establish broad public finance arrangements including the authority to borrow and pay for debt related costs and expenses, and requirements for audit and reporting;
- *Primary Legislation*
  - PFM legislation - Include budget laws, public financial management/ administration laws, fiscal responsibility laws; and establish the framework for budget preparation and execution, cash management, public debt, accounting, auditing, and reporting;
  - Dedicated debt legislation - Include public debt management laws, government borrowing laws, treasury securities laws, or others, which provide more specifically for mandates, institutional, and operational matters relating to public debt management;
  - Others - include other relevant laws such as Central Bank laws. Central Bank laws typically provide for Government borrowing (if any) from Central Banks and the central bank's role as fiscal agent to Government.
- *Secondary Legislation*
  - Regulations
  - Rules, Circulars (e.g. Government Securities Market Rules or Circulars, etc).

The legal framework should define what constitutes public debt. "Public debt" is often used to refer to debt of the general government and in some cases, the debt of the entire public sector. Whether the broader public-sector debt is included or excluded from the scope of application of the legal framework will vary from country to country, depending on the nature of the political and institutional framework. **The scope of public debt under the legal framework should ideally cover all debt instruments representing liabilities of the public institutions covered by law.** From a debt management perspective, the IMF and World Bank recommend that the scope of PDM should encompass the main financial obligations over which the central government exercises control, including both marketable and non-marketable debt. From a statistical perspective, the IMF defines total gross public debt as all liabilities that are debt instruments (i.e. financial claims that require payment of interest and/or principal by the debtor to the creditor at a date, or dates, in the future).[34]

33 See in details in Awadzi, E.A., 2015. Designing Legal Frameworks for Public Debt Management (No. 15-147). International Monetary Fund.

34 Revised guidelines for public debt management. IMF policy paper. International Monetary Fund. April, 2014

As regards the analyzed countries, they all have enacted Law on borrowing or law on public debt (except Montenegro).

A specificity of **Bosnia and Herzegovina** is that, due its highly decentralized governance structure, in addition to the Law on Borrowing, Debt and Guarantees in BiH, it also has a Law on Borrowing and Guarantees in the Federation of BiH (FBiH); Law on Borrowing, Debt and Guarantees in Republika Srpska (RS); and Law on Internal Debt of District Brcko (DB). Bosnia and Herzegovina has a highly decentralized governance structure, with two Entities (the Federation of BiH (FBiH) and the Republika Srpska (RS)) having their own constitutional right to borrow externally and domestically. Hence, under the Law on Borrowing, Debt and Guarantees of Bosnia and Herzegovina, the BiH Institutions (the national level) have a major legal role in contracting of foreign debt of all levels in Bosnia and Herzegovina, including the Entities and District Brcko. After the Entity foreign loans have gone through all of the procedures at the Entity government level, the BiH Parliament must ratify all loans as the BiH Institutions are the ultimate guarantor of debt to international financial institutions (IFIs), and the BiH Ministry of Finance and Treasury (MFT) administers all foreign debt servicing for all levels in BiH. Thus, virtually all of the countrywide foreign debt servicing (except some very small Entity direct foreign debt—around 145.03 million KM in 2016) is a special part of the BiH Institutions budget (both in planned budget and in execution reports).

The Law on Borrowing, Debt and Guarantees of BiH stipulates that an Advisory Committee for Debt (comprising two representatives from Council of Ministers, one of which is the Finance Minister, one representative from the CBBiH, two representatives from the Entity Governments including Finance Ministers, and the Finance Directorate director from the District Brcko), is supposed to be in charge of preparing state debt management strategy. However, in practice, this has not been implemented.

The authorities undertook, by the end of 2016, to submit amendments to the Law on Debt, Borrowing and Guarantees and a new Law on Public Revenue Allocation to the Parliament in order to strengthen controls over lower level governments. Thus far, in accordance with its Letter of Intent to the IMF, only the Government of FBiH has adopted a Draft Law on Debt, Borrowing and Guarantees, on 10 October 2017, subject to ratification by the FBiH parliament. With this law, FBIH aims to implement EU fiscal rules on debt, borrowing and guarantees and the EU statistical methodology for the measurement of public debt. The Maastricht criteria fixing levels of public debt in relation to the gross domestic product will be integrated into BiH law. The law creates preconditions, in accordance with the principles of good practice, for stronger control over borrowing and determines the objectives of borrowing.

Bulgarian government debt is regulated in two main legal instruments - the 2002 Government Debt Act and the Public Finances Act, covering the government debt and the government-guaranteed debt. The Bulgarian legislation also adheres to the EU (The Public Finances Act complements the definition of government debt by adding that it shall also include other forms of debt pursuant to Council Regulation (EC) No. 479/2009 of 25 May 2009 on the application of the Protocol on the excessive deficit, annexed to the Treaty establishing the European Community, which is assumed and repaid from the central state budget and from the persons whose budgets are part of the state budget, including through their accounts for EU funds).[35] Article 2 of the former stipulates that *all financial obligations, undertaken on behalf and for the account of the government in compliance with the Constitution, shall constitute government debt, and shall represent a liability of the government*.[36] The law also recognizes government-guaranteed debt, which includes all financial obligations, for which the Council of Ministers has issued guarantees on behalf and for the account of the government in compliance with the requirements of the Constitution.[37] The Public Finances Act complements the definition of government debt by adding that it shall also include other forms of debt pursuant to Council Regulation (EC) No. 479/2009 of 25 May 2009 on the application of the Protocol on the excessive deficit, annexed to the Treaty establishing the European Community, which is assumed and repaid from the central state budget and from the persons whose budgets are part of the state budget, including through their accounts for EU funds.[38] The borrowing itself is executed by the Minister of Finance who signs on behalf of the government loan agreements on the basis of a Council of Ministers decision according to the procedure established by the International Treaties of the Republic of Bulgaria Act.

Kosovo has a Law on Public Debt and a Law on public financial management and accountability. According to the Law on Public Debt,[39] 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. 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. When calculating this limitation, in accordance with this law, the State Guarantees shall be treated as State Debt. As such, the Ministry of Finance has the legal responsibility to compile the State Debt Program, through which, is both ensured and maintained a sustainable debt, in accordance with the fiscal and macroeconomic framework.

35 Public Finances Act, Bulgaria

36 Government debt act art.2, Bulgaria

37 Government debt act art.18, Bulgaria

38 Government debt act art.18, Bulgaria

39 The Law on Public Debt, No. 03/L – 175, The Republic of Kosovo, available at: http://www.kuvendikosoves.org/common/docs/ligjet/2009-175-alb.pdf

Macedonia's public debt is legally regulated by the Public Debt Law which stipulates the arrangements for public debt management, the purposes of the public debt and the procedure of issuance, servicing and termination of guarantees.[40] The Public Debt Law defines public debt as the *sum of government debt and debt of public enterprises established by the state or by the municipalities, municipalities within the City of Skopje and the City of Skopje, as well as companies being fully or predominantly owned by the state or by the municipalities, municipalities within the City of Skopje and the City of Skopje, for which the government has issued sovereign guarantees*. This new definition of public debt stipulated in the Public Debt Law (amended in 2014) is significantly narrowed, not including the debt of the National Bank of the Republic of Macedonia and the debt of public enterprises without an issued sovereign guarantee. Therefore, the new method of calculating the public debt prevents the comparison with countries whose debts are calculated according to the definition of the IMF and World Bank. However, there are some methodological challenges regarding calculation and assessment of public debt data. The Macedonian budget accounting is performed on a cash basis, that shows only executed cash income and expenses. In such a case, the debts held by the state and arising from unpaid and overdue obligations are not shown; and if these obligations were calculated as public debt, the latter could significantly increase. The IMF has recommended these international accounting standards since 2001, but Macedonia has not yet accepted them.

Montenegro does not have a special act regulating public debt. Thus, public debt is addressed by the Law on Budget and Fiscal Responsibility. Other laws and policies are Law on State Aid Control and strategic framework for debt management. Law on Budget and Fiscal Responsibility stipulates that "public debt" is the debt of the "General Government" which include National Government and governments of all 23 Montenegrin municipalities. The Law also recognizes the „state debt", which is a debt of the National Government only. Furthermore, the Law stipulates that the State may undertake borrowing during the fiscal year up to the level established by the annual State Budget Law (SBL). Borrowing, in this sense, refers to undertaking financial obligations with regard to loan agreements, issue of debt securities and issue of guarantees. Borrowing is defined as short-term or long-term depending if the repayment period is below or above 12 months.[41] The Law also recognizes the possibility of debt assumption from other subjects, but the State may only do so by adopting of a special law or prescribing it into the annual SBL.

The State may borrow funds in order to: finance expenditures of the State Budget in accordance with the annual SBL; redeem and refinance the State Debt; maintain the budget liquidity; hedge against risks by entering into swap contracts[42] and derivative purchase

40 Public Debt Law - Official Gazette of the Republic of Macedonia no.165/2014

41 Ibid, article 50, par. 3.

42 Swap contracts are a financial agreement on granting a borrowing for the purpose of risk hedging, under variable conditions in respect of interest and currency. Law on Budget and Fiscal Responsibility, article 2, par. 1, item 24

contracts;[43] finance other needs in accordance with law.[44] The Law on State Aid Control stipulates that state aid may be granted in the form of: subsidies, fiscal reliefs (taxes, contributions and other public revenues), state or municipal guarantee and interest rate subsidy for loans. It also enables state aid in the form of giving gain and/or dividends of the State or municipality for grantor's development projects to economic entities, discharge of debt, sale of immovable property by the State or municipality at a price lower than the market price or purchase at a price higher than the market price or other aid in accordance with law.[45]

Serbia's public debt is legally regulated by the Constitution of Serbia, the Law on Public Debt, the Law on Budgetary System, Law on Budget and the Law on the Conclusion and Implementation of International Agreements.[46] There is also secondary legislation in the form of regulation and decisions governing mainly the issuing and sales of government securities.

The Constitution of Serbia regulates that Serbia should fulfill its obligations related to the purpose of funding by constitution and by separate laws assigned duties using material resources collected through taxation and other fees established by separate law.[47] Obligations assigned to State of Serbia, provinces of Serbia and autonomous local communities are assigned by constitution of Serbia and separate laws. Constitutional obligations fulfillment is financed by the Budget of Serbia and budgets of autonomous provinces and those of local communities. Those resources are collected and systematized within the Budget of Republic of Serbia, Budgets of autonomous provinces, and Budgets of cities and municipalities of Serbia.[48] As regulated by the Law on public debt, the Republic can borrow for the following purposes: a) Liquidity borrowing - taking loans and/or issuing government securities for the purpose of financing imbalances of revenues and expenses of the budget during a budget year, b) Borrowing for budget deficit financing - taking loans and/or issuing government securities. For this borrowing, the amount of debt is carried forward to the following budget years, c) The Republic may borrow for refinancing purposes by taking loans and/or issuing government securities, d) Borrowing for investment projects financing - taking loans and/or issuing government securities for the purpose of financing development projects which would enable improvement, efficiency and effectiveness of the industry and provide for social development of the Republic, provided that the financing lasts longer than a year.

43 Derivative is a financial security whose value is derived in part from the value and characteristics of another security. Law on Budget and Fiscal Responsibility, article 2, par. 1, item 25

44 Ibid, article 51, par. 2.

45 Law on State Aid Control, Official Gazette of Montenegro no. 74/09 and 57/11, article 7

46 More information available at: http://www.javnidug.gov.rs/default.asp?P=42&MenuItem=3

47 More information available in the Constitution of Serbia in Article 91 at: https://www.ilo.org/dyn/natlex/docs/ELECTRONIC/74694/119555/F838981147/SRB74694%20Eng.pdf

48 More information available in the Constitution of Serbia in Article 92; Budget of Republic of Serbia and Overview of Revenues and Expenditures at: https://www.ilo.org/dyn/natlex/docs/ELECTRONIC/74694/119555/F838981147/SRB74694%20Eng.pdf

The Constitution of Serbia lists all the systems and obligations that Republic of Serbia (its Parliament, its Government and other institutions) should fulfill using resources organized within budget of Serbia.[49]

According to the constitution, Serbia has the right to take loans or as article 93 of constitution regulates, “The Republic of Serbia, autonomous provinces and local self-government units may be indebted. Terms and procedure of getting into debts shall be stipulated by the Law. According to the Serbian Law on public debt, article 2, point 2: “Public Debt is: (1) Debt of the Republic, based on agreements concluded by the Republic; (2) Debt of the Republic based on issuing securities, (3) Debt of the Republic based on contracts/agreements according to which obligations of the Republic, pursuant to previously concluded agreements, have been rescheduled ;(4) Debt of the Republic, based on the guarantee issued by the Republic and/or based on counter-guarantee issued by the Republic; (5) Debt of local government and legal entities indicated in Article 1 hereof for which the Republic has issued guarantees.”[50]

Local government can borrow in the country and abroad, i.e. on domestic and foreign market. Local government can borrow in domestic currency and foreign currency, in accordance with this Law. Local government cannot issue guarantees. The state of Serbia is the instance that provides guarantees for the local communities. The problem of financing local communities is repeatedly highlighted by IMF within article IV reports as one of the important macroeconomic problems. The public debt report for May 2017 shows that 5 local authorities have 80% of overall debt of local authorities and that 10 local authorities are liable for more than 90% of overall debt of local authorities. At the same time overall debt of local authorities is at the level of about 1.8% of GDP as of May 2017. The important fact about loans of local authorities is that 99.5% of loans are actually for the investment purposes. The autonomous province of Vojvodina is considered as a local community. The Law on the Budgetary System regulates the maximum allowed level of public debt as 45% of national GDP”.[51] According to the law on public debt, article 3: “The Republic may borrow in the country or abroad, i.e. on domestic or foreign market.“[52] Serbian Law does not recognize possibility that any loan could be retro actively refused if any government in any circumstances due to politically or any other reasons, while taking loans or guaranteeing loans or issuing bonds has contracted illicit or illegitimate loans.

The key national document in the field of borrowing in **Slovenia** is the Financing Program of the central government budget adopted by the government, which defines strategic and operational targets of borrowing for a given fiscal year. The borrowing strategy[53] should mainly

49 More information available in the Constitution of Serbia in Article 97 at: https://www.ilo.org/dyn/natlex/docs/ELECTRONIC/74694/119555/F838981147/SRB74694%20Eng.pdf

50 Public Debt Law Republic of Serbia, “Official Gazette of the Republic Serbia”, No. 61/2005, 107/2009 and 78/2011., available at: http://ujd.gov.rs/upload/Zakoni/Zakoni%20engleski/Public_Debt_Law_RS.pdf

51 Budget System Law, Article 27, available at: www.mpn.gov.rs/wp-content/uploads/2015/09/Zakon-o-budzetskom-sistemu.pdf

52 Public Debt Law Republic of Serbia, Official Gazette of the Republic Serbia”, No. 61/2005, 107/2009 and 78/2011., http://ujd.gov.rs/upload/Zakoni/Zakoni%20engleski/Public_Debt_Law_RS.pdf

53 Since the Government did not adopt such guidelines, the Ministry was forced to undertake a conservative policy of borrowing in order to minimize the risks.

give a clear directive to the Ministry as to the level of the acceptable risks to minimize the costs of borrowing.[54] The Central Government Debt Management Department is responsible for the execution of the central government budget financing as well as execution of the debt management transactions. The Department reports Central Government Debt data to international and domestic institutions as well as Rating Agencies. Moreover, according to Article 84 of the Public Finance Act, the financing of the central government budget execution and debt management operations in a given fiscal year are performed based on a financing program. Moreover, in Article 82, on debt management, the government may use proceeds from loans and from issue of securities for prepayment of existing central government budget debt instruments and/or for buybacks of own securities, when this results in:

- Support of measures aimed at achieving macroeconomic equilibrium,
- Government debt costs reduction or
- Debt portfolio enhancement without increasing the outstanding central government debt amount.[55]

Therefore, the state is not allowed anymore to borrow, and thus is banned from increasing the public debt. In this way, the state is allowed to spend just as much as it produces, which could also mean that less will be spent on the welfare state, on health, education, pensions, culture, etc.[56]

The Slovenian Public Finance Act prescribes more precisely the rules on the budgetary process. It determines the composition, preparation and execution of the state budget and the budgets of the local communities, asset management, borrowing, guarantees, debt management, accounting and budgetary control. The Act determines that the Government is accountable to the National Assembly for the execution of the budget, whereas mayors are accountable to their local councils. Both need to report to the National Assembly. The Public Finance act provides that the government submit to the National Assembly, a proposed budget for two consecutive years.[57]

54 An important step forward in this field was made by establishing a Board for risk management and debt capital markets at the Ministry. Its task is to provide for appropriate recording of the decision-making and enabling easier reproduction of circumstances at the time when the decisions were adopted. The process of recording the analyses and decisions that were adopted on the basis of such data was until now not complete.
Court of Audit, 2015, Summary of the audit report Effectiveness of planning State borrowing requirements, Effectiveness of planning State borrowing requirements in the years 2013 and first half of 2014, Ljubljana, May 18 2015

55 More information available at: Act Amending the Public Finance Act (Official Gazette of RS, no. 101/13)

56 Fiscal rule, Ministry of Finance available at:
http://www.mf.gov.si/en/areas_of_work/economic_governance/fiscal_policy/fiscal_rule/

57 Constitutional Change through Euro Crisis Law, A Multi-level Legal Analysis of Economic and Monetary Union, Slovenia, IV - Early Emergency Funding, available at: http://eurocrisislaw.eui.eu/country/slovenia/topic/emergency-funding/

Fiscal Rules

Policy tools that promote fiscal sustainability, such as fiscal rules, have garnered attention in countries that face problems of fiscal consolidation. A fiscal rule is a long-lasting constraint on fiscal policy through numerical limits on budgetary aggregates. This implies that boundaries are set for fiscal policy which cannot be frequently changed.[58] Their main objective is to strengthen the credibility of fiscal policy and the fiscal authorities. Fiscal rules are aimed at alleviating distortionary incentives and constraining the deficit bias. This especially applies to 'good times', in order to secure fiscal responsibility and sustainability. In a monetary union the supranational fiscal rules are intended also to internalize regional costs of fiscal non-discipline.[59] Well-designed and effectively implemented fiscal rules can help improve policy predictability, smooth output volatility, and manage procyclicality. Fiscal rules can smooth the distribution of public spending over time and allow for uninterrupted implementation of multiyear projects and programs. They can also provide greater transparency, make fiscal policy more resilient to the demands of public agencies and interest groups, and create an explicit commitment on the part of the government to achieving its fiscal goals.[60]

