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Public Finances on the Balkan Peninsula – A Comparative Study of Twelve Countries

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Abstract

Over the past three decades the Balkan countries have experienced a range of transformations, from a change in political and economic governance in some and difficult early years of transition to stabilisation and an accelerated economic growth, crisis- and post-crisis periods, with certain countries going not only through hard economic times but also through political, including military, turmoil. This poses major challenges for their fiscal policies, to the extent that these developments affect the fiscal sector and its governance both directly and indirectly. After a period of enhanced revenues that helped finance higher spending, the Balkan countries like the European Union countries and the rest of the world have been enduring severe recessions during the years following 2008. Falling revenues and rising spending needs together have put heavy stress on fiscal balances thus reflecting in a serious increase of government debt. Despite the subsequent recovery in public finance, public sector governance in later years again faces serious challenges such as mitigating the consequences of the COVID-19 pandemic, while at the same time certain Balkan countries continue to experience serious economic problems. The aim of this paper is to offer a comparative study of public finances in twelve Balkan counties and provide an overall picture of fiscal policies implemented in these countries during the period 2004—2018.

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INTRODUCTION

The Balkans are often described as a contradictory region that, considering its small size, concentrates a huge conflict potential, historical baggage and political tension. Tracing indisputable boundaries in the Balkan Region is hampered to a certain extent by the fact that the natural geographic borderlines of the Balkan Peninsula do not coincide with state borders. The definition of a region's borderlines is the result of "the geographic proximity factor as much as it is the result of other factors such as the cultural, social and economic similarity among countries, the economic flows among them and the foreign policies they implement" (Moraliyska, 2014). According to Karastoyanov and Popov, "the Balkan countries are a geographic space that is unique in its features and stands out with a range of specific characteristics in terms of political space, culture and history" (2011, p.23). The spatial scope of the Balkan Region covers not only the states that are located in their entirety on the Balkan Peninsula such as Bulgaria, Greece, North Macedonia, Albania, Bosnia and Herzegovina, and Montenegro, but also Slovenia, Croatia, Turkey and Romania, the territories of which are only partially located on the Balkan Peninsula. The Balkan Region spans across South-Eastern Europe and the south-west peripheral parts of the Asian continent where Turkey is located. The area of the Balkan Region includes, in full or in part, 12 countries. The Balkan Peninsula is the region's heartland but in terms of territory, it takes up only one-third of the Balkan Region.

Over the past three decades the Balkan countries have experienced a range of transformations, from a change in political and economic governance in some and difficult early years of transition to stabilisation and an accelerated economic growth, crisis- and post-crisis periods, with certain countries experiencing not only economic hardship but also political, including military, turmoil. This poses major challenges for their fiscal policies, to the extent that these developments affect the fiscal sector and its management both directly and indirectly. It could be said that at the start of the new millennium the Balkan countries in general are seeing an overall stabilisation of their economic and political situation. Following a period of intensive economic growth until 2008 which had a positive effect on public revenue and spending as well, the Balkan countries, just like the EU, are experiencing a period of slow-down in economic activity. Currently, the Balkans are faced also with new serious challenges such as the wave of refugee since the main route of migrants to Central and Western Europe crosses the region, and the Balkan countries, and in particular Turkey, are suffering some of the gravest economic consequences of the current wave of refugees. Another challenge comes from the emerging future fiscal risks for the economies caused by the COVID-19 pandemic. To start with, the most serious of these has to do with the need to relocate increasing amounts in the government budgets to finance various healthcare activities. Next in terms of significance is need for fiscal governance to be able to respond in a timely manner to the capacity to allocate budget funding to make an increasing number of social payments, in view of the realization of unfavourable forecasts for rising unemployment rates and the growing number of people who need financial aid. Social systems experience an additional burden from the worsening demographic trends and the increasing life expectancy, with a gap that has appears to be growing.