Nevertheless, there are two views on public debts and deficits, like on the need for fiscal rules. The fiscal rules proponents may blame Keynesians for opening a Pandora's Box. How to avoid demagogic choices, once it is recognized that debts and deficits are allowed? The opponents of fiscal rules may reply that fiscal policy adequacy criterion lies on the employment level, inflation, interest rates, and not on a priori public debt or deficit levels. They may request rules consistent with the macroeconomic stabilization objective. For neo-classical economists, the rise in deficits and public debts in recent years shows that rules are needed to avoid this drift. For Keynesians, this rise was necessary and fiscal rules would be harmful if they prevent fiscal policy to play.[61]

Furthermore, the old rules generally empower budget-makers by enabling them to allocate resources according to the preferences of government. Fiscal rules, by contrast, constrain budget-makers, taking away much of their authority to decide aggregate revenue and spending policy. These rules typically prescribe the balance between revenue and spending policy. Every fiscal rule is a limit on the exercise of political will. Why have democracies accepted or imposed fiscal limits on themselves, and why should we expect these limits to be effective when they run counter to the preferences of voters and politicians? Fiscal

58 IMF Country Report No. 17/125. 2017 Article IV Consultation – press release; staff report; and statement by the executive director for the Republic of Slovenia

59 Wyplosz, C. (2012) Fiscal Rules: Theoretical Issues and Historical Experiences. NBER Working Paper 17884. National Bureau of Economic Research, available at: http://www.nber.org/papers/w17884

60 World Bank. 2017. *Western Balkans - Regular Economic Report No.11: Faster Growth, More Jobs*, World Bank Group, Spring

61 Do we need fiscal rules? Catherine Mathieu and Henri Sterdyniak (OFCE), available at: https://www.boeckler.de/pdf/v_2011_10_27_mathieu_sterdyniak.pdf

rules also depend on political leaders who are willing to operate within the constraints, even when they are thereby compelled to take unpleasant actions such as reducing services or boosting taxes. When political will is lacking, as is often the case, compliance will be weak. However, the point is fiscal rules have a limited effective life and must be reinvigorated or replaced from time to time.[62]

Nevertheless, too rigid rules implemented simultaneously in Europe will reduce GDP growth which will have vicious effects: lower output growth will generate lower tax receipts, will increase the debt-to-GDP ratio, government balance targets will not be reached; the rise in unemployment and political and social tensions will raise the fear that the country does not stick to the rule.[63]

Fiscal policies should be given back more rooms for maneuver, through implementing strong measures at the EU and world levels, fighting against tax evasion, abolishing tax heavens, and restoring the ability of countries to tax multinational companies' benefits, high incomes and wealth. Financial globalization should step back, because it is a source of economic instability and of excessive misappropriation by the finance sector. This implies that public financial circuits are developed to use households long term savings to finance and guide companies' productive investment towards innovative sectors, and in the green economy, so as to support activity without rising public debt.[64]

All Western Balkan countries except Macedonia and Bulgaria have adopted fiscal rules. Most of these rules are amendments to budget laws that introduce numerical target to ensure long-term fiscal sustainability, discipline, and transparency. Aspirations to join the EU are helping drive reforms in the region, such as fiscal rules. Fiscal rules in Albania, Bosnia and Herzegovina, and Kosovo target only the central government budget, deficit, and debt levels; in Montenegro and Serbia they also apply to local governments. A common feature is that the fiscal rules apply only to public debt—not arrears or liabilities stemming from public guarantee for companies or public-private partnerships (PPPs).[65]

In **Bosnia and Herzegovina,** both Entities have introduced legal fiscal rules. Bosnia and Herzegovina does not use national fiscal rules for the consolidated general government but instead maintains separate rules for each of the two constitutional and legal entities. Both Entities have introduced legal fiscal rules that satisfy the usual definition of fiscal rules (being numerical, serving as a permanent constraint on fiscal policy, and relating to expenditure or debt levels). The contracting of loans and issuance of guarantees are made within limits

62 The Role of Fiscal Rules in Budgeting by Allen Schick*, OECD, 2003, available at: https://www.oecd.org/gov/budgeting/43494591.pdf

63 Ibid

64 Ibid

65 World Bank. 2017. Western Balkans - Regular Economic Report No.11: Faster Growth, More Jobs, World Bank Group, Spring

for total debt and total guarantees, and always approved by a single responsible level of governance. However, there are no fiscal rules for BiH Institutions.

In Republika Srpska (RS), the fiscal rule was introduced in 2012, by the Law on Borrowing, Debt and Guarantees, which prescribes that the total debt of RS, which covers the public debt of RS, the debt of public enterprises, the debt of the RS Investment Development Bank, and the debt of other public sector institutions, cannot exceed the level of 60% of GDP, while the public debt of RS (which covers the debt of Republika Srpska, debt of units of local self-governance, and the debt of the EBFs for social insurance) cannot exceed 55% of GDP. The Law on Borrowing, Debt and Guarantees of RS also stipulates that units of local government may borrow long term only if in the course of the period of the onset of debt the total amount that accrues for repayment, on the basis of the proposed debt and the total of accrued, outstanding existing debt, in any of the subsequent 32 years, does not exceed 18% of the amount of its regular revenues executed in the preceding fiscal year.

The Law on Budgets in Federation BiH (FBiH) stipulates a fiscal rule that the planned current budget must be balanced and, if a current deficit is executed, the government must plan for a current surplus in the next three years. The Law on Borrowing, Debt and Guarantees of FBiH stipulates that future servicing of FBiH public debt cannot exceed 18% of current revenues, while future servicing of cantonal and local self-governance units' public debt in FBiH cannot exceed 10% of current revenues.

However, there are no fiscal rules for BiH Institutions. The authorities undertook, by the end of 2016, to submit amendments to the Law on Debt, Borrowing and Guarantees and a new Law on Public Revenue Allocation to the Parliament in order to strengthen controls over lower level governments. Thus far, in accordance with its Letter of Intent to the IMF, only the Government of FBiH has adopted a Draft Law on Debt, Borrowing and Guarantees, on 10 October 2017, subject to ratification by the FBiH parliament. With this law, FBIH aims to implement EU fiscal rules on debt, borrowing and guarantees and the EU statistical methodology for the measurement of public debt. The Maastricht criteria fixing levels of public debt in relation to the gross domestic product will be integrated into BiH law. The law creates preconditions, in accordance with the principles of good practice, for stronger control over borrowing and determines the objectives of borrowing.

In 2013 **Bulgaria** ratified the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, the fiscal component of which is the Fiscal Compact. This treaty postulates that the fiscal discipline has to be scrutinized by an independent national institution. To this end in 2015 the Parliament enacted the law on Fiscal Council and automatic corrective mechanisms. The main aim of this council is to identify deviations from the mid-term budget objective and to ensure the state goes back on track within 2 years.

Effective from the beginning of 2012, Bulgaria introduced two fiscal rules into national law – a maximum budget deficit of 2% of the expected GDP and a limit on public spending at 40% of GDP. The Bulgarian fiscal rules also contain provisions on the maximum growth of the general government expenditures in line with the preventive arm of the Stability and Growth Pact. In order to comply with the "fiscal compact" signed March 1, 2012, the Public Finance Law also introduces a structural budget balance rule to be effective from January 1, 2014 (specifying that the structural deficit of the general government on an annual basis should not exceed 0.5 percent of GDP), and also introducing automatic correction mechanisms in case of deviations from the target. Its binding character was strengthened since it is part of the Financial Stability Pact (it is established also with an amendment to the Organic Budget Law, effective since January 2012). From 2014, the Organic Budget Law was replaced by the Public Finance Law, adopted in January 2013, with the provisions for the national expenditure rule unchanged. In addition, the annual expenditure growth shall not exceed the reference growth of the potential GDP.[66]

The domestic fiscal rules also require that the general government debt-to-GDP ratio is below 60%. Based on information provided in the Convergence Programme and in national budget documents, the fiscal performance in Bulgaria complies in full with the requirements of the applicable national numerical fiscal rules. The same conclusion applies to the fiscal plans for the programme period 2017-2020. The recently established Fiscal Council has recruited a small support staff and is now operational. However, the available resources and the limited financial autonomy granted to the institution could be a bottleneck for fully playing its role in the national fiscal framework. The Fiscal Council was not involved in the endorsement or the ex-ante assessment of the macroeconomic scenario underpinning the Convergence Programme.[67]

Additionally, Bulgaria complies with supranational rules, as a member of the European Union. The Maastricht criteria include a limit of 3 % of GDP for the fiscal deficit. If the deficit exceeds that limit an excessive deficit procedure is normally opened ("corrective arm"). With the 2005 reform of the Stability and Growth Pact (SGP), an excessive deficit procedure (EDP) may not be opened when two conditions are simultaneously met: (i) the deficit exceeds only temporarily and exceptionally 3 % of GDP, and (ii) if the deficit is close to the 3 % deficit threshold. The 2011 governance reform added further flexibility for countries with a debt-to-GDP ratio below 60 %. The ECOFIN Council sets a timeframe with the annual fiscal effort to be at least 0.5 % of GDP in structural terms. Deadlines for the correction of the excessive deficit can be extended by the ECOFIN council in case of adverse economic developments.

66 International Monetary Fund (IMF) 2017, Fiscal Monitor: Achieving More with Less. Washington, April

67 More information available at: https://ec.europa.eu/info/sites/info/files/file_import/02_bg_scp_en_4.pdf

Insufficient progress can lead to closer surveillance and sanctions (0.2 % of GDP non-interest-bearing deposit at the launch of the EDP) and fines (0.2 to 0.5 % of GDP in case of no effective action) for euro area members. A qualified majority of the Council is needed to open an excessive deficit procedure; a reversed qualified majority is needed to impose sanctions. In addition to the ceiling for the headline deficit, medium-term budgetary objectives (MTO) are set for the structural budget balance ("preventive arm"). Until 2005, MTOs were defined as a budgetary position "close to balance or in surplus." As part of the 2005 reform of the SGP, country-specific MTOs were introduced with MTOs not to be less than 1 % of GDP deficit (in structural terms). When euro area members have not reached their MTO, they should make annual efforts of at least 0.5 % of GDP to reach them. No enforcement procedures related to MTOs were in place in the past, but with the 2011 governance reform (Six Pack), lack of action to correct a significant deviation from the MTO can lead to the imposition on an interest-bearing deposit (0.2 % of GDP) for euro area member states.

The 2012/13 reforms (Fiscal Compact and Two Pack) reinforced monitoring and enforcement procedures. In 2015, a revised guidance on the implementation of the SGP clarified the existing provisions for flexibility by describing in greater details the escape clauses to encourage investment and structural reforms, and to account for the economic cycle under the preventive arm. The Maastricht criteria include a limit of 60 % of GDP for general government debt. With the November 2011 governance reform, a required annual pace of debt reduction was introduced (based on a benchmark of 1/20th of the distance between the actual debt ratio and the 60 % threshold on average over three years), starting three years after a country has left the current excessive deficit procedure (EDP). If progress is insufficient during the transition period, an excessive deficit procedure can be opened, with sanctions and fines (for euro area members). Opening an excessive deficit procedure requires a qualified majority of the ECOFIN council.

With the November 2011 governance reform, the annual growth of primary expenditure—excluding unemployment benefits and subtracting revenue discretionary increases—should not exceed long-term nominal GDP growth. This benchmark applies only when a country is not in excessive deficit procedure and is thus part of assessing adequate progress toward the MTO (i.e., structural budget balance target). No excessive deficit procedure can be opened when the rule is violated but sanctions can be applied to euro area members (0.2% of GDP interest-bearing deposit).[68]

Kosovo has introduced and adopted numerous constitutional and legal stipulations on preventing public debt from reaching unsustainable growth. Such stipulations include (i) the Law on Public Debt that sets the maximum public debt-to GDP ratio at 40% (a recent amendment of the fiscal rule reduced it to 30 % of GDP); (ii) a constitutional stipulation,

68 International Monetary Fund. 2017. World Economic Outlook. Seeking Sustainable Growth: Short-Term Recovery, Long-Term Challenges. Washington, DC, October

according to which a parliamentary ratification with a qualified majority is required when the Government makes external borrowing (including for highly concessional International Development Association(IDA) credits), (iii) a law on public financial management and accountability that requires any additional budget to be "deficit neutral"; and (iv) a specific fiscal rule which would, with few exceptions, limit overall budgetary deficits, to 2 % of GDP (as agreed with the International Monetary Fund).[69] The overall deficit ceiling is 2% of GDP. Capital spending is exempt from the ceiling provided it is financed from privatization receipts and the government bank balance exceeds a certain threshold. Framework contains carryover rules in case of under- or over performance and an escape clause for well-defined events with major fiscal consequences. In December 2015, parliament adopted an amendment to the investment clause that creates additional space for capital projects. The amendments allow for new donor-financed capital projects—in addition to privatization-financed projects—to be exempted from the deficit ceiling. DR (since 2010): A debt limit of 40 % of GDP exists since the adoption of the Law on Public Debt in 2010 but it does not provide operational guidance since the debt ratio is far below that ratio.[70]

While **Macedonia** does not have a fiscal rule in place, the country has been recognized for implementing prudent macroeconomic policies and maintaining fiscal discipline, and the authorities did not feel the need to adopt numerical fiscal rules.[71] Preparations for the introduction of the fiscal rule, planned for the beginning of 2017, are still on hold. The legal framework for the fiscal rule should include independent monitoring and oversight, as well as other enforcement mechanisms, such as corrective measures to restore deviations over a certain period of time.

Montenegro - BBR (since 2014): A fiscal responsibility law limiting the cash deficit of the General Government to no more than 3 % of GDP at market prices was adopted in 2014 in line with the Maastricht deficit limits. If the deficit deviates from the limit there exists a formal procedure which requires the government to outline the measures to be implemented within 60 days of the date of the established deviation to bring the deficit back to the prescribed level. DR (since 2014): A limit of 60% of GDP for general government debt was adopted in 2014 in line with the Maastricht criteria. If the debt reaches 60% of GDP, the Government is to propose the measures as an amendment to the State Budget Law to bring the debt to the prescribed level. If the debt exceeds 60 % of GDP the Government is to propose to the Parliament a reduction of multi-year expenditures, reduction of expenditures of municipalities, as well as propose other measures to ensure reduction of State debt. If the debt exceeds 60 % owing to implementation of capital projects, whereby the borrowing in respect of such projects is decided by the Parliament, the Government is to propose a debt reduction program for a period not exceeding five years. It appears as if the provisions of the

69 The World Bank in Kosovo, Country Snapshot", the World Bank, April 2016) BBR (from 2013)

70 International Monetary Fund. 2017. World Economic Outlook. Seeking Sustainable Growth: Short-Term Recovery, Long-Term Challenges. Washington, DC, October

71 World Bank. 2017. Western Balkans - Regular Economic Report No.11: Faster Growth, More Jobs, World Bank Group, Spring and Report No.12: Job Creation Picks Up. World Bank Group, Fall

law might have been violated in 2015 and 2016.

Serbian Law on budgetary system is regulating maximum allowed level of public debt as 45% of national GDP".[72] In October 2010, Serbia introduced fiscal responsibility law provisions in the Budget System Law from 2009. These include numerical fiscal rules and the adoption of a fiscal council to scrutinize the government's fiscal assumptions, policy, and performance. Over the medium-term the targeted annual deficit will be 1% of GDP. DR (since 2011): General government debt, excluding the liabilities arising from the restitution cannot exceed 45% of GDP. The decision for a Fiscal Council was adopted by parliament in March 2011. Its tasks are to assess the credibility of the fiscal policy in terms of compliance with established fiscal rules and to provide the publicity and responsibility in fiscal policy implementation.[73]

According to Article 84 of the Public Finance Act of **Slovenia**, the financing of the central government budget execution and debt management operations in a given fiscal year are performed based on a financing program.[74] In that way, the state is allowed to spend just as much as it produces, which could mean that less will be spent on the welfare state, on health, education, pensions, culture, etc.

The Fiscal rule act, which defines in detail the constitutional principle of the medium-term fiscal balance, calls for the gradual reduction of the structural government deficit. It defines the method and timing of the implementation of the principle of medium-term balance of revenue and expenditure of budgets without borrowing and the criteria for determining the exceptional circumstances and the manner upon their occurrence.

Since countries borrow money, they have to devote a large portion of their budget revenues to servicing the debt or repaying the principal and interest on borrowed money instead of for the functioning of the state. Therefore, balancing the budget does not mean "to waste only as much as we create", but to spend only part of what we create, the rest being intended for financial organizations.[75] The intention of the fiscal rules is to balance the budget, but in their absence the government could actually stimulate economic activity in order to create extra revenues, part of which could be used for repaying the debt.