Existing research in the problem area tend to focus on a more limited range of countries. In particular, some of the authors place the stress on examining fiscal governance in the so-called Western Balkans, which encompasses states that are potential candidates for EU membership such as Albania, Bosnia and Herzegovina, Kosovo, North Macedonia, Serbia and Montenegro. A core subject of those studies are the fiscal vulnerabilities and the possibilities to strengthen fiscal discipline with a view to the future EU accession (Teqja and Polena, 2015), and the impact of the global financial crisis on their economies (Bartlett, 2010). An evaluation of fiscal policies pursued on the Western Balkans during the various stages of the economic cycle in the period 2000—2015 and a comparison to the experience of new EU member states are provided also in an IMF study (IMF, Working Paper 15/172). In another group of studies, the analysis focuses on the countries that joined the EU most recently, i.e. Bulgaria, Romania and Croatia (Vasiloiu, 2019). There is also research (Gechert and Ansgar, 2015) where the focus is on fiscal challenges faced by countries that are already part of the Euro area, and studies on the impact of fiscal policy on macroeconomic aggregates in Turkey (Karagöz and Keskin, 2015).

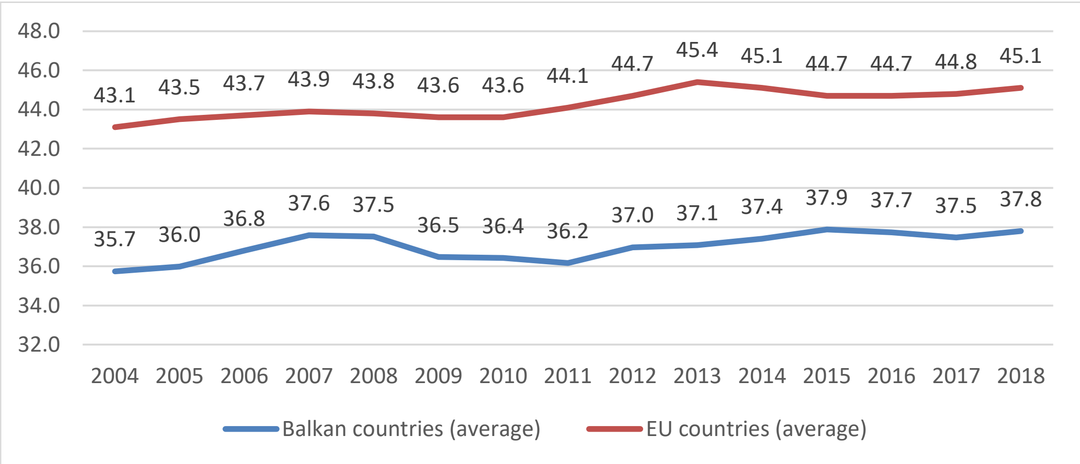
This paper aims to provide a brief comparative overview of the current status and the development of public finance in 12 countries in the Balkan Region in the period 2004—2018, namely Bulgaria, Romania, Slovenia, Croatia, Greece, Serbia, North Macedonia, Kosovo, Albania, Bosnia and Herzegovina, Montenegro and Turkey. The first five are EU member states, while the rest are potential members. Part One describes the developments in public revenue and presents the mix of tax revenues of the Balkan countries by main types of taxes. Part Two traces the dynamics of public spending over the same period and presents their structure as per the economic and functional classification. Part Three analyses budget balance dynamics in the countries under examination.

The data sources used to obtain the information necessary for the study include statistical international databases of the IMF, World Bank and Eurostat. To obtain additional data for certain periods or countries, the official websites of local institutions such as ministries of finance, statistical offices, central banks, etc. have also been used.

Dynamics in public sector revenue

Developments in the size and structure of public sector revenue of the Balkan countries in the period 2004—2018 are largely due to their fiscal policies aimed at promoting investment and economic growth. These policies are manifested in the adoption of relatively low tax rates and expanding the tax base. Changes in the business cycle stages, and in particular, the global financial and economic crisis, also affect the dynamics of budget proceeds via the automatic fiscal stabilizers and via the discretionary measures undertaken. As a third determinant, one can be highlighting the consolidation of public finance in the post-crisis years.

In the period under examination, public revenues of the Balkan countries in general remain at relatively low levels compared to EU member states. Nevertheless, there are distinct fluctuations, in line with the cyclical changes in the economy (Figure 1). In the period from 2004 to 2007, the General Government sector revenue share in GDP terms grew from 35.7 % to 37.6 % on the average. Considering the fact that, in that period, the tax policies of most of the Balkan countries was aimed at reducing the tax burden, the observed growth in fiscal revenue should be attributed largely to cyclical factors, and in particular to a strong growth in GDP and in consumption. These cyclical factors are particularly manifest in Montenegro, and less so in Kosovo and Albania (Koczan, 2015, p. 6). The period from 2008 to 2011 exhibits a decrease in public revenue in the Balkan countries to 36.2 % in GDP terms, due to the decline in economic activity following the onset of the global crisis. In the following years, fiscal proceeds revamped and in 2018 stood at 37.8 % in GDP terms on the average. Throughout the 2004—2018 period, EU countries stand out, with a significantly higher level of public revenue in GDP terms. The average figure is 43.1 % for 2004 and 45.1 % for 2018, respectively. It is noteworthy that in both groups of countries the share of public revenue in GDP grew by about 2 percentage points over the analysed period.



Source: See Appendix 1, author's calculations

Figure 1. General Government sector revenue (% of GDP)

Despite the relatively low average of public revenue, significant differences are observed among the Balkan countries. As shown in Table 1, in 2018, the contribution of public revenue in GDP was the highest in Greece and Croatia, where it exceeds the EU average. In Slovenia, Bosnia and Herzegovina, Serbia and Montenegro, the share of revenue is also above 40 % of GDP. In the same year, Kosovo and Albania have the lowest public revenue-to-GDP ratio, at below 30 % in both countries.

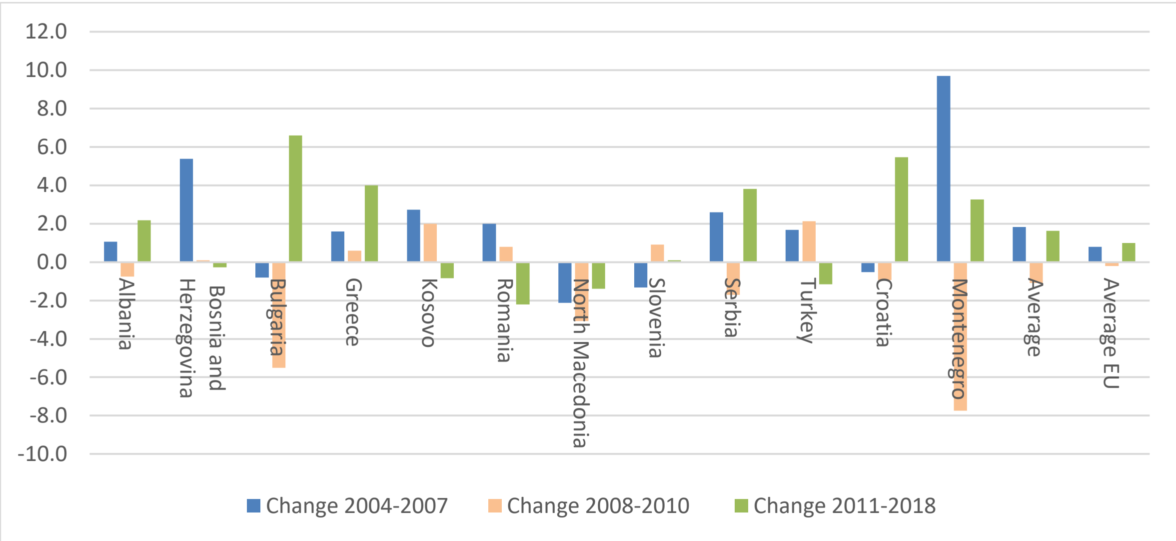
Table 1. General Government sector revenue (% of GDP)

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Albania	25.0	25.4	26.3	26.1	26.9	26.1	26.2	25.4	24.8	24.2	26.3	26.4	27.6	27.7	27.6
Bosnia and Herzegovina	38.2	40.4	42.8	43.6	42.7	41.7	42.8	43.3	43.7	42.6	43.7	43.1	42.7	43.0	43.0
Bulgaria	39.6	37.8	35.5	38.8	38.7	35.2	33.2	31.9	34.1	37.5	37.9	38.7	35.1	36.0	38.5
Greece	38.8	39.4	39.2	40.4	40.7	38.9	41.3	43.9	46.9	49.2	46.7	47.9	49.5	48.2	47.9
Kosovo	21.0	21.3	22.8	23.7	24.3	28.2	26.3	27.0	26.1	24.6	23.9	25.1	26.3	26.2	26.1