In July 2015 a fiscal rule was adopted into the constitution whereby the state specifically defines how the commitment expressed in the highest legal act of the country is put into practice. The golden fiscal rule simply means that the revenue and expenditure of the

72 Article 27, Law on Budget system, available at: www.mpn.gov.rs/wp-content/uploads/2015/09/Zakon-o-budzetskom-sistemu.pdf

73 IMF. 2017. IMF Country Report No. 17/263. 2017 Article IV Consultation, seventh review under the stand-by arrangement and modification of performance criteria – press release; staff report; and statement by the executive director for the Republic of Serbia

74 More information available in: Act Amending the Public Finance Act (Official Gazette of RS, no. 101/13)

75 Rok Kralj, 2012, Zlato monetarno pravilo, Za-misli, 7.9.2012, available at: https://za-misli.si/kolumne/rok-kralj/515-zlato-monetarno-pravilo

Treasury should be in balance. However, as it is explained by economist Rok Kralj, the fiscal rule "is something completely illusory, for the reason that the state has completely lost control of monetary policy."[76]

The amendment to the Constitution and later on the Fiscal Rule Act was meant to strengthen fiscal discipline; in particularly numerical fiscal rules have been a common response to the fiscal crisis legacy of the member states in the EU.[77]

Moreover, the adoption of the fiscal rule act in 2015 set the foundations for establishing a fiscal council for the independent monitoring of fiscal policy. As its president Davorin Kračun put it, "Due to irresponsible fiscal behavior, public debt can start to accumulate. When we need to pay for its servicing, suddenly it becomes one of the most important part of public expenditures, and a downward path begins that is difficult to stop. Therefore, we must detect in a timely manner whether the country's fiscal policy is sustainable in the long run." In this way, he explained that it is not about deciding on how the state uses money, but whether this ratio corresponds to macroeconomic conditions and forecasts, and its task is to firstly warn the government and then the parliament.[78]

In addition, the government withdrew the part from the amendment to Article 148 of the Constitution on the role of the fiscal council. It could be concluded that the government does not want independent control over its budget preparation. But this is precisely the key part of the effectiveness of the function of the fiscal rule. If the government is planning on the basis of incorrect assumptions, it will always violate its own law and will have major problems in respecting the constitution. Moreover, the functioning of the fiscal rule depends essentially on the accuracy of the projections of the economic growth movement. Therefore, quality forecasts of growth are the key.[79]

Nevertheless, Slovenian economist Franjo Štiblar claims that the introduction of fiscal rule is damaging, because it eliminates the fiscal instrument of economic policy and leads to fiscal austerity which damages economic and social life. He argues that it is based on wrong theory and it diminishes economic sovereignty of a country, all under the dictate of "ordoliberals". After adoption, the application of the fiscal rule created normative exuberance, methodological discretion, based on weak statistical data, all leading to the wrong empirical calculations and suboptimal growth of the Slovenian economy thus contributing to the Slovenia's »lost decade«.[80]

76 Ibid.

77 Fiscal rule, Ministry of Finance, available at: http://www.mf.gov.si/en/areas_of_work/economic_governance/fiscal_policy/fiscal_rule/

78 Kakšna pregretost, imamo sto tisoč brezposelnih, Večer, 31.3.2017, available at: http://www.vecer.com/kaksna-pregretost-imamo-sto-tisoc-brezposelnih-6254604

79 Jože P. Damijan (2012): Fiskalno pravilo za telebane, Damijan blog, 19.9.2012, available at: https://damijan.org/2012/09/19/fiskalno-pravilo-za-telebane/

80 Franjo Šiblar (2017): The damaging fiscal rule, Gospodarska gibanja 494, Franjo Štiblar, available at:

Debt management Strategy

The Law on Borrowing, Debt and Guarantees of **Bosnia and Herzegovina** stipulates that an Advisory Committee for Debt (comprising of two representatives from Council of Ministers, one of which is the Finance Minister, one representative from the CBBiH, two representatives from the Entity Governments including Finance Ministers, and the Finance Directorate director from the District Brcko), is supposed to be in charge of preparing state debt management strategy. However, in practice, this has not been implemented. In *BIH*, a mid-term debt management strategy (MTDMS) document was published in March 2016, based on strategic documents produced by the entities in December 2015 for the period 2016-2018. In 2015, all Entities published their DMS.

A BiH mid-term debt management strategy (MTDMS) document was finally published in March 2016, based on strategic documents produced by the entities in December 2015 for the period 2016-2018. Reflecting the highly decentralized governance structure, the BiH Law on Borrowing, Debt and Guarantees does not define debt management objectives. Hence, a bottom up approach was adopted with the determination of the borrowing strategies at the Entity level dictating the strategy at the national level. In the opinion of the IMF, the exercise was a success in ensuring improvements not only in the borrowing stance but also in overall debt management practices at the Entity level. In 2015, all Entities published their DMS. By late 2016, RS presented its auction calendar for the upcoming year 2017 to investors, after FBiH already had adopted this practice.

The MTDMS identifies the medium-term debt management objectives. Given both dependence on multilateral lenders and exclusion from international capital markets, an additional objective is the development of the domestic securities market, as a basic prerequisite for effective debt management, i.e. to enable the effective management of borrowing and liquidity costs, and the diversification of the debt portfolio. The MTDMS is prepared with technical assistance from the World Bank and follows the methodology of the World Bank and the International Monetary Fund.

Following the "bottom-up" approach the entities develop their own debt management strategy. Entities identify the best strategy, and a strategy that could be considered as the status quo (continuation of existing policy), on the basis of its gross financing needs and sources of funding and macroeconomic indicators.

In order to improve debt management in BiH needs to conduct an annual review and update of its MTDMS. At present, the MTDMS does not include the entire public debt. It covered

http://www.eipf.si/en/publications/gospodarska-gibanja/2017/gospodarska-gibanja-494/the-damaging-fiscal-rule/

90.1% of the public debt of Bosnia and Herzegovina in 2014. It does not include: external state guarantees issued in Bosnia and Herzegovina; the internal guarantees of entities; internal debt incurred by the direct borrowing of municipalities, cities, cantons, public companies and social security funds. This remaining part of the public debt is not serviced by the budget of BiH institutions, the entities and BD, which is why it is not included in the MTDMS. But the internal debt due to direct borrowing is an increasing share of the debt and has been identified as a growing burden on public budgets.

The **Bulgarian** Ministry of Finance develops a government debt management strategy for the respective medium-term period of three years, which has to be approved by the Council of Ministers. It contains information about the status of the government debt and the government guaranteed debt, economic prospects for the period and analysis of the risks, ending with goals to be achieved.[81] Every year the State Budget Act sets a limit on the maximum amount of new government debt, which may be assumed during the year.[82] Municipal debt is not guaranteed by the state and is not an obligation of the government except in cases when a government guarantee is issued.[83] The strategy for the management of the national debt shows the size, legal restrictions, eventual sanctions for non-published information, economic expectations, risks, but even there the sources for the repayment of the debt are not indicated. According to the Strategy for management of the national debt 2017-2019[84] the debt will increase but in light of the expected growth of GDP the overall forecast is for the debt to reach the level of 25.1% at the end of the mid-term period. The Strategy envisages new loans to be taken only in case of necessity to refinance the debt, to cover liquidity needs of the budget and depending on the current state of the fiscal reserve. In addition to these factors, the two clearly indicated objectives of the national debt are- financing the National program on energy efficiency of multifamily buildings and co-financing projects under the European Cohesion policy. This conservative approach is explained with the need of “market-oriented debt financing”. The strategy resembles a plan to develop a market finance company and not a state. The stability is founded primarily on the lower activity as well as on the fact that with a currency board the possibility of conducting any monetary policy is significantly curtailed.

In June 2016, a reform strategy named public financial management (PFM) entered into force in **Kosovo’s** financial structure. Along with this strategy, there are four other ones that together form a so-called strategic package as part of the public administration reform package. Part of this newly adopted strategy suggests improving revenue forecasting and the aspect of macroeconomics as well as fiscal discipline. Even though Kosovo receives loans from domestic as well as from international actors, public debt is not as high as

81 More information available in: Government Debt Management Strategy 2017-2019

82 More information available in: Public Finances Act art.37 (1) point.1.

83 More information available in: Municipal Debt Act art.7.

84 More information available in: https://www.minfin.bg/document/19352:1

forecasted; however, the suggestion is for budget commitments to be under control. Also, there are a few challenges that the PFM reform might face, such as the combination of tax and customs administrations. Another priority of this reform is to contribute to making the budget credible. That is, making improvements to the quality of medium-term budgeting, preparing budgets, and providing information regarding capital investments.[85]

Pursuant to the Law on Public Debt, the Parliament of the Republic of **Macedonia** adopted the Public Debt Management Strategy, which provides the framework for the Government, and above all, the Ministry of Finance, to focus on prudent public debt management in the medium term, i.e. in the next three years. Public Debt Management Policy is set for a period of three years and became part of the Fiscal Strategy, as result of the amendment of the Law on Public Debt from 2011. Public debt management policy includes the following: determining the level of the amount (limit) of public debt in the medium term; determining the maximum amount of new borrowing in the first year which the Fiscal Strategy refers to; and determining the maximum amount of newly issued sovereign guarantees in the first year which the Fiscal Strategy refers to.[86]

Ministry of Finance is assigned to prepare the Annual Report on Public Debt Management which, pursuant to the Law on Public Debt, is submitted to the Parliament and Government for information purposes. The Law states that the annual report should also be published on the MoF website. No requirement currently exists to publish public debt data as an integral part of the annual budget execution report.[87]

The Fiscal Strategy as a significant strategic document of the country provides allocation for the available funds in compliance with the strategic priorities, identifies the most significant goals and action policies, as well as sets out the policy for public debt management. Analyzing the fiscal strategies of the Ministry of Finance over the years, it can be noticed that there is inconsistency in terms of the projections and the limits of government and public debt. The main risk to economic projections in the strategy is how this document will be respected and implemented consistently by the authorities. Considering that the previous fiscal strategy 2016-2018 largely failed, there is still a perception that the risk connected with the optimistic intentions of the economic policy makers demonstrated in the fiscal strategy 2017-2019 is the risk connected to disobedience of the strategy. Furthermore, the late submissions of the fiscal strategies, contrary to Article 4 from the Law on the Budgets,[88] raises the question of whether the fiscal strategy sets the limits and framework for the Budget (or balancing of the Budget) or the other way around. This strategy for the period 2017-2019 does not have enough arguments about the limit for public borrowing. In this context, the identification

85 "Public Finance Management Reform Strategy", Ministry of Finance, June 2016. available at: http://www.kryeministri-ks.net/repository/docs/Public_Finance_Management_Reform_Strategy2016-2020.pdf

86 Public Debt Law - cleared version - "Official Gazette of the Republic of Macedonia" no. 165/2014

87 Report No. 93913- MK FYR Macedonia Public Expenditure Review Fiscal Policy for Growth, World Bank Group, July 2015

88 Law on Budgets (cleared version) – available at: http://www.finance.gov.mk/files/u6/5.pdf

of a sustainable level of public debt with the Maastricht criterion of 60% of GDP (Fiscal Strategy 2017-2019), is not backed up with data and argumentation in the context of local characteristics and intended use of the already generated debt. On the other hand, such a definition of the limits of public borrowing could create a perception that there is room for further borrowing, which can be harmful if such borrowing is not strictly earmarked for priority productive purposes.[89]

Montenegrin law prescribes that the Government, taking account of the opinion of the Central Bank, adopts the Debt Management Strategy, which defines a framework borrowing program for a three-year period, guidelines for risk assessment for borrowing, guidelines for management of debt, cash, guarantees, and borrowing, and other matters significant for debt management. However, inputs from the Central Bank are not obligatory. If the Central Bank fails to submit an opinion within 15 days as of the day the proposal of the Strategy is submitted, the Government will adopt the Strategy without the Central Bank's opinion.[90] All these categories are incorporated into the current Strategy which refers to the 2015 – 2018 period.

The Public Debt Administration in **Serbia** is an administrative authority within the Ministry of Finance of the Republic of Serbia, having the role in the public finance system of ensuring liquidity of the state and supporting governmental bodies, public enterprises and other state institutions in financing projects of public importance. The Public Debt Administration is responsible for public debt policy, representing one of the most important branches of macroeconomic policy and having a stabilization and development function. The activities of the Public Debt Administration are regulated by the Law on Budget System, Law on Budget of the Republic of Serbia and other laws and by-laws. The Public Debt Administration performs tasks related to: borrowing on the financial market aimed at covering budget deficit of the Republic of Serbia and financing projects of public importance, through the issuance of government securities and contracting loan agreements, issuing guarantees in favor of public enterprises, governmental agencies and local self-government units, public debt proceeds management, execution of public debt service, recording and reporting, preparing the public debt management strategy, as well as other obligations in accordance with the Law. The Public Debt Administration was established on 1 October 2009, in accordance with the recommendations of the World Bank.[91]

A strategy for management of public debt has been formulated since 2012/2013. The main goals of the strategy are to a) reduce the Debt to GDP ratio, at the end of 2015 the balance of the central government's debt reached 74.7% of GDP and the general government's debt

89 Will the fiscal strategy be respected and implemented consistently, available at: http://utrinski.mk/?ItemID=78E31959888D5E47877A9D749381FD2B [accessed, February 10, 2017]

90 Law on Budget and Fiscal Responsibility, (article 58, par. 3)

91 More information available in: http://www.javnidug.gov.rs/eng/default.asp?P=32&MenuItem=2

reached 76% of GDP. The ratio of public debt to GDP for the central government was 70.8% of GDP at the end of September 2016 and for the general government this ratio stood at 72%. A slight increase is expected until the end of 2016 and the share will reach approx. 73.5% of GDP on the central level and 74.6% of GDP on the general government level,[92] b) reduce exposure to foreign currency denominated loans. The key strategic goals in the upcoming long-term period, in order to minimize the risk of increasing indebtedness and the cost of servicing public debt, are: - that the share of debt denominated in dinars amounts to approx. 20-25% of the total public debt in the medium run; - that the share of debt denominated in euros in the public debt amount to no less than 60% of the debt in foreign currency, including future borrowings and transactions, c) to extend maturity of loans. At the end of 2013 the share of long-term dinar instruments at original maturity of three and more years amounted to 37% in the balance of dinar securities and 67% at the end of September of 2016. In 2014, ten-year bonds were issued for the first time, which completed the development of maturity in the yield curve for both dinar and euro denominated government securities d) reduce number of loans with variable interest rates.

The objectives of fiscal policy in **Slovenia** are set out in the National Reform Programme and the Stability Programme. In line with the fiscal strategy, Slovenia will pursue a gradual reduction of government debt, which will be possible in the medium term with the use of incomes from privatization, the improvement of the state's credit rating and effective debt management.[93] The Central Government Debt Management Department reports Central Government Debt data to international and domestic institutions as well as Rating agencies.[94]

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92 More information available in page 15, 16, 17 at: http://www.javnidug.gov.rs/upload/Strategija/2016/Public%20Debt%20Management%20Strategy%202017%20-%202019%20eng.pdf.

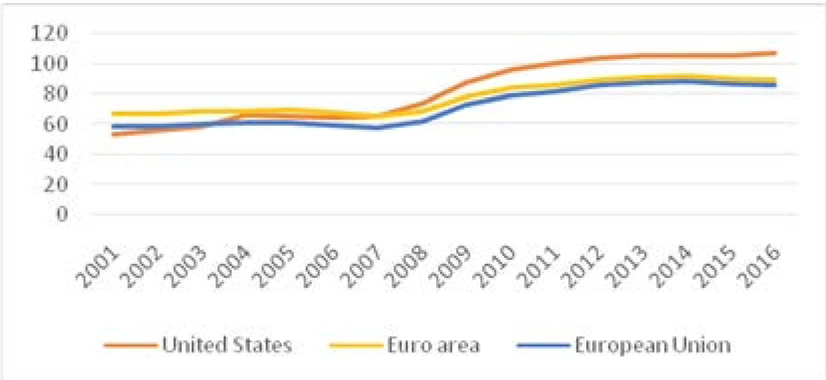
93 Fiscal policy, Ministry of Finance available at: http://www.mf.gov.si/en/areas_of_work/economic_governance/fiscal_policy/

94 The Treasury Directorate at the Ministry of finance, led by Marjan Divjak, was awarded Sovereign Risk Manager of the year 2017 by the Risk Magazine.

Characteristics of the public debt – current situation in every country

Advanced economies eased their fiscal stance by one-fifth of 1 percent of GDP in 2016, breaking a five-year trend of gradual fiscal consolidation. Their aggregate fiscal stance is expected to remain broadly neutral in 2017 as well as in the following years. As result, public debt in advanced economies should stabilize in the medium term, averaging more than 100 percent of GDP, rather than decline as previously expected.[95] While the debt level in the pre-crisis period was rather stable, the crisis triggered a dynamic growth of debt in developed countries (see chart no.5 for US and EU). The average debt in the advanced countries in 2007 was 72% it reached 107% in 2012.

Graph 5. General government gross debt in the USA and the EU



Source: IMF datamapper

The crisis caused particular problems in the Eurozone. The large fiscal stimuli resulted in higher fiscal deficits and accumulation of large amounts of debt. A number of countries broke the Maastricht criteria, while failing to achieve positive growth outcomes.[96] The Eurozone barely achieved growth in 2008 and entered a recession in 2009. The severity of the debt crisis led euro area authorities to break the non-bailout clause of the SGP and several countries received bailout packages from the EU and the IMF (Greece was the first to receive such assistance). The ECB reached for unconventional monetary measures in order to support the eurosystem. Later a series of measures and activities were implemented:

95 International Monetary Fund (IMF). 2017. Fiscal Monitor: Achieving More with Less. Washington, April

96 Barta, Z., 2015. Fiscal sustainability and the welfare state in Europe, ACRN Journal of Finance and Risk Perspectives Special Issue of Social and Sustainable Finance, 3, pp.135-147

establishing the European Financial Stability Mechanism for problematic countries, the Europact, the signing of a new "Fiscal Compact" within the Treaty on Stability, Coordination and Governance of the EMU.[97]

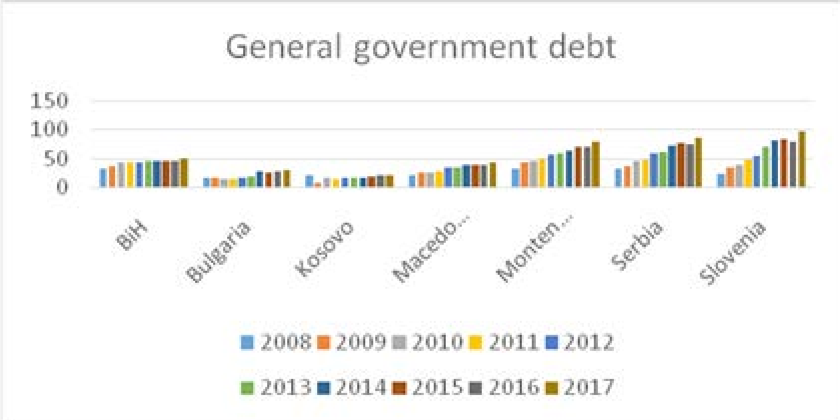
Due to considerations regarding the adverse effects of the rising public debt in certain countries and threats to the debt sustainability, advanced countries turned to austerity measures. Some authors, however, warn against austerity measures, especially during recessions, arguing that its contractionary effects can reduce the consolidation results and even end with higher debt levels.[98]

As classified by the World Bank, countries with public debt of 40% of GDP are considered lower indebted, those with debt of 40% - 60% of GDP are considered moderately indebted and those with debt above 60% of GDP are considered highly indebted countries. For developed countries, studies show and refer to the prudential limit of 60% of GDP (this coincides with the Maastricht criteria). In less developed countries and developing countries the prudent limit is estimated at 40% of GDP. It can be seen from chart no.3 that the countries from the region can be divided into two groups according to their gross general government debt in 2016: countries with debt levels above 70% of GDP, making them highly indebted (Montenegro, Serbia and Slovenia) and countries with debt levels below or slightly above 40% of GDP (BiH, Bulgaria, Kosovo and Macedonia). However, even for the lower indebted countries, there is an apparent rising trend of debt (except in Kosovo). For example, it has increased almost threefold since 2006 in BIH, in large part because of budget support loans, due to a structural budget deficit. For six years (2008-2013) *Bulgaria* had the lowest national debt to GDP ratio in the EU second only to Estonia. In 2014 the debt ratio jumped by 7 % and reached a level of 26.9% and has continued to rise with more steady steps peaking at 29.5% at the end of 2016.

97 More informaiton available at ECB, 2012

98 Krugman, P. 2010. Self-defeating Austerity. *The New York Times.* July 7, available at: http://krugman.blogs.nytimes.com/2010/07/07/self-defeating-austerity/

Graph 6. General government debt 2008-2017



Source: WEO database

Bosnia and Herzegovina - In 2016, total public debt increased by 1.18 percent compared to the previous year, from 11.949 billion KM to 12.089 billion KM, but fell in GDP terms for the first time since 2008, from 40,75% of GDP to 39.78%%. The shares of the total public debt in 2016 were: FBiH 54.28%, RS 45.04%, BD 0.24% and the BiH institutions 0.44%. FBiH's share of total public debt servicing costs was 52.55%, RS 46.34%, while the BiH Institutions amounted to 0.24%. The share of external debt in the structure of total public debt in 2016 was 70.63%, while in 2015 it was 70.38%. Thus, while both increased in absolute terms, the share of external debt compared to internal debt rose as a proportion of total public debt.

The external debt portfolio shows that concessional loans (with grant element larger than 35%) account for largest share of total external debt; while the main sources of such financing (over 73%) are multilateral institutions. The external debt can be divided into "old" and "new" debt. The "old" debt is inherited from commercial debts on the part of the Socialist Federal Republic of Yugoslavia to the Paris Club and London Club creditors, and IBRD loans. As of the end of 2016, the share of the "old debt" in external indebtedness was 16.16% and showed a constant decreasing tendency, its share falling from 21.75% in 2013 to 19.65% in 2014% and 17.89% in 2015. The lion's share of the "new debt", which makes up 83.84% of total external debt, is represented by debts to international financial institutions (World Bank, IDA and IBRD, EIB, IMF, EBRD, European Commission). The new debt in the period 2015-2016 increased from 6.906,14 million KM to 7.158,81 million KM. The new debt in the period 2006-2016 increased three-fold as a result of IFI loans to finance infrastructure projects and to support budgets. Thus, of "new" external debt, 52.78% relates to infrastructure projects, 34.43% to the public sector (including budgets), and 12.79% to promotion of economic activities. Of total withdrawn funds in 2016, 68.68% pertain to infrastructural projects, 27.65% to the public sector, and 3.67% to economic activities. 668.71 million KM of approved credit funds was engaged in 2016. Of the total amount, 39.45% relates to the EIB, 22.41% to the IMF, 13.02% to IDA credits and 6.32 % to OPEC, while other creditors participate with 18.8%.

The internal debt of Bosnia and Herzegovina amounted to 3,550.62 mil KM as of 30.06.2016, 11.79%. This represented a sharp slowdown in the growth of internal debt: which in 2015 was 7.20% higher than in 2014, while in 2014 it was higher by 9.26% compared to 2013. An increasing segment of the internal debt represents long-term borrowing to cover budget deficits in the wake of the financial crisis. Since 2011, these are financed by auctioning treasury bonds and notes on the stock market.

Although it is still among the lowest in the EU, the government's unwillingness to invest in key projects, moderate economic growth and the high share of the grey economy pose the question of the sustainability of the **Bulgarian** public debt. For six years (2008-2013) Bulgaria had the lowest national debt to GDP ratio in the EU second only to Estonia.[99] In 2014 the debt ratio increased significantly by 7 per cent and reached a level of 26.9% by the end of the year. Since then it has continued to rise steadily, peaking at 29.5% at the end of 2016. The latest increase of the debt is due mainly to the necessity of guaranteeing the liquidity of the banks' guarantees, which might or might not be triggered and are therefore, called conditional debt. The last issued guarantees in September 2016 were three: two for 300 million euro in connection with the project for stabilizing the guarantee of deposits and one for 150 million euro for the partial financing of the national program for energy efficiency of multifamily buildings. At the end of 2016 the government-guaranteed debt amounted to 1.8% of the GDP.[100] The biggest part of the national debt is owed to foreign investors. The majority of it is made up of emissions of bonds, the rest are credits from international financial institutions (EIB and the World Bank).

Compared to other Member States of the EU, this increase is not the result of more social expenses but due to the support of the banking sector after the bankruptcy of the fourth largest bank in Bulgaria. The issuing of more state bonds can be explained with the need to guarantee liquidity in case of future financial shocks as well as with the favorable market interest rate. However, no sources for the paying off the debt are indicated. There are also no plans for significant public investments, which could eventually turn into a source of income that would repay the debt. The conservative approach of the Bulgarian governments creates an illusory vision of stability, which cannot guarantee real sustainability of the Bulgarian economy and society.

99 General government gross debt - annual data, Eurostat, available at: http://ec.europa.eu/eurostat/tgm/table.do?tab=table&init=1&plugin=1&language=en&pcode=teina225

100 The biggest challenge is the state companies in the energy sector. One such example is the project for the Belene Nuclear power plant. After taking the decision to terminate the project, the state was sentenced to pay 601 million euro. There is also the "hidden" guaranteed debt. A recent example is the two foreign-owned coal power plants, which are protected by the contractual obligation of Bulgaria to pay 1.5 billion euro in case of pre-term termination of the contract.

The first significant rise of the debt is from 2014, the next one was due to the bankruptcy of the fourth largest bank in Bulgaria, caused by insider dealing. The government secured liquidity to another Bulgarian bank with some additional debt, which the latter repaid the following year. Despite the current stable banking system, a new loan was taken to guarantee liquidity in case of shocks, which now rests in the fiscal reserve.

Kosovo - In the current setting, public debt is estimated to be only 12.5% of GDP, according to the Central Bank, at about 749 million euros in 2015, with an annual increase of 28.5%, and is deemed of no real concern for the time being. However, public expenditure continues to show its Achilles' heel in particular areas. The public sector employs 83,000 citizens or ¼ of the total work force and 34% of the total public expenditure – 540 million euros – is funneled to support wages and related expenses in the public sector. Kosovo's relatively low public debt has not been a matter of concern, considering recent reports from both the IMF and the World Bank. During 2010 and 2011, the vast majority of Kosovo's debt consisted of World Bank – IBRD CLC loans, inherited in the aftermath of Kosovo's country's independence. The remaining part of debt, moreover, was borrowed from the International Monetary Fund (IMF) and World Bank – IDA. In September 2016, Kosovo's public debt reached the value of EUR 842.1 million. Public debt, as a percentage of GDP, experienced an increase from 12.5 percent in September 2015, to around 14.3 percent in September 2016. The accelerated public debt increase, is mainly a result of the growth of domestic debt of 34.5 percent (which reached EUR 473.6 million), whereas the external debt increased slightly by 0.3 percent, reaching EUR 368.4 million. Also, in September 2017, there was a documented decreased level of the share of the external public debt to the total domestic debt, from 51 to 43.8 percent. For comparison, in 2015, the public debt consisted of 51% external debt (largely owned by the *International Bank for Reconstruction and Developments*, *IBRD*, (49.3 % of total international public debt) and *International Monetary Fund*, *IMF*, (36.1 % of total international debt).[101] and 49% domestic debt (mostly government debt to commercial banks (71 % of total domestic debt) and pension funds (22% of total public domestic debt). For the period of 2016-2018, according to the Central Bank of Kosovo, the Kosovo government initially planned numerous capital projects, to be financed by international borrowings. Most of the projects approved for funding are for the improvement of infrastructure, social development, and welfare promotion. Moreover, numerous other projects have been tabled for funding approval from the government to renovate, among others, agriculture, irrigation, hospital infrastructure, energy efficiency, welfare, social housing, etc.

The 2000-2008 period in **Macedonia** is characterized by a continuous decline of public debt from 47.9% of GDP to the lowest level of 23% of GDP in 2008, while the 2008 general government debt was 20.5% of GDP. Strong domestic demand, as well as favorable lending conditions, helped the acceleration of economic activity. In this period, policy of fiscal

101 Macroeconomic Developments Report" Central Bank of Kosovo, 2016

discipline and primary balance (small surplus) was also carried out. In 2007 the debt to the Paris and the London Club was paid, as well as parts of the debt to multilateral creditors, and two structural bonds. However, from 2008 onwards the debt began to rise as a result of worsened economic conditions and the Government's expansive fiscal policy. The country's borrowing, especially from abroad, became an important source of assets to cover public expenditures. In August 2014, Macedonia took out a 36.4-million-euro loan for competition development policies, financed by the World Bank. In 2014 public debt reached 45.9% because the Government issued a 500-million-euro bond under very favorable conditions (3.975%, 7 years) and thus completely, ahead of time, financed the 15-million-euro bond, and carried out payments to the IMF in 2015 (154 million EUR). Public debt was reduced in the first half of 2015 to 43.7% of GDP. Nevertheless, the issuing of a new Eurobond of 270 million Euros and increased borrowing at home of 94 million Euros caused the general government debt to be 38.1% of GDP at the end of 2015, while the total public debt was 46.5% of GDP, which is an increase of 23.5pp compared to 2008 (23% of GDP).[102] In July 2016, the Republic of Macedonia issued the fifth Eurobond on the international capital market, intended for financing the budget needs and refinancing the liabilities falling due in 2016 and 2017 on the basis of previously issued public debt. The Eurobond was issued in the amount of EUR 450 million, with a coupon interest rate of 5.625% annually and 7-year maturity and it is traded on the Irish Stock Exchange. The ownership structure of the Eurobond is mainly distributed between hedge and asset funds, insurance companies and banks from the USA and Continental Europe. According to a recent official data released by the Ministry of Finance, as of the end of 2016, the public debt reached 4.71 billion Euros, or 47.6% of GDP. But according to the projections for the budget deficit for 2017 by the end of this year, the public debt will exceed 5 billion Euros.[103] [104] But the real problem with the public debt is not its level. The real problem is that it is growing too fast and funds from borrowing are spent unproductively and irresponsibly for funding short-term political interests or spent on useless white elephant projects that do not yield the return needed to maintain debt service. Accordingly, there are considerations that most of the money the government borrows is misused, while the effect of credits on economic growth is weak. In the long-run, this behavior calls into question the ability of the state to avoid default. The consequence is that many loans create illegitimate debts. Irresponsible lending and borrowing and the illegitimate debts it creates constitute major risks for debt crises. In this sense, borrowing is justified in cases where funds are used for capital expenditures (investments) whose contribution exceeds the cost of financing.

102 Fiscal Sustainability of Macedonia on its path towards the EU, Faculty of Economics- University of "Ss. Cyril and Methodius"- Skopje, prepared by Borce Trenovski and Biljana Tashevska, 2016

103 Macedonian public debt is at an alarming level of 5 billion euros, available at: http://www.dw.com/mk/македонскиот-јавен-долг-на-алармантни-5-милијарди-евра/a-37364678 [accessed on March 20, 2017]

104 According to the announcement of the Ministry of Finance on March 24, 2017, it is reported that after publishing the data on GDP (revised by the State Statistical Office), the Ministry published on its website the revised data for public and state debt according to the data of the SSO. Accordingly, it is necessary to take into account that small variations in the data for 2016 in this study are possible, compared with those published by the MoF, due to the aforementioned adjustments with the SSO in relation to GDP.

Montenegro is a highly-indebted country, whose public debt increased three times over the last 10 years, since it gained independence. Key reasons for a significant increase of the debt are related to increase of public sector expenditures - over employment and increase in salaries and pensions, extensive provisions of state guarantees and subsidies to the privately owned, privatized companies and large infrastructure projects which were not supported by an equal growth of the economy. During last 10 years, since Montenegrin independence, several issues critically contributed to the increase of the public debt, as shown in the table below:

Table 1: Key milestones for increase of the public debt

Year	*Description*	*Amount (in million €)*
2006	*Restitution*	*125*
2008	*Compensations to pensioners, owners of deposits in former Yugoslavia and support to private banks*	*195*
2009	*Compensations to pensioners*	*32*
2010	*Payment of interest rates and subsidies to private sector*	*69*
2011	*Payment of guarantees*	*56*
2012	*Payment of interest rates, subsidies and guarantee*	*102*
2013	*Repayment of previous loans and securities and subsidies to KAP*	*322*
2014	*Loan from EXIM bank for the highway*	*809**
2016	*Additional social giving and increase of salaries in the public sector*	*87*

**Actual costs for the highway will occur in following years*

At the end of 2016 the public debt of Montenegro was over 2.5 billion EUR, or 68.27% of GDP. According to some analysis, public debt might reach 3 billion EUR by the end of 2017. The last, more extensive increase of the public debt is related to the highway project financed from the Chinese loan, with an estimated cost of just the first out of three phases of the project exceeding one billion EUR (higher than initially expected due to exchange rate effects). At the end of 2016, Montenegro has 20 foreign and nine domestic groups of creditors for the state debt only. At the same time, there is no information on creditors of municipalities, just information on the level of the debt. Key Montenegrin foreign creditors were holders of Montenegrin EUROBONDs, worth over one billion EUR, the European Bank for Reconstruction and Development (EBRD) with over 210 million, the Chinese EXIM Bank with over 189 million, the Credit Suisse Bank with over 128 million and the European Investment Bank with over 105 million EUR of loans.

In the period between 2001-2016 about 96 billion EUR went in to **Serbia** and the sale of 2420 companies earned 2.6 billion of EUR of income. Despite such heavy investments, the Serbian economy is not showing signs of sustainability. Serbia was allowed in first years after 2000 to borrow cheaper, to even receive support as a highly indebted country from World Bank and EU and it has actually received a number of loans and donations that have significantly helped the country to stabilize its macroeconomic position, seriously reduce its inflation and moreover to reduce its deficit and debt. Serbia increased its vulnerability with regards to overreliance on foreign technologies, services, finances and resources. According to the IMF in the framework of Stand By arrangement of Serbia is highly exposed to considerable external imbalances and reliant on external financing, exposing country to sudden changes in investor sentiment. At the same time despite strict legal limitations Serbia has levels of debt per GDP much higher than 45%. Such levels of public debt first started to occur in the period after 2008. Since 2012 Serbia has been involved in structural reforms in line with IMF and World Bank advice and has implemented significant fiscal adjustments in recent years and achieved debt stabilization.

Despite explicit regulations Serbia has violated its own laws with regards to the maximum allowed level of public debt since 2010, despite the fact that public debt was reduced until the 2008 structurally problems remained (import dependence, low technological competitiveness, high energy and resource intensity, high subsidies to foreign companies for labor intensive activities with low value added etc) that have exposed Serbia to risks that in conjunction with the external pressures have led to the sharp increase in levels of domestic and foreign liabilities of State of Serbia.

According to the data as of 30 September 2016, the largest portion of public debt of the general government of the Republic of Serbia is still denominated in Euros and amounts to 41.3%. US dollars follow with 32.5% and dinars with 21.4%.[105] As of 30 September 2016 the greatest portion of public debt of the general government of the Republic of Serbia had a fixed interest rate – 78.1%, while the public debt with variable interest accounted for 21.9% of total public debt. Of the variable interest rates, the most common ones are EURIBOR and LIBOR for euro, which account for 68.4%, then LIBOR for US dollar which accounts for 10.8%, while liabilities linked to the NBS key-policy rate account for 7.2% and other liabilities 13.6%, mostly variable interest rate for special drawdown rights.

A big part of Serbian debt comes from more than 15 years of systemic and massive support for the SMEs and also to large companies through different mechanisms including tax incentives, subsidies, tax holidays, cheap electricity, cheap loans through financial intermediaries etc. looking at the assessments made by main macro assisting institutions (World Bank, IMF, EU) one would never get impression how big and lucrative was the financial and other support of Serbia to private initiative and also attracting foreign large and middle sized corporations and financial institutions. Data about all the forms of support are lacking and it is very hard to present the amount of financial resources that was invested into the transition to market economy. Such non-transparency is partly caused by the interest of large neo-liberal economy promoting institutions to demand always more support.

105 Economic Reform Program 2017-2019, p. 19

When **Slovenia** joined the EU in 2004, the state deficit was only 2.4% of GDP, and it reached 6.1% of GDP in 2009. It was highest at 15% of GDP in 2013, therefore, overlapping with the peak of the financial crisis in Slovenia. This sudden hike of public deficit, alongside with accumulated minor deficits from previous years, contributed the most to the current state of the public debt.