Romania	32.7	32.7	33.5	34.7	32.3	30.3	33.1	34.1	33.7	33.3	34.1	35.5	31.9	30.8	31.9
North Macedonia	36.1	33.9	33.7	33.9	35.4	33.0	32.3	31.9	32.1	30.1	29.7	31.0	30.4	30.6	30.5
Slovenia	44.7	45.1	44.3	43.4	43.7	43.5	44.6	44.2	45.4	45.7	45.3	45.9	44.3	44.0	44.3
Serbia	38.9	40.9	41.6	41.5	41.0	39.3	39.3	37.7	38.6	37.3	39.0	39.3	40.8	41.5	41.5
Turkey	30.5	31.7	33.4	32.2	31.5	33.0	33.6	33.9	34.1	34.6	33.8	34.2	34.7	33.1	32.7
Croatia	43.9	43.3	43.4	43.3	43.0	42.8	42.1	41.1	43.0	42.9	43.4	45.3	46.5	46.1	46.5
Montenegro	39.7	40.1	45.2	49.4	50.0	45.6	42.2	39.6	41.1	42.9	45.1	42.1	43.0	42.2	42.9

Source: See Appendix 1, author's calculations

The dynamics of public revenue in each of the Balkan countries in the period 2004—2018 shows significant fluctuations caused by changes in the business cycle and by the discretionary measures undertaken. Figure 2 illustrates the change in the revenue amount of the General Government sector in % of GDP in the countries on the Balkan Peninsula before, during and after the global financial and economic crisis. As indicated above, the 2004—2007 period saw an increase in fiscal proceeds in most Balkan countries that was most pronounced in Montenegro (9.7 percentage points) and in Bosnia and Herzegovina (5.4 p.p.). In that period, the share of public revenue in GDP terms decreased only in Bulgaria, North Macedonia, Slovenia and Croatia, despite the increase in revenue in absolute terms.



Source: author's calculations

Figure 2. General government revenue share in GDP (percentage points change)

During the years of the global crisis (from 2008 to 2010), public revenue share in GDP terms declined by 1.4 percentage points on the average. The drop was most pronounced in Montenegro (–7.7 p.p.) and in Bulgaria (–5.5 p.p.). Fluctuations in the figures for public revenue in the countries under examination are the result of the openness of their national economies. The strong dependence on foreign investments creates conditions for steep shifts in the stage of the economic cycle (the so-called boom-and-bust cycle). The substantial deterioration of the budget position of the Balkan countries post-2008 shows that the spike in fiscal proceeds in previous years was largely cycle-driven (Koczan, 2015, p. 8). Against that backdrop, increasing national savings with a view to limiting the dependence on external financing can be seen as a major task for the Balkan countries. This challenge is particularly acute for countries with ageing populations (European Commission, 2019).

The dynamics of tax revenue, including social security contributions, as a share of GDP in the period 2004—2018 is shown in Table 2. Throughout the analysed period, the Balkan countries saw an average growth rate of 2.4 percentage points, most significantly in Greece (9.4 p.p.) and in Bosnia and Herzegovina (5.7 p.p.) and Kosovo (4.9 p.p.). Despite the overall upward trend, fluctuations in the share of tax revenue in GDP are observed in most countries. From 2004 to 2007, there was a significant increase in Montenegro, Bosnia and Herzegovina and in Serbia.