The public debt used to be stable and stagnant for more than 15 years, it was around 25% of GDP before the crisis, until 2009, and then it started to increase. The outburst of the trend was during the crisis in 2014, when government started to solve the banking crisis, after the results of banking stress tests, with injections of capital into banks and the formation of the so-called "bad bank" - following Ireland, Spain and the Baltic countries. In 2015 public debt reached its peak at 83%. However, it is at 79% of GDP now (that is around 31 billion euro); which ranks Slovenia in the middle of the EU member states. However, Slovenia is still among the states whose debt has increased the most relative to pre-crisis levels. Growth of debt and interest expenditure, together with a further growth of certain expenditures on social protection (pensions, health), which in a few years moved Slovenia from a low-indebted to medium indebted country (in 2013 alone it grew by 17.3% points), significantly contributed to the pressing situation.[106]

The borrowing of the state primarily comprises issuances of long term securities, i.e. bonds. In the period from 2012 to 2014 Slovenia borrowed for the central government budget in global capital markets by issuing bonds denominated in USD. The share of EUR denominated debt as at the end of 2014 stood at 73% of the total debt. However, 28.6% of the USD debt portfolio was changed to EUR in the three USD buy back transactions executed in 2016.[107] In March 2013, the newly elected Prime Minister, Alenka Bratušek, announced the end of austerity and structural reforms. In only one week, the interest rate on 10 year government bonds sharply increased from 5% to 6.73%. "It was at this point that we started to think about how it would be possible to buy back this expensive debt on the global market and fund it with issuance on the local market," says Marjan Divjak, the treasury's director general at the Ministry of Finance.[108] Nowadays, Ministry of finance has used the opportunity to lower interest costs and take advantage of improved investor confidence and low euro yields related to the ECB's quantitative easing programme.[109]

The Slovenian economist Franček Drenovec analyzed the effects of the breakdown in the

106 Miroslav Verbič, Andrej Srakar, Boris Majcen, Mitja Čok (2016) Slovenian public finances through the financial crisis. Teorija in prakasa let. 53, 1/2016

107 Financing Program of the Republic of Slovenia Central Government Budget for the Fiscal Year 2017, Ministry of finance available at: http://www.mf.gov.si/fileadmin/mf.gov.si/pageuploads/vrednostni_papirji/Program_financiranja/Financing_Program_2017__EN_.pdf

108 Risk.net, Sovereign risk manager of the year: Treasury Directorate of Slovenia, 25.1.2017 available at: http://www.risk.net/awards/2479838/sovereign-risk-manager-year-treasury-directorate-slovenia

109 Slovenia's Launch of Debt Buyback Is Credit Positive, Moody's investor service, May 15, 2017 available at: http://www.mf.gov.si/fileadmin/mf.gov.si/pageuploads/mediji/2017/Maj/Moody_s_Slovenia_Buyback_MCO_2017_05_15.pdf

Slovenian banking sector on the public debt. The processes of bank rehabilitation between 2011 and 2014 directly contributed to a 6 billion euro increase in the state debt. At the end of 2014, the accumulated debt of these operations equaled 15.8% of GDP. To some extent, the banks already rehabilitated themselves before the financial aid of the state, by large scale formation of reserves and provisions. From 2009 to 2014, the banks thus acquired 3.6 billion euros (10% of one annual GDP) from the domestic market. The immediate burden of state rehabilitation of the banks was lesser accordingly. The public costs for bank rescues were therefore much higher than 6 billion euro.[110] IMAD/UMAR calculated in its forecast report that owing to the debt increase in recent years, the average annual contribution of interest will remain almost unchanged despite the lowering of the implicit interest rate and favorable borrowing terms.[111] Regarding debt sustainability IMF reports that historical debt dynamics in 2013–14 were dominated by the impact of bank restructuring, and are thus unlikely to occur again given the banks' good health. Slovenia's relatively high public debt ratio remains vulnerability, while debt service is projected to remain manageable, even under the stress scenarios.[112] In other words, like the European Commission states in its semester report that "a prolonged recession coupled with significant bank recapitalizations has resulted in a sharp rise in public debt in recent years. The fiscal framework reform, which provides an important anchor for sustainable public finances, is yet to be fully implemented."[113]

In general, most of the debt can be attributed to the central government, with a significantly lower proportion of indebtedness of the local government and social security funds. Political reasons were among the main reasons why the spreads of Slovenian government bonds and thus the cost of debt grew excessively (which can be verified by observing the correlation of government changes and bond spreads) and only with gradual measures and the stability of each new government the situation has gradually stabilized.[114]

110 Franček Drenovec (2015) Formation of the public debt in Slovenia, Rastko Močnik and Maja Breznik (ed) Public debt: Who owes whom? *cf, Ljubljana In addition, the state budget debt is also composed of loans raised or assumed from former SFR Yugoslavia and securities issued as legal entity for the execution of state budget. From 1996 on Slovenia was gradually signing agreements with creditors of former SFRY concerning reprogrammed liabilities from New financial Agreement (NFA) and bilateral agreements with states members of Paris Club. In 1999 the agreement with creditors from NFA and with most of Paris Club members was reached. Bulletin of Government Finance 4/2017, Ministry of Finance available at: http://www.mf.gov.si/en/areas_of_work/general_government_finance/public_finances/bulletin_of_government_finance/

111 Their analyses show that (in advanced economies) approximately 1% point of additional real GDP growth would be needed during the next 10 years, on average, in order for the debt-to-GDP ratio to return to its pre-crisis level. In Slovenia, GDP growth that is 1% point higher than assumed in the baseline scenario would reduce the share of general government debt to around 50% of GDP by 2026. Economic Issues 2016, IMAD/UMAR, available at: http://www.umar.gov.si/fileadmin/user_upload/konference/2016/AN_EI2016.pdf

112 IMF says the debt ratio will: (i) register a further 1¾ percentage point decline in 2017, as the Treasury continues to draw down its cash buffer; (ii) continue declining at a slower pace in-2018–19, and (iii) virtually stabilize thereafter, settling at about 76 percent by 2022. IMF, 2017, Republic of Slovenia: 2017 Article IV Consultation-Press Release; Staff Report; and Statement by the Executive Director for the Republic of Slovenia. Annex V. Public-Sector Debt Sustainability Analysis available at: http://www.imf.org/en/publications/cr/issues/2017/05/15/republic-of-slovenia-2017-article-iv-consultation-press-release-staff-report-and-statement-44921

113 Government debt has grown substantially and is currently stabilized, but pension and healthcare spending will be concerned by considerable ageing pressures looking forward. Public debt is projected to decrease until 2023 but increase again thereafter under a no-policy-change assumption. Age related expenditure, namely on public pensions, healthcare and long-term care puts pressure on public finances in the long run.

114 Miroslav Verbič, Andrej Srakar, Boris Majcen, Mitja Čok (2016) Slovenian public finances through the financial crisis.

Budget transparency

Bosnia and Herzegovina has not yet achieved sufficient budget transparency. Annual budgets are published and annual reports on budget implementation are produced by the Ministry of Finance and Treasury and audited by the Supreme Audit Institution. Similar provisions also apply in the entities and in the District Brcko. The lack of harmonization at state level and in the entities hampers access to consolidated data. In the context of budget scrutiny, follow-up on external audit findings and recommendations needs improvement. In-year reporting is insufficient, as is citizens' participation in the budget process. However, the situation was clearly not satisfactory since in May 2016 the House of Representatives of BiH adopted a resolution asking the BiH Ministry of Finance and Treasury to provide information on the state of public indebtedness of Bosnia and Herzegovina every 6 months. Thus, it must be noted that these monitoring activities are not carried out particularly transparently: for example, the website of MFT at the moment carries no execution reports, monitoring reports exist only for three years, and the last debt servicing report is from 2009.

The **Bulgarian** Ministry of Finance publishes a monthly bulletin of the national debt and an annual review. On the website of the ministry there is information about the government-guaranteed debt, the fiscal reserve and overdue payments (published every three months). Despite this, it is difficult to make an analysis of the dynamics because the main data is in PDF form. The only files with data from previous years which can be analyzed are those about the government-guaranteed debt and the Consolidated fiscal program, with the latter containing only the interest expenditure. Another difficulty is posed by the different data about the GDP and the national debt published on the website of the Ministry of Finance and the Bulgarian national bank. The website of the National association of the municipalities in the Republic of Bulgaria, which includes all municipalities and is their legitimate representative, contains statistics about the revenues and expenditures of the local government. However, it is not regularly published (the last one dates from 2015) and contains information only about the temporary no-interest loans of the municipalities. It is difficult to find information about concrete expenditure on single projects financed with debt as well as government-guaranteed debt for different spheres. Very often for the purposes of an analysis what can be used are only the statements of ministries and experts from state institutions. Ministry of Finance prepares an annual report on the state of the government debt, which is discussed by the Council of Ministers and presented before the National Assembly together with the report on the implementation of the state budget for the relevant year. To ensure transparency the Ministry of Finance maintains an official register of the government and government-guaranteed debt.

The **Macedonian** Ministry of Finance published public debt data for the first time in 2005.

Between 2006 and March 2010, it published public debt information every quarter. This was interrupted in March 2010, when the MoF started to publish information on central government debt and publicly guaranteed debt in two different documents. Public debt as of end September was published once a year in the context of the EU pre-accession economic program. This was not in line with international best practice. In October 2014, the Ministry resumed the publication of public debt statistics, including of all the external and domestic debt of the central government, the state-owned enterprises (SOEs) and the municipalities, on a quarterly basis. The Ministry also prepares comprehensive annual reports on public debt management which are discussed in the Cabinet and presented to Parliament. The Law states that the annual report should also be published on the MoF website. No requirement currently exists to publish public debt data as an integral part of the annual budget execution report.[115] The last Annual Report on Public Debt Management (for the year 2016) is published on the MoF website. The MoF publishes quarterly data about government and public debt, as well as adjustments to macroeconomic indicators. Following the publication of the data on GDP, the Ministry on its website publishes the revised public and government debt according to the State Statistical Office. The new government has already commenced implementing a number of measures, indicated in the International Financial Institutions' strategic documents. According to this, transparency in the public finance reporting has been improved. The Ministry of Finance changed the structure of its website and added a special section, "Statistics" where in all important information is easily available, such as: budget execution, public debt and state debt, macroeconomic indicators, statistical data, monthly and quarterly data on budget execution by budget users and municipalities. The semi-annual report on budget execution has been revised. There is also information on overdue liabilities. All this information is published in an open Excel format (instead of previous PDF format) which is suitable for further analysis. At the same time, with the aim of making the state budget more available and transparent for the citizens, MoF prepared a so-called Citizens' Budget, presenting, in an understandable manner, the key information from the state budget to the broader public. This is one of the tools by which MoF creates transparency and accountability of public finances and for the purpose of increasing public awareness, as well as intensifying citizens' inclusion in the creation of governmental documents.[116]

The **Montenegrin** Ministry of Finance, in accordance with the Law, publishes quarterly reports on the State debt on its website. However, when it comes to overall public debt, these reports are published on an annual basis, at the website of the Ministry. Nevertheless, this information is not published in open data format, but in PDF. On the other hand, municipalities do not publish reports on their debt on a quarterly basis on their websites, as prescribed by the law. Furthermore, information about expenditures for certain guarantees,

115 Report No. 93913- MK FYR Macedonia Public Expenditure Review Fiscal Policy for Growth, World Bank Group, July 2015)

116 Ministry of Finance, more information available at: http://finance.gov.mk/, accessed on September 6, 2017

subsidies and other forms of state aid are also not disclosed in a timely manner, while a great deal of information related to the state aid for the construction of the highway is not available to the public.

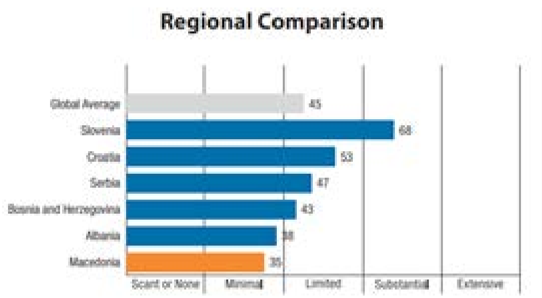
The **Serbian** Ministry keeps public debt records. The record has the obligation to contain data about outstanding amounts, interest rates of guarantees and counter-guarantees. Once a year, the Ministry must submit to the Government a report with information from the record.

Slovenia reports twice a year on the deficit and debt to Eurostat. The report covers a set of reporting tables with data on the country's deficit and debt. The report is prepared by the Statistical Office in cooperation with the Bank of Slovenia and the Ministry of Finance. The report includes the forecast for 2017 on general government deficit and consolidated gross debt at the end of 2017.

Fiscal transparency - Regional context

Fiscal transparency allows a better-informed debate by both policymakers and the public about the design and results of fiscal policy, and provides legislatures, markets, and citizens with the information they need to hold governments accountable. Having in mind the close connections of fiscal transparency and accountability with: the trend of increasing budget deficits and public debt, i.e. lower fiscal discipline; the credit rating of the country and the possibility of borrowing on the international capital markets; and the level of corruption – measuring and improving fiscal transparency in the Western Balkan countries is of enormous importance. The methodology developed by OBI provides a unique opportunity for Western Balkan countries, first to measure the level of transparency and second to detect the weak points regarding the transparency. On the Figure below we present the OBI scores (Kosovo and Montenegro are not surveyed by OBI) of the countries in the Western Balkans plus Croatia and Slovenia. We can draw several general conclusions: all of the countries except Serbia have an downward trend of OBI, they are decreasing the level of budget openness and transparency; Slovenia notices/records the highest OBI of 68, almost double than Macedonia; the strongest fall of OBI in 2015 is noticed/recorded in Albania and Croatia (this downward trends are noticed even in the global report prepared by OBP).

Graph 7: OBI scores of the countries in Western Balkans[1]



Source: Open Budget Survey 2015.

Taking into account the results we could briefly summarize the general recommendations directed to Western Balkan countries:[2]

- All countries (except Croatia) should begin to publish / develop a Citizens' budget as the main tool for bringing the budget and its implementation closer to the public;
- Most of the countries (except Albania and Bosnia and Herzegovina) should develop and publish Pre - Budget Statement;
- Some countries need to increase the coverage of information (important information missing) regarding the supporting budget documents (mid-term budget framework, fiscal strategy, EU PEP-pre-accession program, etc.), as well as to provide additional detailed information on the proposed budget that will allow easier monitoring of the effects of the budget and determining the fiscal position of policy makers;
- All countries should create mechanisms and opportunities for public involvement in the discussions about the budget and the budget process (all Western Balkan countries are in the lowest group by OBI for this area – except Slovenia);
- Increased attention needs to be paid to the auditor's report on the budget, especially regarding the implementation of the audit remarks and recommendation;

1 Kosovo and Montenegro are not surveyed by OBI.

Independent regulatory and oversight bodies/ accountability

It is said in the Guidelines for public debt management prepared by the IMF and the World Bank in 2001 that debt management activities should be audited annually by external auditors. Audits of government financial statements should be conducted regularly and publicly disclosed. Public disclosure of the review by the audit bodies would strengthen the accountability framework for debt management. A national audit body, responsible for auditing government operations, should provide timely reports on the financial integrity of the central government accounts. In addition, there should be regular audits of debt managers' performance, and of systems and control procedures.[117]

National Audit Body

In **Bosnia and Herzegovina,** all four main government levels have their own SAIs (supreme audit institution), each with its own laws and regulations in this area. However, the BiH Constitution and the constitution of the entities do not include a clear declaration of the SAI role. Legislation includes the Law on Auditing Institutions of Bosnia and Herzegovina, Law on the Auditing Institutions of FBiH, Law on Audit of Public Sector of RS, and Law on Audit of Public Administration and Institutions of DB. SAIs is independent of the legislature and the executive. Coverage is uneven across the two Entities, since in FBiH not all units of the general government sector are regularly audited. The SAIs also cooperate with the internal audit function. All four SAIs have formally adopted the standards of the International Organization of SAIs (INTOSAI). Following the establishment of Committees for Audit in all three parliaments, which are specifically dedicated to the examination and follow-up of SAI audit reports, there has been an improvement in the use of audit reports and in Parliament's recognition of the roles of SAIs. Annual budgets are published and annual reports on budget implementation are produced by the Ministry of Finance and Treasury and audited by the Supreme Audit Institution. Similar provisions also apply in the entities and in the Brčko District. Notwithstanding regular independent auditing, in the view of the European Commission, Bosnia and Herzegovina has not yet achieved sufficient budget transparency. In the context of budget scrutiny, follow-up on external audit findings and recommendations needs improvement.

In **Bulgaria**, the National Audit Office (NAO) is the body that exercises control over the implementation of the budget and other public resources. Its main task is to oversee the

117 Guidelines for public debt management prepared by the IMF and the World Bank in 2001

reliability and accuracy of the financial statements of budget organizations and the lawful, effective, efficient and economical management of the public finances. It is independent when exercising these functions and reports the results to the National Assembly. The objects of audit are the state budget, the budget of the public social security scheme, the budget of the National Health Insurance Fund, the budgets of municipalities, accounts for the EU funds. The NAO also audits the origin and management of the government debt, the government guaranteed debt, the municipal debt, and the utilization of debt instruments. The NAO compiles a report and recommendations to be followed by the audited organization, which is obliged to take measures for implementation of the recommendations. Since the NAO does not have sanctioning powers itself, in the event of noncompliance it sends a report with suggestions for penalties to the National Assembly, the Council of Ministers or the Municipal Council. Until 2005 the internal audit and financial inspection of the public sector was centralized in the hands of the Agency for state internal financial control. After a reform inspired by European practices the two functions were separated and now the internal audit is done by a unit in each organization while the ex post inspection is conducted by the Public Financial Inspection agency under the auspices of the Ministry of Finance. Its main objective is to protect the public financial interests and unlike the NAO it has the legal authority to impose administrative and financial sanctions in the case of a violation.[118]

Kosovo - The process of oversight of public accounts and expenditure in Kosovo is carried out in three different tiers. The first tier is the internal audit, which is carried out within the public institutions that are recipients of public funds. Every budget organization recipient of public money is obliged to have an internal auditor or procure the services of an Internal Auditor in case they do not have one. The internal auditor's job is to review the expenditure of the budget organization in light of the laws and practices for benefit of the budget organization for which it carries out the auditing. The second tier of oversight is the external audit, which is conducted by external institutions mandated to independently review the manner in which public institutions have managed the public funds. The Law on Public Financial Management and Accountability (LPFMA) provides that every budget organization and public undertaking which is a recipient of public funds will have to undergo an independent audit process provided by the Office of the Auditor General.[119] The office of the Auditor General is an independent constitutional institution for economic and financial control of public institutions which reports only to the Assembly of the Republic of Kosovo, established in 2008 with the Law on the Establishment of the Office of the Auditor General of Kosovo and the Audit Office of Kosovo, No. 03/L-075. In June 2016, the Assembly approved a new LAW No. 05/L-055 on the Auditor General and the National Audi Office

118 Public Financial Inspection Act art.2

119 In the immediate post-war period the auditing in Kosovo was carried out by the Netherlands Court of Audit, which was externally contracted by UNMIK12 based on the provisions of the UNMIK Regulation 1999/16, which called for the assurance of proper independent auditing by the Special Representative of the Secretary General (SRSG).13 The Netherlands Court of Audit performed auditing services from 1999 until 2003 when UNMIK established the Office of the Auditor General based on Regulation 2002/18. According to this law the Auditor General was appointed by and accountable to the SRSG. (KIPRED, 2009)

of the Republic of Kosovo.[120] The Auditor General's duties include Performance and the Regularity Audits on any public institution, publicly owned enterprise or other authority managing public funds subject to audit. Performance auditing is the auditing of the economy, efficiency and effectiveness with which the audited entity manages its funds, whilst the Regularity Audit scrutinizes the financial statements and other financial records of budget organizations for their compliance with the law. The manner of auditing in Kosovo is based on the standards of the International Organization of Supreme Audit Institutions (INTOSAI), European Union (EU) and other relevant international auditing standards, as well as relevant requirements of the Kosovo Board on Standards for Financial Reporting (KBSFR).[121] The law requires the NAO to publish on its website: all individual audit reports; the Annual Audit Report; the Annual Performance Report of the Office including the audited financial statements; internal guidelines and regulations; and other information regarding the Office and its activities.

Finally, the third and most important tier of oversight of public finance is the Parliament. As the highest legislative body the Assembly of Kosovo ensures the existence of an independent auditing institution, and carries out the final approval of the budget proposed by the Government and as such also carries out the duty to oversee the manner in which the budget is spent. According to the current Rules of Procedure (RoP) in force in the Assembly the oversight of public accounts is carried out by the Committee for Budget and Finances (CBF).[122]

The State Audit Office (SAO) is a supreme audit institution in **Macedonia.** The SAO provides support to the Parliament for execution of its jurisdiction, through identification and presentation of irregularities and illegal operations of audited entities, uncovered with the performed audits. In line with the Rules of Procedure of the Government, the Audit Committee submits written reports to the Government with opinions and suggestions for measures undertaken upon recommendations in audit reports, and the General Secretary of the Government informs the SAO on the conclusions of the Government regarding the measures undertaken by the auditees.[123] The SAO is obliged to immediately inform the authorities when there are findings of misdemeanor or criminal acts by the audited entities. One of the main prerequisites for Macedonia's accession to the European Union is the independence and autonomy of SAO. The Government has proposed amendments concerning SAO's constitutional independence, but this process has not been resolved yet. This said, although according to the Law SAO has a certain operational independence for conducting audits, the body adheres to the same regulations as any other budget user, and in practice its independence and autonomy are limited by legal and financial aspects.

120 Official Gazette of the Republic of Kosovo / No. 17 / 10 JUNE 2016, PRISTINA

121 Kipred (2009): Oversight of Public Finance in Kosovo. Kosovar Institute for Policy Research and Development. Pristina

122 Ibid

123 State Audit Office of Republic of Macedonia, available at: http://www.dzr.mk

According to the last PEFA Report 2015[124], SAO does not have the resources needed to carry out a full financial and compliance audit of all its auditees every year, and therefore aims to cover most of them in detail over a period of several years. Also in the Progress report of the European Commission for Macedonia (2015) it was noted that audit coverage has been limited, leaving a majority of public funds unaudited, so improved transparency and accountability could be achieved by developing the capacity of this body. Another particular problem is that the Law does not give jurisdiction to SAO to impose penalties (sanctions) to entities that do not implement the recommendations of the authorized state auditor or have failed to provide feedback for SAO regarding the status of the recommendation. Also, the authorized organs (State Commission for Prevention of Corruption, the Public Prosecution Office and the Ministry of Interior) have no clear legal obligation to take action upon the notification by the authorized state auditor of reasonable suspicion of a misdemeanor or a felony, and to inform the SAO on regular basis about the measures taken until a final decision is reached by the authorities on a previous SAO notification. Additionally, in the Progress Report 2015 was noted that SAO's annual audit report is discussed in parliament but its recommendations and findings are still not followed up systematically to guarantee that public resources are used more transparently and have a legal justification.[125]

In **Montenegro**, the State Audit Institution, which is by law an independent and supreme state audit body, is in charge of analyzing the state budget. According to the law, audited entities are the authorities and organizations managing the budget or state property and of the local self-government units, the funds and other legal entities being founded by the state or in which the state is a majority shareholder or holds a majority stake. This institution produces reports on audit of the final accounts of the state budget, containing information on management of budget and state finances by various institutions and provides recommendations for improvements. It has no authority to impose any sanctions for violations of the law or mismanagement of funds. SAI is not a truly independent institution despite such a legal requirement. In March 2017 a high level official of the ruling party, involved in the vote buying scandal was appointed as member of the SAI's Senate. Previously, other high-level political officials were also appointed as members of the Senate of SAI. Public authorities do not always implement recommendations given by the SAI. The Parliament has authority to control public finances. In the last six years there has been no session of the Committee for Economy, Finance and Budget dedicated to public debt. Several sessions related to specific guarantees, concessions and the final account of Montenegro were held, but none of these were dedicated especially to the public debt or implementation of strategic documents related to the public debt management.

According to article 92 of the law on the budgetary system that regulates external audit, the

124 PEFA Assessment on the FYR Macedonia, prepared by John Wiggins, Jean-Marc Philip, Bojan Pogačar and Anto Bajo

125 Progress Report FYROM 2015

annual financial statement of the Republic of **Serbia** and annual financial statements of the organizations for mandatory social insurance shall be subject to external audit, pursuant to the provisions of the law regulating the jurisdiction the Supreme Audit Institution. Annual financial statements of local government budgets shall also be subject to external audit. The audit referred to in paragraph 2 of this Article shall be performed by the Supreme Audit Institution in line with the law regulating the jurisdiction of the Supreme Audit Institution.

Slovenia *r*eports twice a year on the deficit and debt to the Eurostat. The report covers a set of reporting tables with data on the country's deficit and debt. The report was prepared by the Statistical Office in cooperation with the Bank of Slovenia and the Ministry of Finance. The report includes the forecast for 2017 on general government deficit and consolidated gross debt at the end of 2017.[126]

The Court of Audit audited public debt, firstly, in 2008.[127] In its concluding report it said that the Government and the Ministry of Finance did not act effectively in the allocation of guarantees in 2003-2006 because they did not adopt strategic guidelines at the level of the state. During that period, they were also not successful in securing dedicated financial means for the construction of motorways, to the extent prescribed by the regulations. A country-specific strategic document governing the field of granting guarantees and document that would regulate the field of granting Slovenia's guarantees were not drawn up.[128]

Secondly, it audited public debt, concerning the effectiveness of planning State borrowing requirements in the years 2013 and first half of 2014. The Court decided to undertake an audit, which would give an overview of State borrowing and public debt in the years 2013 and first half of 2014.[129] Since the Government did not adopt guidelines for defining medium-term borrowing strategy, the Ministry was forced to undertake a conservative policy of borrowing in order to minimize the risks. The same fact emerges from the Court's analyses of the debt portfolio in which no specific risks with regard to debt management were detected. Even then the Government did not formally adopt a medium-term strategy.[130]

126 Deficit for 2017 is estimated at EUR 337 million or 0.8 % of GDP. Consolidated gross debt of the general government for the end of 2017 is estimated at EUR 32,052 million or 77.0% of GDP. April excessive deficit procedure report, Slovenia, 2013–2016, forecast 2017, SURS, 20. 4.2017, available at: http://www.stat.si/StatWeb/en/News/Index/6630

127 Audit was titled the efficiency of borrowing, planning, management and reporting on Slovenia's public debt in the period from 2003 to 2006. The audit assessed the performance in achieving the planned public debt targets, the efficiency of borrowing for the needs of financing the state budget and the repayment of the principal debt, the suitability of issuing state guarantees, the regulation and supervision of the borrowing of the remaining public sector at the state level, the economy of debt management of the state budget, and Transparency and integrity of public debt reporting.
Court of Audit, 2008, Revizija o stanju in upravljanju dolga širšega sektorja države - načrtovanje, upravljanje in poročanje o višini javnega dolga v Republiki Sloveniji v obdobju od leta 2003 do 2006, 5.11.2008 available at: http://www.rs-rs.si/rsrs/rsrs.nsf/I/K17CAA01294CC1636C12572F2002793B4

128 Court of Auidt, News, Javni dolg Republike Slovenije (6. 11. 2008) available at: http://www.rs-rs.si/rsrs/rsrs.nsf/I/K2F1D46CAC6515585C12574F9002970F5

129 In the audit it has been established that strategic targets of borrowing comply with best practices recommended by international financial institutions and represent the appropriate basis for the future phases of planning.

130 In addition the Court submitted to the Government and the Ministry several recommendations concerning

According to the president of the Court of Audit, Tomaž Vesel, one of the institutions that is the most resilient to their controls is the Bank of Slovenia. For many years the financial system has regulated itself, but all consequences of such self-control have been revealed by the financial crisis. And therefore, the state is afraid about what kind of irregularities audits can reveal about banks and the negative impacts of such revelations on the entire financial system.[131]

Fiscal Council

The crisis enhanced the trend of establishing and strengthening independent fiscal institutions, such as the Fiscal Council. A fiscal council is an independent body that usually has a mandate to set more objectively the fiscal projections and to assess and monitor the implementation and effects of fiscal policy. Since the onset of the crisis, many countries introduced a fiscal council. According to Wyplosz (2012),[132] the advisory fiscal councils make a notable contribution to fiscal discipline in the countries where politicians are willing to listen.

In **Bosnia and Herzegovina,** A Fiscal Council was set up in 2008 to coordinate fiscal policies between the BiH Institutions and the Entities and set medium-term fiscal targets each year with the aim of reducing the primary deficit and total public consumption and setting the annual ceilings for indebtedness of the budgets of BiH, FBiH, RS, and DB. The Council prepares the Global Framework of the Fiscal Balance and Policy (GFFBP), determines revenues from indirect taxation and the budget of BiH Institutions, thereby creating preconditions for budget planning at lower level of governments, which are responsible for over 90% of public expenditures. The GFFBP should set medium-term fiscal targets each year; however, the only fiscal goal is the reduction of the primary deficit and total public consumption; concerning debt it sets the annual ceilings for indebtedness of the budgets of the BiH Institutions and the Entities in compliance with legal limits. While there has been some success in consolidating primary balances, the problem of coordinating debt ceilings

development of the medium-term borrowing strategy, implementation of stress tests, and recording of input information and different factors affecting the preparation of the annual Financing Program. Moreover, risks pertaining to effective implementation of the borrowing execution also relate to providing all necessary information on the situation of the State to possible investors by the Ministry. Specific communication channels between the Ministry and the stake holders were not well established.
Court of audit, 2013, Audit report: Effectiveness of planning State borrowing requirements, 18.5.2015, available at: http://www.rs-rs.si/rsrs/rsrseng.nsf/I/KAC07678804F61B29C1257F46002EDD72?openDocument&appSource=91F2455D38551D7CC1257155004755A7

131 Anže Voh Boštic, 2016, Računsko sodišče: zakaj ga pravzaprav imamo in kako učinkovito je, Pod črto - medij za neodivsno novinarstvo, 19.8.2016, available at: https://podcrto.si/racunsko-sodisce-zakaj-ga-pravzaprav-imamo-in-kako-ucinkovito-je/

132 Wyplosz, C. (2012) Fiscal Rules: Theoretical Issues and Historical Experiences. NBER Workiing Paper 17884. National Bureau of Economic Research, available at: http://www.nber.org/papers/w17884

remains. Indeed, the share of lower levels of government (cantons, municipalities, cities and public enterprises) in the total external debt of FBiH is constantly rising (from 1,046.76 million KM in 2010 to 2,447.62 million KM in 2015).

The Law on Borrowing, Debt and Guarantees of BiH stipulates that an Advisory Committee for Debt (comprising of two representatives from Council of Ministers, one of which is the Finance Minister, one representative from the CBBiH, two representatives from the Entity Governments including Finance Ministers, and the Finance Directorate director from the District Brcko), is supposed to be in charge of preparing state debt management strategy. However, in practice, this has not been implemented.

In 2013 **Bulgaria** ratified the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, the fiscal component of which is the Fiscal Compact. This treaty states that fiscal discipline has to be scrutinized by an independent national institution. To this end in 2015 the Parliament enacted the law on Fiscal Council and automatic corrective mechanisms. The Fiscal Council members were elected by National Assembly on November 25, 2015. The main aim of this council is to identify deviations from the mid-term budget objectives and to ensure the state is back on track within 2 years. The Council prepares opinions on the spring and autumn macroeconomic forecasts of the Minister of Finance and on his suggested law on the state budget. Total public debt is reviewed annually by the MFT, CBBiH, and the Fiscal Council through the regular Article IV consultations with the IMF, and this scrutiny is currently intensified under the monitoring required by the Standby Agreement (SBA).

Kosovo and Macedonia has not established Fiscal Council yet. Nevertheless, **Macedonian** MoF recognizes in its Public Financial Management Reform Programme 2018-2021 the need for institutionalized independent evaluation of the macroeconomic and fiscal (budget) projections by establishing the Fiscal council. The structure and budget for operation of Fiscal council are defined and it is projected to be fully operational by 2019.

The Fiscal Council is an independent state body, accountable to the National Assembly of the Republic of **Serbia.** On March 31, 2011, the National Assembly adopted a decision on the appointment of the Fiscal Council members. On April 5, 2011, they assumed their office by taking an oath before to the National Assembly. There are three Fiscal Council members. Professional services are established for professional and administrative purposes. The Fiscal Council's work is stipulated by the Budget System Law. The Fiscal Council's mission is to assess the credibility of fiscal policy in terms of compliance with established fiscal rules and to provide transparency and responsibility in fiscal policy implementation. By making an independent survey of fiscal policy and stimulating professional discussions on fiscal policy, the Fiscal Council should improve fiscal responsibility trends in the Republic of Serbia. So as to meet the goals, the Fiscal Council reviews the macroeconomic and fiscal presuppositions upon which Government documents are developed, provides an independent and credible assessment of economic policy, assesses fiscal risks and the prospects for the Government to fulfill its fiscal objectives in the future and assesses to what extent the Government respected fiscal rules in the past. During budget development and adoption procedure, the Fiscal Council performs different activities: prepares an opinion on the draft Fiscal Strategy Report, prepares and submits the analysis on revised Government Fiscal Strategy Report, prepares an analysis of the draft Budget Law, prepares an analysis of the proposed Law on final accounts of the budget and prepares assessments on fiscal impact of draft laws.[133]

Slovenia has committed itself to establishing the Fiscal Council by ratifying the international Treaty on Stability, Coordination and Governance in the Economic and Monetary Union. The Fiscal council is a consultative body for the independent evaluation of fiscal policy. Further to the Fiscal Rule Act, the Fiscal Council consists of three members, appointed by the Parliament at the proposal of the Government, and supported in their work by a team of experts. The three-member Fiscal Council was appointed in March 2017, after three failed attempts over a period of almost two years. The Fiscal Council of Slovenia joined the Network of EU Independent Fiscal Institutions in 2017.[134] The overall mandate of the Fiscal Council is to publish timely assessments and recommendations to the government and the parliament regarding the consistency of fiscal policy with the fiscal rules. Its members are appointed by the Government on a proposal of the Minister of Finance. The Fiscal Council performs inter alia the following tasks: (i) ex-post evaluation of the sustainability and stability of fiscal policy; (ii) assessment of the medium-term fiscal targets of the fiscal framework; (iii) assessment of the effectiveness of public spending (iv) provision of an estimate of the trends of individual categories of revenue and expenditure of public finances in terms of impact on the sustainability of public finances; (v) assessment of government compliance of fiscal policy with long-term sustainability of public finances. The fiscal council is financed by the government. Administrative tasks for the Fiscal Council are performed by the services of the Court of Auditors. [135] The Court of Audit of the Republic of Slovenia [4] is the highest body for supervising state accounts, the state budget and all public spending in Slovenia. The Constitution of Slovenia provides that the Court of Audit is independent in the performance of its duties and bound by the Constitution and law (Article X).[136]

133 http://www.fiskalnisavet.rs/english/o-fiskalnom-savetu.php
134 http://www.euifis.eu/eng/fiscal/194/slovenia%E2%80%99s-fiscal-council-joins-the-network
135 Country annex SLOVENIA to the REPORT FROM THE COMMISSION C (2017) 1201
136 http://eurocrisislaw.eui.eu/slovenia

Public Debt Management

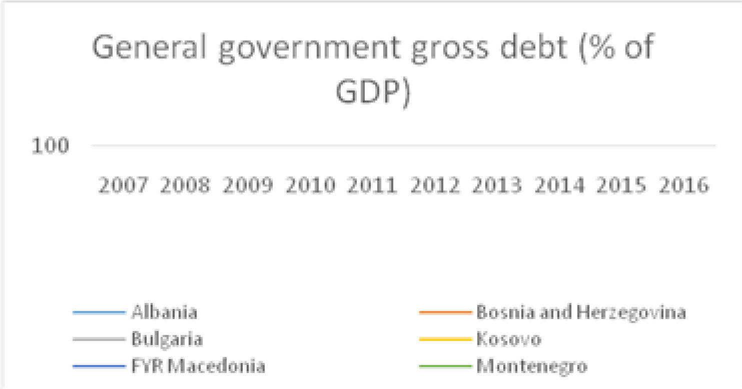
Several debt market crises have highlighted the importance of sound debt management practices and the need for an efficient and sound capital market. Sovereign debt management is the process of establishing and executing a strategy for managing government debt in order to raise the required amount of funding, achieve its risk and cost objectives and to meet any other sovereign debt management goals the government may have set, such as developing and maintaining an efficient market for government securities. The main objective of public debt management is to ensure that the government's financing needs and its payment obligations are met at the lowest possible cost over the medium to long run, consistent with a prudent degree of risk. Debt management needs to be linked to a clear macroeconomic framework, under which governments seek to ensure that the level and rate of growth in public debt are sustainable. Public debt management problems often find their origins in the lack of attention paid by policymakers to the benefits of having a prudent debt management strategy and the costs of weak macroeconomic management.[137]

The legal framework should clarify the authority to borrow and to issue new debt, invest, and undertake transactions on the government's behalf.

The public debt trend is alarming in some of the countries, questioning its long-term fiscal sustainability, a problem recognized also by international organizations, according to IMF and World Bank. The debt levels vary, with Kosovo having the lowest debt level (around 20% of GDP), while Slovenia is most indebted (around 80% of GDP). The graph shows that the countries are divided into two subgroups, one with debt levels above the Maastricht criteria of 60% of GDP and the other one with debt levels below 40% of GDP. However, the rapid growth of debt since the crisis is a cause of concern in most of the countries.

137 IMF Guidelines

Graph 8: General government gross debt in the SEE 2007-2016



Source: WEO database.