Table 2. General government tax revenue in % of GDP (including social security contributions)

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Albania	22.5	22.9	23.5	23.6	24.5	23.7	23.3	23.4	22.6	22.2	24.1	23.9	25.1	25.7	25.7
Bosnia and Herzegovina	32.4	34.6	37.3	37.5	37.3	36.3	37.3	38.4	38.5	37.4	37.7	37.7	37.6	37.9	38.1
Bulgaria	31.4	30.2	29.7	31.4	30.5	27.0	26.0	25.2	26.6	28.3	28.3	28.9	28.9	29.3	29.8
Greece	31.9	33.3	32.5	33.4	33.6	32.8	34.1	36.0	38.7	38.5	39.0	39.4	41.4	41.3	41.4
Kosovo	18.3	18.4	20.2	19.0	21.1	20.3	20.6	22.3	21.9	21.0	20.9	21.8	23.4	23.3	23.2
Romania	28.1	28.7	29.3	28.9	27.3	25.8	27.0	28.2	27.7	27.3	27.5	28.0	26.5	25.7	26.7
North Macedonia	30.2	29.0	28.6	29.4	29.8	28.0	27.7	27.6	27.3	25.6	25.9	26.8	26.9	26.9	27.4
Slovenia	38.7	39.4	38.9	38.1	37.7	37.5	38.2	37.7	38.1	37.7	37.6	37.7	37.8	37.5	37.7
Serbia	33.0	36.2	36.3	36.2	36.2	34.6	34.2	33.0	33.9	33.2	34.6	33.9	35.1	36.1	36.0
Turkey	22.8	22.9	23.6	23.3	23.5	24.7	26.4	27.2	26.7	27.2	26.5	27.0	27.6	26.7	26.1
Croatia	36.4	36.3	36.8	37.0	36.9	36.4	36.0	35.2	35.9	36.4	36.6	37.2	37.7	37.7	38.5
Montenegro	34.4	35.3	37.3	40.5	40.7	36.8	36.4	35.2	36.1	37.5	40.3	37.3	37.3	37.2	37.4
Average	*30.0*	*30.6*	*31.2*	*31.5*	*31.6*	*30.3*	*30.6*	*30.8*	*31.2*	*31.0*	*31.6*	*31.6*	*32.1*	*32.1*	*32.3*

Source: See Appendix 1, author's calculations

After the onset of the global crisis, in the 2008—2010 period, revenue in GDP terms fell down in most countries on the Balkans and the drop was most pronounced in Bulgaria and Montenegro. In that period, tax revenue rose substantially in Turkey (2.9 p.p.), less significantly in Greece and Slovenia (0.5 p.p.), and it remained at its pre-crisis level in Bosnia and Herzegovina. After 2011, the tax revenue-to-GDP ratio climbed back up in most of the countries under examination, with the largest increase registered in Greece and Bulgaria. To sum up, the dynamics of tax revenues in the period 2004—2018 exhibited strong fluctuations in Montenegro and Bulgaria, and to a lesser extent in Serbia as well. In 2018, the tax revenue-to-GDP ratio ranged from 41.4 % in Greece to 23.2 % in Kosovo, and it averaged 32.3 % for the countries under examination.

Proceeds from taxes and social security contributions dominate within the total amount of revenue in the General Government sector in the Balkan countries. As evident from Table 3, the share of tax revenue in the analysed period was on the rise in most Balkan countries, with most pronounced increases in North Macedonia (6.1 p.p.) and in Turkey (5.1 p.p.). In 2018, the share of tax revenue ranged from 77.3 % in Bulgaria to 93.2 % in Albania, with the average for all Balkan countries at 85.7 %.

Table 3. General government tax revenue share in total public revenue (including social security contributions)