External debt is subject to currency, interest rate and refinancing risk. The average interest rate on the external debt of **Bosnia and Herzegovina** is relatively low, reflecting concessional borrowing and low benchmark interest rates. The average interest rate on external debt fell from 1.5 % in 2015 to 1.42% in 2016, reflecting a trend. Approximately half of the BiH external debt is exposed to interest rate risk as the share of loans with variable interest rates in the structure of external debt is 47.3%, down from 49.8% in 2015. This means that about half of the foreign debt portfolio is exposed to changes in referent market interest rates, while these changes can affect the costs of debt servicing. On average, interest rate refinancing, i.e. changes in foreign debt interest rates takes 4 to 5 years, while the debt to be refixed in Year 1 is 49.9 percent, i.e. 49.9 percent of total foreign debt in 2016 is susceptible to changes in foreign exchange rates. Indicators of risk of refinancing continued to deteriorate in 2016, suggesting that maturities should be extended to mitigate risk.

IFI assessments tend to agree that the level of public debt is not excessive – for example it is well below the Maastricht limit of 60% of GDP – and is sustainable in relation to foreign currency reserves and share of exports. Similarly, at first glance it seems that the level of the consolidated deficit is low (2% of GDP). However, given the structural trade deficit, and the consequently high current account deficit (7.9% in 2015), the economy remains extremely dependent on borrowing to finance current consumption and expenditure as well as existing debt. It is thus extremely vulnerable to external risks (Eurozone rates of economic activity, foreign bank lending). Furthermore, as BiH is unable to borrow on the international capital markets by issuing government bonds the only possible sources of funding remain the IFIs and the domestic capital market. IFI conditionality may in fact threaten public finance sustainability: the downsizing of the public sector reduces government spending, without necessarily replacing it with public or private investment, and thus short-term debt is repaid without checking longer-term rising public debt.

Regarding the DMS, FBiH and RS have common goals; the development of the domestic securities market, especially through the introduction of longer term bonds; the reduction of interest rate, refinancing and currency risk; and preferred borrowing at a fixed interest rate in EUR. RS has a greater preference for variable interest rate borrowing in EUR and USD currencies due to lower costs of variable in relation to fixed interest rates. BD does not plan to issue bonds. However, these strategies are not entirely consistent and moreover represent the composition of separate strategies. Furthermore, the lack of financial integration between the entities, for example in the existence of two separate stock markets, means less liquid domestic financial markets and thus more expensive and more limited sources of domestic lending.

FBiH has chosen a DMS that aims to reduce currency risk, interest rate and refinancing risk and to develop the domestic securities market. According to this preferred strategy external borrowing should be made in euros at a fixed interest rate, where possible, and internal borrowing through treasury bills and bond maturities of 3, 5 and 7 years. Budgetary support will be financed from current receipts, from the IMF from the beginning of 2016, through better conditions - higher grace period and a greater maturity of the principal - and by issuing treasury bills with a maturity of 3, 5 and 7 years. In the period from 2016 to 2018, the government of FBiH is not planning to enter the international capital market by issuing bonds.

RS has chosen a DMS whose main objective is the financing of approved investment projects, refinancing debt and fulfilling budget commitments, at minimum cost and risk, bearing in mind the level of development of the economy and the internal securities market. RS aims to develop the internal financial market by introducing, in 2016, bills of 3, 5, 7 and 10 years maturity with "bullet" repayment. Treasury bills and bonds of 3 and 5 years maturity will be issued to a lesser degree, while 7 and 10-year bonds will be gradually increased over the period 2016-2018. External borrowing will be from multilateral creditors in EUR and USD currencies (at fixed and variable interest rates), with a planned entry onto the international capital market, issuing bonds in 2018, preferably in cooperation with FBiH.

The 'status quo' strategy enables the benefits of the preferred strategy to be assessed in relation to the situation without any change. Bearing in mind that Bosnia and Herzegovina has access to concessional IDA funding sources, the nominal amount of debt and the cost of debt are higher in the preferred strategy than the strategy that is the continuation of the current borrowing policies, while the risk of refinancing and the interest rate risk is lower. The analysis shows that the ratio of debt to GDP is expected to decrease compared to the current situation, while it will slightly increase in relation to the status quo. The average interest rate will increase due to reduced availability of favorable loans and expected increases in variable interest rates. According to the preferred strategy, the cost of funding will rise to 2.3%, which is slightly above the 2.2% of the status quo. The average time to maturity and the average time to re-fix according to the preferred strategy will be extended via greater external borrowing at fixed interest rates and the development of long term domestic bonds. The debt share with fixed interest rate increases to 61.5% according to the preferred strategy.

Under the preferred strategy the share of external debt in total debt slightly increases in relation to the status quo. This is due to domestic market constraints, meaning that external borrowing will need to increase to service the existing debt due and finance investment and development projects in Entities and BD. The share of short-term foreign debt shows an improvement. The projection of debt shows a heightened burden of repayment until 2019, as a result of maturing obligations to the IMF based on the stand-by arrangement (SBA IV), and domestic bond maturities of 5-7 years.

In order to improve debt management, *BiH* needs to conduct an annual review and update of its MTDMS. At present, the MTDMS does not include the entire public debt. It covered 90.1% of the public debt of Bosnia and Herzegovina in 2014. It does not include: external state guarantees issued in Bosnia and Herzegovina; the internal guarantees of entities; internal debt incurred by the direct borrowing of municipalities, cities, cantons, public companies and social security funds. This remaining part of the public debt is not serviced by the budget of BiH institutions, the entities and BD, which is why it is not included in the MTDMS. But the internal debt due to direct borrowing is an increasing share of the debt and has been identified as a growing burden on public budgets.

The 2016 European Commission Progress Report highlights the chronic weaknesses of public finance management in Bosnia and Herzegovina. Given the decentralized administrative structure, public finances continue to be managed on a sub-system basis by adopting separate debt management or internal financial control strategies in the absence of an all-encompassing public financial management reform programme (PFM), although commitments to this end have been recently been made by both the BiH institutions and the entities. The institutions at all levels have considerable weaknesses in internal control and public procurement, making them vulnerable to inefficiency and waste. Social contributions and pension entitlements, which account for a significant portion of public funds, are managed by extra-budgetary funds that are neither integrated into the budget process nor into budget documentation such as the medium-term or annual budgetary outlooks. The inclusion of the pension fund in RS's treasury system as of January 2016 in order to stabilize its liquidity has yet to produce the expected results.

In response to EC recommendations, both entities have agreed to put in place a Finance Management Strategy for the 2016-2020. The BiH Council of Ministers also adopted the Public Finance Management Strategy of the Institutions of BiH for the 2017-2020 period. The Strategy aims at improving the public finance system in order to insure higher functionality, transparency, accountability and efficiency in managing public funds, thus contributing to improving of macroeconomic stability in BiH. It represents one of the key pillars of public administration reform and will be integrated in the new public administration reform strategy in BiH.

The Commission supports the authorities' efforts at fiscal consolidation in the context of the Reform Agenda, arguing for a balance between gradually reducing public debt and supporting growth friendly structural reforms and development projects. The aim is to reduce current spending by 3 percent of GDP by 2019. The public debt ratio should fall by 4 percentage points to reach about 37.6% in 2019. Given BiH's high external debt service obligations and limited access to financing, combined with the need for fiscal policy to support growth, there is a balance of payments gap estimated at about 5½ percent of GDP through 2019.

The strategy for the management of the national debt in **Bulgaria** shows the size, legal restrictions, eventual sanctions for non-published information, economic expectations, risks, but even there the sources for the repayment of the debt are not indicated. The prognoses show gradual reduction of the national debt to 25.15% of GDP by 2019. The reduced debt to GDP ratio is expected to be the result mainly of the increased GDP- 2.7% in 2018-2019. FDIs are also expected to return. Reasons for optimism come from the data about the budget balance from the end of 2016. For the first time since 2008 the budget ended with a surplus of 750 million euro. This is, however, due to frozen social spending and the chronic underfinancing of the public systems. The Strategy envisages new loans to be taken only in case of necessity to refinance the debt, to cover liquidity needs of the budget and depending on the current state of the fiscal reserve. In addition to these factors, the two clearly indicated objectives of the national debt are- financing the National program on energy efficiency of multifamily buildings and co-financing projects under the European Cohesion policy. This conservative approach is explained with the need of "market-oriented debt financing". The challenges posed by this approach include: Significant grey economy- research shows that the size of the non-formal sector is 30-35%; Tax evasion- several practices of tax evasion were revealed in the past few years; a fragile tax system- the main revenue to the budget is from indirect tax. On the one hand, this affects the sustainability of the state treasury as lower consumption leads to lower revenues. On the other hand, the flat tax on persons without non-taxable minimum income puts disproportionate pressure on the most vulnerable households. Until recently the corporate tax in Bulgaria was the lowest in all EU. Lowering the tax was framed as the most-efficient way of bringing economic growth and attracting foreign investors. None of the two objectives was achieved but rather revenues to the state budget were weakened and deficits had to be covered by taking debt.

The strategy for the management of debt 2017-2019 and the annual report of the European Commission point towards sustainability of the debt. Unlike them the reports of the IMF reveal some challenges to the financial system such as the high rate of non-performing loans. They also underline the need for stricter control on the deals between insiders and credit concentration. According to the IMF in case of a new bank crisis it will be difficult to provide quick liquidity in sufficient amounts, which would in turn require restructuring and supporting specific banks.

Although **Kosovo**, based on estimated data, is fairly stable in terms of public debt, the country is nevertheless challenged with debt sustainability. According to the World Bank, Kosovo possesses limited, but growing state guarantees and negligible municipal debt. In terms of borrowings, the government completely relied on foreign borrowings, secured from the international financial institutions. Whereas in 2014, the structure of government borrowing tended to complete dependence on domestic borrowing, in 2015 the newly compiled IMF programme triggered the government's return to foreign borrowing. Despite its inexpensiveness and its sensitiveness towards political uncertainty, the domestic financial market in Kosovo remains shallow. Although Kosovo has witnessed an increased debt level, the country is classified, compared to the region, as the country with the lowest public debt levels (only 14.3 % of the GDP in 2016). Bearing that in mind, Kosovo remains relatively far from exceeding its level of public debt in relation to GDP, considering that the established fiscal regulation, regulating the public debt, stipulates that the highest levels of general public debt shall not exceed 40% of the total GDP. Countries like Kosovo, characterized with a low development, are stimulated to increase their public debt levels. Nevertheless, it should carefully manage the debt received from international financial institutions. As such, rather than spending it on salaries or social transfers Kosovo should invest in projects that yield financial benefits.[138] In a similar vein, Kosovo has increased its spending on salaries and social transfers for the past two years, thus impairing capital investments. To illustrate this, in 2013, public investments reached 10.1 % of the GDP, while in 2017, such percentage decreased to 7.7%. Yet, while public spending on salaries, in 2013, accounted for 7.9 % of the GDP, and that of social subsidies reached 4.2% of the GDP, Kosovo has increased the spending on the two, to 9.2% and 7.4 respectively. As such, according to Demi, being of the opinion that Kosovo has the highest economic growth hasn't done any good to its citizens, defining such perspective as an "only a desperate attempt to grab on to a positive indicator, which at the end of the day has not brought any improvements to the life of citizens in any way."

In **Macedonia** Public debt management policy is set for a period of three years and it is part of the Fiscal Strategy of the Ministry of Finance. Public debt management policy includes the following: determining the level of the amount (limit) of public debt in the medium term; determining the maximum amount of new borrowing in the first year which the Fiscal Strategy refers to; and determining the maximum amount of newly issued sovereign

138 Insufficient Growth", Agron Demi, Prishtina Insight, May 2017

guarantees in the first year which the Fiscal Strategy refers to.[139] According to World Bank report (2015), debt management and debt reporting have evolved over the past years. All debt management functions were transferred to the Ministry of Finance and there is a new system that is comprehensive and covers all front, middle and back-office functions. Debt is being monitored at the central and local government level by institutions, by stock, flow, interest, and currency. It includes all debt (loans and guarantee) instruments. Recently, the MoF included explicit targets for refinancing needs, interest payments and currency risks in the debt management strategy that accompanies the medium-term fiscal strategy. In an effort to further strengthen debt management and reduce risks, the authorities could consider strengthening the strategy by including information on the debt of SOEs as well as contingent liabilities, particularly to manage currency risk. In 2011, in the Public Debt Law a change was introduced in order that the Public debt strategy be part of the Fiscal strategy of the Ministry of Finance, as Public debt policy.

Given the high global economic and financial uncertainty, assessing a country's external and fiscal sustainability is of great significance. The need for this type of assessment is crucial for Macedonia, since the country is a small and open economy, with a fixed exchange rate regime. The analysis of sustainability of debt has long-term and strategic nature and its purpose is to assess the country's ability to finance its programs and activities and repay the incurred debt without major adjustments in the budget revenues and expenditures that may impair macroeconomic stability.[140] Lately, worldwide and in Macedonia, there is a quite popular discussion on "prudent" limits on the amount of public debt, on the amount of public debt as a percentage of GDP in order to be sustainable in the long run with no negative repercussions on long-term economic growth. In this context, it is important to distinguish between developed countries or developing countries. For developed countries, studies show and refer to the prudential limit of 60% of GDP (this coincides with the Maastricht criteria). In less developed countries and developing countries the prudential limit is estimated at 40% of GDP. Accordingly, the country's public debt of 47.6% of GDP[141] already exceeds this limit. There aren't many empirical analyses that touch on the problem of Macedonia's fiscal sustainability. In the analysis of public and external debt sustainability, the National Bank of the Republic of Macedonia is actively using the IMF's DSA framework. The IMF's Debt Sustainability Analysis (DSA) framework, in the case of external sustainability, provides analysis of the factors that drive public debt dynamics.[142]

139 Public Debt Law - cleared version - "Official Gazette of the Republic of Macedonia" no. 165/2014

140 Public Debt: Currrent situation, challenges and possible solutions, prepared by Kire Naumov and Nikola Popovski

141 According to the announcement of the Ministry of Finance on March 24, 2017, it is reported that after publishing the data on GDP (revised by the State Statistical Office), the Ministry published on its website the revised data for public and state debt according to the data of the SSO. Accordingly, it is necessary to take into account that small variations in the data for 2016 in this study are possible, compared with those published by the MoF, due to the aforementioned adjustments with the SSO in relation to GDP.

142 Transmission of external shocks in assessing debt sustainability, the case of Macedonia, prepared by Danica Unevska Andonova and Dijana Janevska Stefanova, 2015

In Macedonia, as we can notice from the data released by Research Center for Computer Science and Information Technology (MASA), the average interest on debt was 3.3%, and by one percentage point higher than the average growth rate in the last five years. In other words, the capacity of the economy to repay this debt grows at a slower pace than the debt. The IMF and the World Bank also warned that the dynamic of the debt growth presents a cause for concern and imposes the need for higher caution in the management of public finances in order not to endanger their sustainability. The International Monetary Fund has demanded that the government in Macedonia take urgent measures in order to cut expenses, to start a fiscal consolidation without delay and suggests that public debt should be below 50% of GDP. According to IMF predictions, this year will mark a 2.2% economic growth. Public debt this year will be 47.9%, while in five years it will go up to 54.7% of GDP.

Montenegro is highly-indebted country. Its public debt increased three times over the last decade and reached 2.5 billion Euros at the end of 2016 or 68% of the GDP. The main burdens to the budget include construction of the highway, interest rates for previous loans, state guarantees for private companies and salaries for oversized public administration. The Parliament did not conduct oversight in this area, while the Government frequently ignores findings of the State Audit Institution. The Government does not provide clear public debt prognoses, only measures for its management - rationalization of the public sector wages, harmonization of tax policies and improvements in tax collection. However, international financial institutions estimate that the public debt might reach 3 billion Euro or nearly 90% of the GDP in the following three years. It is expected that *Montenegrin* public debt will increase in the following years. According to the International Monetary Fund, government debt is projected to increase to 82 % of GDP by 2019 or 89% including all issued guarantees. While the highway will bring some economic benefits, it is provided with significant subsidies and exemption of taxes and customs for goods and services needed for the construction and fees and benefits for employees working on it. The very high costs of that project will limit the Government's ability to undertake other important investments and expose the economy to risks. The government has not managed so far to be fully consistent with the legislative and strategic framework on management of the public debt. The Law stipulates that in order to remove risks of public finance instability, the Government will, in the event that the public debt reaches 60% of GDP, adopt a proposal of the law amending and supplementing the State Budget Law to ensure maintaining the debt within 60% of GDP. However, this has not occurred so far, although public debt exceeded the prescribed percentage of the GDP by the end of 2014.

As recognized by the Debt Management Strategy, the main challenge for the sustainability of state budget is a loan taken for construction of highway Bar-Boljare. Therefore, instead of reducing public debt, its further increase is envisaged. Public debt will trend upwards in the coming years as the Government continues disbursing the highway construction loan, according to World Bank projections. "Even under the government medium-term fiscal scenario, public debt will grow to 79 percent of GDP by 2019. Under the current policies scenario, public debt is estimated to peak in 2018 at close to 80 percent of GDP, before stabilizing. However, this is based on the assumption that the highway construction would end by 2018 and that deficit will be around 8 percent of GDP in the 2016-18 period. There are number of additional risks to this scenario. The largest comes from a potential growth shock. If growth stagnates in the 2016-2020 period instead of expected over 3.5 percent average growth per year, public debt to GDP ratio would surge even further to close to 90 percent of GDP."

There are further risks for the reduction of public debt in the next several years. Firstly, the World Bank believes that fiscal and debt levels are highly sensitive to shocks related to real GDP growth, financing costs, contingent liabilities, primary balance, exchange rate and most notably to an overrun in financing costs associated with the highway, which is why debt levels and financing needs far exceed those assumed by the authorities. Secondly, debt exposure to the US dollar-denominated highway loan and recent social and public wage policy measures place addition burden on public finances and contribute to public debt increase. Finally, historical performance suggests that government deficit targets are typically missed by a large margin (2-3 percentage points of GDP on average per year since 2008) due to over-commitments (public arrears estimated at close to 11 % of GDP) and contingent liabilities (like guarantees repayment or court suits). Although the Government prepared a medium-term fiscal framework for 2016-18, as noticed by the World Bank, the World Bank also suggests a further rise in the fiscal deficit underpinned by large capital investments and further consolidation of current spending. Through this fiscal framework, the Ministry of Finance announced a set of fiscal measures to achieve current spending consolidation: (i) public sector wage system rationalization; (ii) further harmonization of the excise tax on cigarettes; (iii) stricter sanctioning of tax non-payers and a fight against the informal economy; (iv) new pension indexation and streamlining early retirement options; (v) collection of tax debt through debt-equity swaps and offering a discount for one-time settlement; and (vi) improving the regulatory framework for public procurement.