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Albania	90.0	90.0	89.6	90.7	90.8	90.6	88.9	92.0	91.1	91.7	91.6	90.3	90.9	92.6	93.2
Bosnia and Herzegovina	84.7	85.7	87.2	85.9	87.3	86.9	87.0	88.7	88.0	87.9	86.2	87.3	88.0	88.2	88.5
Bulgaria	79.4	80.1	83.7	80.9	78.8	76.5	78.2	79.1	77.9	75.6	74.7	74.8	82.5	81.2	77.3
Greece	82.3	84.7	83.1	82.7	82.6	84.3	82.5	82.2	82.5	78.2	83.5	82.2	83.6	85.8	86.3
Kosovo	87.3	86.5	88.3	80.0	86.8	72.1	78.4	82.6	83.9	85.4	87.2	87.1	89.0	88.9	89.0
North Macedonia	83.7	85.5	84.7	86.5	84.1	85.1	85.7	86.6	85.0	84.9	87.4	86.3	88.4	87.9	89.8
Romania	85.9	87.7	87.5	83.2	84.5	85.2	81.8	82.8	82.3	81.9	80.4	78.9	83.1	83.5	83.8
Slovenia	86.6	87.4	87.8	87.9	86.3	86.1	85.7	85.2	84.1	82.5	82.9	82.2	85.3	85.1	85.1
Serbia	84.9	88.5	87.4	87.2	88.1	87.8	86.9	87.4	87.8	88.9	88.8	86.4	86.1	87.1	86.6
Turkey	74.7	72.3	70.7	72.3	74.7	74.9	78.4	80.2	78.1	78.7	78.2	79.0	79.5	80.8	79.8
Croatia	82.9	83.8	84.9	85.4	85.7	85.1	85.5	85.7	83.6	84.7	84.4	82.1	81.0	81.7	82.7
Montengrgo	86.6	88.1	82.5	82.1	81.4	80.8	86.1	88.8	87.8	87.5	89.4	88.5	86.7	88.1	87.3
Average	84.1	85.0	84.8	83.7	84.2	83.0	83.8	85.1	84.3	84.0	84.6	83.7	85.3	85.9	85.8

Source: See Appendix 1, author's calculations

Table 4 shows the structure of tax revenue of the Balkan countries by type of tax (direct, indirect and social security contributions) as a ratio to GDP. In most of the countries analysed (except for Romania and Slovenia), proceeds from indirect taxes account for the highest relative share which, in 2018, averaged 15.7 %. In that year, Kosovo and Croatia were at the top, with the highest proceeds from consumer taxes in GDP terms of 20 %, while the lowest ratio is exhibited by Romania (10.4 %) and Turkey (11.1 %). Over the examined period 2004—2018, there is an increase of 0.7 p.p. on the average. The most significant increases were registered in Greece (5.4 p.p.), Kosovo (4.1 p.p.) and Montenegro (3.2 p.p.). On the other hand, a more noticeable decrease was recorded in North Macedonia (–3 p.p.). Proceeds from social security contributions rank second in terms of relative share of GDP in the Balkan countries. In 2018, the average ratio was 10.2 %, ranging from 15.8 % in Slovenia to 5.7 % in Albania. Kosovo does not have any revenue from social security contributions. In 2004 — 2018, revenue from social security, contributions grew by an average of 1 percentage point in the countries on the Balkan Peninsula. The most significant increase was registered in Turkey (3.7 p.p.) and in Bosnia and Herzegovina (3.1 p.p.). During the same period, the share of revenue declined more significantly only in North Macedonia (–1.4 p.p.) and in Bulgaria (–1.2 p.p.). Finally, revenue from direct taxes account for 6.1 % of GDP on the average in 2018. The highest ratio is that of Greece (10.2 5), and the lowest are those of Kosovo (4 %) and Bosnia and Herzegovina (4.1 %). An examination of the change over the analysed period reveals that revenue from direct taxes in GDP terms has increased by an average of 0.6 p.p. The most significant increases were registered in Greece (1.9 p.p.) and Kosovo (1.6 p.p.). A notable drop was registered only in Romania (–1.6 p.p.).