Serbia is a highly indebted country. Its structural imbalance and heavy reliance on imports is the main reason why the level of debt that Serbia has in period after 2010 is hardly sustainable. To reduce fiscal pressure the Government of Serbia, under the close observation and support of IMF and World Bank, has initiated a restructuring process that had as it main goal reduction of spending mostly in form of pensions that are considered as the main budgetary burden. The goal of such fiscal tightening is that actually the ratio of pension would be below 10% of GDP. As shown by S. Komazec and Radenkovic, after 2012 and especially after 2014 with the SBA, IMF deflationary policy targeting low inflation rates is in place in Serbia. Since 2012 Serbia is involved in structural reforms in line with IMF and World Bank advice, implementing significant fiscal adjustments in recent years and achieving debt stabilization.

The IMF Article IV 2017 concludes that the implementation of previous recommendations (Article IV consultation in February 2015) aimed at reducing fiscal deficits and restoring public debt sustainability, boosting financial sector resilience, and strengthening competitiveness and growth has been strong, supported by the 36-month SBA approved concurrently. Strong fiscal adjustment has continued, reducing debt sustainability risks. General government debt followed a sharp upward trajectory since the global financial crisis, reaching a high of 76 % of GDP in 2015- more than double its 2009 level. Expansionary fiscal policies, sluggish output growth, a rise in government guarantees to large SOEs and local governments, high real interest rates and a significant exchange rate depreciation- all were significant contributors to the increase. External public debt accounts for 60 percent of the total, while more than 75% is denominated in foreign currencies. Most external debt is owed to multilateral and bilateral creditors (61 percent of total external public debt), which has helped Serbia keep interest costs relatively low. However, the share of market debt has been increasing rapidly since the first Eurobond issuance in 2011 Domestically-issued debt, dominated by Treasury bills and bonds with maturities above 12 months, increased as a share of total debt significantly over the last five years. In the DSA, the IMF states that Serbia faces risks to debt sustainability despite the significant fiscal adjustment assumed in the baseline scenario. Even though Serbia's public debt is estimated to go down from its current level of 74 % of GDP to 54½ % of GDP by 2022, public debt and gross financing needs are still high and; thus, still exhibits vulnerabilities under all shock scenarios.[143]

Regarding debt sustainability in **Slovenia**, the IMF reports that historical debt dynamics in 2013–14 were dominated by the impact of bank restructuring and are thus unlikely to occur again given the banks' good health. Slovenia's relatively high public debt ratio remains vulnerable, while debt service is projected to remain manageable, even under the stress scenarios. In other words, as the European Commission states in its semester report, "a prolonged recession coupled with significant bank recapitalizations has resulted in a sharp rise in public debt in recent years. The fiscal framework reform, which provides an important anchor for sustainable public finances, is yet to be fully implemented." Slovenia achieved substantial fiscal consolidation during and after the 2012–2013 crises with a mixture of tools, many of them of a one-off nature. The budget's structural primary balance improved by 4½ percentage points of GDP between 2011 and 2016 reaching a surplus of 1.4 % of GDP. Consolidation was achieved by a mix of structural measures (such as a VAT increase, pension reform, and debt management operations) and crisis-motivated fiscal restraint (one-off freezes on the wage bill, pension and other social transfer indexation, as well as

143 More information available in: Article IV 2017

a squeeze of non-EU-financed public investment). After peaking at 83 % of GDP in 2015, public debt declined last year for the first time since 2008. A reform-based consolidation strategy is needed to keep debt on a downward path, create room to counter any adverse growth shocks, and address future demographic challenges. Fiscal consolidation continued in 2016, as Slovenia exited the EC's Excessive Deficit Procedure (EDP) when the cash budget deficit measured a below-target 1.8 % of GDP.

But Slovenia still faces high sustainability risks over the medium and the long term due to the high initial debt-to-GDP ratio, the unfavorable initial budgetary position and the strong projected impact of age-related public spending (notably pensions, healthcare and long-term care). In the Debt sustainability Monitor 2016 of the EU, Slovenia is classified as high risk with substantial long-term sustainability challenges, facing also rising costs from ageing and the Monitor detects the need for further fiscal consolidation and reforms of welfare systems to keep age-related expenditures (pensions and health care) under control, in order to bring future liabilities in line with the capacity to generate assets. However, regarding the medium-term sustainability risk (S1), Slovenia has moved downward from high to medium sustainability risk.

IMAD/UMAR calculated in its forecast report that, owing to the debt increase in recent years, the average annual contribution of interest will remain almost unchanged despite the lowering of the implicit interest rate and favorable borrowing terms. Regarding debt sustainability the IMF reports that historical debt dynamics in 2013–14 were dominated by the impact of bank restructuring and are thus unlikely to occur again given the banks' good health. Slovenia's relatively high public debt ratio remains vulnerability, while debt service is projected to remain manageable, even under the stress scenarios.[144] In other words, like the European Commission states in its semester report that "a prolonged recession coupled with significant bank recapitalizations has resulted in a sharp rise in public debt in recent years. The fiscal framework reform, which provides an important anchor for sustainable public finances, is yet to be fully implemented."[145]

A good example of promoting and implementing the EU policies related to privatization is a report, the View of the Bank of Slovenia, conducted in 2014 on strategic challenges for economic policies in Slovenia. It promotes and establishes a new institution, Slovenian Sovereign Holding (SSH) in 2014 to implement the divestment, privatization of state owned companies. In this context, the main argument the government uses in support of privatization

144 IMF, 2017, Republic of Slovenia: 2017 Article IV Consultation-Press Release; Staff Report; and Statement by the Executive Director for the Republic of Slovenia. Annex V. Public-Sector Debt Sustainability Analysis available in: http://www.imf.org/en/publications/cr/issues/2017/05/15/republic-of-slovenia-2017-article-iv-consultation-press-release-staff-report-and-statement-44921 and at:
https://ec.europa.eu/info/sites/info/files/2017-european-semester-country-report-slovenia-en.pdf

145 European Commission, Country Report Slovenia 2017: Including an In-Depth Review on the prevention and correction of macroeconomic imbalances. Commission Staff Working Document. 22.2.2017, Brussels, available at: https://ec.europa.eu/info/sites/info/files/2017-european-semester-country-report-slovenia-en.pdf

is a reduction of the high public debt through selling off state-owned companies. Another commonly heard argument is that Slovenia promised to the international community to privatize state-owned companies.

Apart from giving BAMC a visible role in the bank system reform and hence in the Slovenian economy, it is also worrisome that the government decided to put foreign managers in control of BAMC at its beginning. What was troubling was that the selected managers have an obvious connection to the "Troika" institutions - ECB, European Commission and IMF.

One of the outcomes of the bank restructuring was a formation of the Bank Assets Management Company (BAMC) and Slovenian Sovereign Holding (SSH) in 2014 as measures to solve the banking and sovereign debt crisis. The lack of transparency over the functioning of the BAMC raises concerns and it is an on-going issue for the BAMC.

The power of the Slovenian central bank is enormous and there are no institutional safeguards. The oversight of the Bank is very limited or even nonexistent. The governor Boštjan Jazbec and his team of Vice governors have been shaping Slovenian destiny in recent years much more than any Slovenian government. As it is now revealed by a criminal investigation of the Bank of Slovenia, the governor had a final say in calculating the Slovenian banking "hole" through conducting a system-wide bank asset quality review – stress-tests.

However, also here in calculating banks non-performing loans the national political and financial elite cooperated fully with the European Commission and ECB suggestions and guidelines. Therefore, based on a new devastating scenario our banks were to be recapitalized for more than 3 billion euro after the transfer of assets to BAMC. On the basis of the Governor's instructions, for instance, the very costly consultants (30 million euro) calculated NLB (New Ljubljana Bank) equity value at 1.55 billion euros. The size of bank hole also determined the level of government borrowing - public debt, and thus directly affecting the scope of welfare state. The bigger calculated banks' deficit is also consequently related to cheap sell-off of non-performing assets (bad loans) through BAMC and selling of companies. Moreover, Slovenian economist Velimir Bole at the Economic Institute EIPF calculated in 2017 that an artificially made panic, dramatization, during the crisis cost us in dealing only with our banks, NLB and NKBM 2013, at least 1.5 billion euros.

Nevertheless, now we are witnessing the criminal investigation of the Bank of Slovenia and its governor. Investigators are looking for whether public funds invested into the NLB alone too much of public money. According to their findings, the methodology was created promptly at the meetings of the Steering Committees, managed by the governor, now accused of the abuse of power and position. Because of the criminal investigation the ECB's president sent protesting letters. Moreover, a member of the ECB's Executive Committee, Yves Mersch, in May 2017, sent a letter to the Slovenian Parliament President, Milan Brglez, in which on behalf of the ECB he opposed the current change of legislation to the new law on the Bank of Slovenia. It is noticeable from Milan Brglez reply that ECB "requires… re-consultation with the ECB".

Conclusions

- The studies carried out for this report considered, on the one hand, the national public finance contexts and, on the other, the relevant policy prescriptions of the IFIs, EU accession requirements, and the developments in Eurozone/EU monetary and fiscal policy, in the following areas: fiscal consolidation and accumulation of a primary surplus; fiscal rules and pro-cyclical fiscal policy; transparency and accountability of governance of public finance; participation of CSOs and the public more generally in monitoring public finance; consolidation of public spending as the basis for increased capital investment; fiscal consolidation and restructuring of the public sector to increase competitiveness and growth; financing and nature of capital investments.

- What emerges are some striking differences of opinion regarding IFI policy prescriptions and EU accession requirements in the area of public finance, based on differing assessments of their impacts in different national contexts, but also in relation to the priorities and needs of partners operating in these different contexts. In this dialogue between various ways of thinking about public finance the report carries out the duty of the CSO sector to monitor public finance, stages a debate that is sorely lacking in the public sphere of the region, and thereby contributes to citizen participation through better education of the issue involved.

- However, there were some areas of overlap in two important areas, which are unique in the existing CSO engagement in these issues. Firstly, the importance of informed participation by citizens in the affairs that directly concern them, through citizen debt audit mechanisms, that go beyond the need for independent institutional audit of executive bodies charged with public finance and enable a structured approach to CSO monitoring. Secondly, the importance of the reform of the tax system, not in terms of budgetary savings, but in financing public investment in jobs and growth; that is as one of the pillars of public finance sustainability.

- **The pre-crisis years were favorable for the Balkan countries in the fiscal area.** As in many emerging economies, but more generally in the Eurozone periphery, growth was based on an unsustainable model of finance and import led growth, concentrated in the real estate, service and consumer sectors, at the expense of capital investment in domestic manufacturing or public sectors. Capital flows thus fed positive global expectations and developments, as well as solid economic growth in the region (the average growth in the pre-crisis period 2002-2007 was around 5%) led to a stable period and positive budget outcomes, resulting in periods of balanced budgets and even surpluses in some of the countries. The debt had a general downward trend, falling from an average of 52.8% of GDP in 2002 to an average of 28.2% of GDP in 2007 (lowest – Bulgaria 17.6%).

- **The onset of the crisis in 2008 revealed underlying fiscal vulnerabilities in many emerging European countries. A sharp decline in capital inflows led to economic recessions and modest recoveries thereaft**er. In this context, part of the revenue surge of the boom years turned out to be temporary, and, together with rising expenditures to cover increased social security payments, and in some countries bank bailouts, set the stage for large deficits across the Balkan countries (especially Western Balkans).

- **The average debt in the analyzed countries went up from 25% of GDP in 2007 to 51% in 2016.** Kosovo is the only country that has managed to keep debt lower than its pre-crisis level. All other countries are struggling to get their fiscal positions back on track. Slovenia experienced the largest jump in indebtedness by 61 p.p. from 2008 to 2015 (from 22% to 83% of GDP).

- **The rising trend triggered alarm bells concerning the long-term sustainability of public finances, especially given that the debt tolerance level is lower for lower income economies.** *This makes this unique analysis even more desirable and significant. Unsustainable public finances and rising public debts are a threat to some of these countries. Thus, closely monitoring the debt movements is necessary and a timely response to unsustainable developments is of crucial importance for maintaining macroeconomic stability*.

- **All the countries except Montenegro narrowed their fiscal deficit in 2016, showing signs of fiscal consolidation.** The average deficit in the countries of interest fell from 3% in 2015 to 1.6% in 2016. Montenegro's deficit remains almost unchanged at 6% of GDP. However, the average projected deficit for 2017 is 2.3% of GDP.

- **Almost all the countries have a Law on borrowing or public debt (except Montenegro).** Concerning public debt management, most countries have developed medium term public debt management strategies.

- **All countries except Macedonia have adopted fiscal rules.** Most of these rules are amendments to budget laws that introduce numerical targets to ensure long-term fiscal sustainability, discipline, and transparency. Fiscal rules in Bosnia and Herzegovina and Kosovo target only the central government budget, deficit, and debt levels; in Montenegro and Serbia they also apply to local governments. A common feature is that the fiscal rules apply only to public debt—not arrears or liabilities stemming from public guarantee for companies or public-private partnerships (PPPs). For Macedonia preparations for the introduction of the fiscal rule, planned for the beginning of 2017, are still on hold.

- **It should be noted that some of the countries have established a Fiscal Council.** In Bosnia and Herzegovina, a Fiscal Council was set up in 2008 and in Serbia in 2011. Bulgaria and Slovenia have ratified the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, the fiscal component of which is the Fiscal Compact. Following that, Bulgaria enacted the law on Fiscal Council and automatic corrective mechanisms and established a Fiscal Council and nominated its members in 2015, while Slovenia established the Fiscal Council complying with the Fiscal Rule Act adopted in 2015, but nominated the council members much later, in March 2017.

- **All the countries have some type of an independent audit body.** In *Bosnia and Herzegovina*, all four main government levels have their own SAIs (supreme audit institution), each with its own laws and regulations in this area. In *Bulgaria*, the National Audit Office (hereinafter NAO) is the body that exercises control over the implementation of the budget and other public resources. The State Audit Office (SAO) is a supreme audit institution in *Macedonia*, which provides support to the Parliament for execution of its jurisdiction, through identification and presentation of irregularities and illegal operations of audited entities, uncovered by the performed audits. In *Montenegro*, the State Audit Institution, which is by Law an independent and supreme state audit body, is in charge of analyzing the state budget. According to article 92 of the law on the budgetary system that regulates external audit, the annual financial statement of the Republic of *Serbia* and annual financial statements of the organizations for mandatory social insurance shall be subject to external audit, pursuant to the provisions of the law regulating the jurisdiction the Supreme Audit Institution.

- At present the mechanisms for enabling the CSO sector to participate in the monitoring of public finances are weak and far from transparent. Governments that in some extent provide mechanisms for CSO oversight must be obliged to demonstrate that CSO feedback has been considered and provide justifications concerning whether or not it has been taken into account in the framing and execution of policy.

Recommendations

1. Strengthening Public Debt Management Mechanisms

- **Inclusion of all liabilities of public institutions in legal definition of public debt**

  The scope of public debt under the legal framework should ideally cover all debt instruments representing liabilities of the public institutions defined in the law. It should encompass the main financial obligations over which the central government exercises control, including both marketable and non-marketable debt. Only once all liabilities are included is it possible to assess the fiscal position of the government and thus properly manage public finances.

2. Greater Transparency and Accountability in Public Finance

- **CSOs participation in monitoring public finances**

  Governments must systematically introduce mechanisms enabling the CSO sector to participate in the monitoring of public finances, from the performance of budget execution to reviews of budget and tax policy. Greater participation by citizens in affairs that directly concern them is in itself a public good and is a stimulus to greater transparency and accountability in public finance.

- **Independent and Public Auditing of Public Debt Management**

  The debt management activities should be audited annually by external auditors and audits of government financial statements should be conducted regularly and publicly disclosed. The State Audit Office should have a legal obligation to inform and educate citizens in finance issues, of the fiscal performance of government and state institutions, and of the work of the audit office itself.

- **Development of a Citizens debt audit mechanism and publication of a Citizens budget to fully involve the public in public finance monitoring**

  There should be legally enshrined regular and independent mechanisms for public involvement in auditing public debt. In order monitor the movement of public finances and to ensure long term fiscal sustainability there should also be similar mechanisms for public participation in the budget process and in the formulation of the public budget.

- **Introduce a legal obligation of governments to publish Pre-Budget Statements**

  In order to enable the public to participate in the formulation of alternatives, governments should publish Pre-Budget Statements and **provide fully comprehensive supporting budget documents** (mid-term budget framework, fiscal strategy, EU PEP-pre-accession program, etc.), as well as to provide additional detailed information on the proposed budget that will allow easier monitoring of the effects of the budget and determining the fiscal position of policy makers. Similarly, governments should provide the public with regular public debt management reports which list the different components of the debt, how they are financed and at what cost to the public. In order for this information to assist public deliberation governments must be legally obliged to regularly inform the public as to the basis of state finances in relation to taxation of incomes, business, consumption and excises.

- **Introduce a legal obligation of governments and legislatures to formally consider and respond to 1) the findings of the State Audit Office report on the budget, and 2) to the Citizens Debt Audit, and 3) Citizens Budget**

  Without a legal framework, there is no mechanism that can hold governments to account for their fiscal policy, whether from the side of the executive (audit office) or civil society (citizens audits), between elections. Such a framework would serve long term fiscal sustainability by enabling regular deliberation by legislatures on policy efficacy and alternatives.

3. Independent and fair procedure for debt resolution

- At present mechanisms to resolve public debt crises are led by creditors, based on ad hoc procedures and ignore the issue of whether the debt is unsustainable or illegitimate. The sustainability of debt is only seen as a financial problem, ignoring development needs and human rights obligations. A sustainable solution to public debt requires an international mechanism that:
  - is based on **an independent and fair procedure for debt resolution, which should assess the legitimacy and the sustainability of countries' debt burdens**;
  - takes into account legal human rights obligations, including provision of essential services, when assessing a government's capacity to service its debt, and considers the impact of ongoing debt servicing, hence **supporting a human rights-based approach to debt sustainability**;
  - holds lenders and borrowers to account for irresponsible behavior by auditing the legitimacy of lenders' claims and **demanding the cancellation of unjust debts based on corrupt, irresponsible or undemocratically contracted loans which did not benefit the people of the borrowing country**; **gives all stakeholders, including civil society, the right to participate in the resolution of public debt crises through the mechanisms of the citizens debt audit and citizens budget.**[146]

146 More information available at: http://www.eurodad.org/debt

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