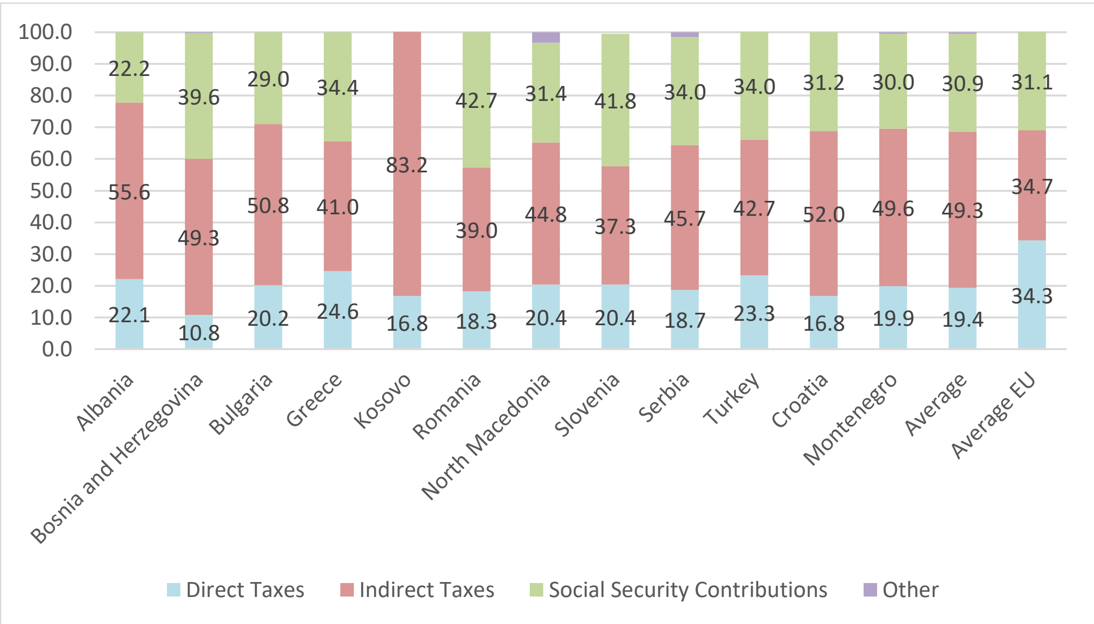
Table 4. Tax revenue structure (% of GDP)

	Year	Direct Taxes	Indirect Taxes	Social Security Contributions
Albania	2004	3.1	13.5	4.5
	2010	3.8	14.4	4.3
	2018	4.7	14.3	5.7
Bosnia and Herzegovina	2004	2.9	17.0	12.0
	2010	3.2	19.0	15.0
	2018	4.1	18.8	15.1
Bulgaria	2004	5.8	15.8	9.9
	2010	5.1	14.2	6.7
	2018	6.0	15.0	8.7
Greece	2004	8.2	11.6	12.1
	2010	8.4	12.6	13.1
	2018	10.2	17.0	14.2
Kosovo	2004	2.4	15.9	0.0
	2010	3.2	18.1	0.0
	2018	4.0	20.0	0.0
Romania	2004	6.5	11.9	9.8
	2010	5.8	11.9	9.4
	2018	4.9	10.4	11.4
North Macedonia	2004	3.8	15.2	10.0
	2010	3.3	13.1	8.9
	2018	5.4	12.3	8.6
Slovenia	2004	8.1	15.4	15.2
	2010	8.0	14.0	16.1
	2018	7.9	14.0	15.8
Serbia	2004	5.5	17.5	10.1
	2010	5.3	15.9	11.6
	2018	5.8	16.4	12.2

	Year	Direct Taxes	Indirect Taxes	Social Security Contributions
Turkey	2004	5.9	11.7	5.2
	2010	5.9	12.7	7.7
	2018	6.1	11.1	8.9
Croatia	2004	6.1	18.5	11.7
	2010	6.6	17.6	11.8
	2018	6.5	20.0	12.0
Montenegro	2004	6.0	15.3	11.7
	2010	4.9	17.6	12.2
	2018	5.4	18.5	11.3

Source: See Appendix 1, author's calculations

The main characteristic feature of the Balkan countries is the high share of indirect taxes, which, on the average, account for almost 50 % of the total amount of tax proceeds (fig.3). It is worth noting the extremely high level of indirect tax revenue in Kosovo, where it provides for over 80 % of all tax revenue. In Albania, Croatia and Bulgaria, indirect taxes also amount to more than half of the tax revenue. To compare, the share of indirect taxes in the EU-28 is about 34 %. At the same time, most Balkan countries stand out for their relatively low level of proceeds from direct taxes. In 2018, they account for 19.4 % of their tax proceeds, against 34.5 % in the EU, on the average. The lowest share of direct taxes is observed in Bosnia and Herzegovina (10.8 %), Kosovo and Croatia (16.8 %), and the highest was that in Greece (24.6 %).



Source: author's calculations

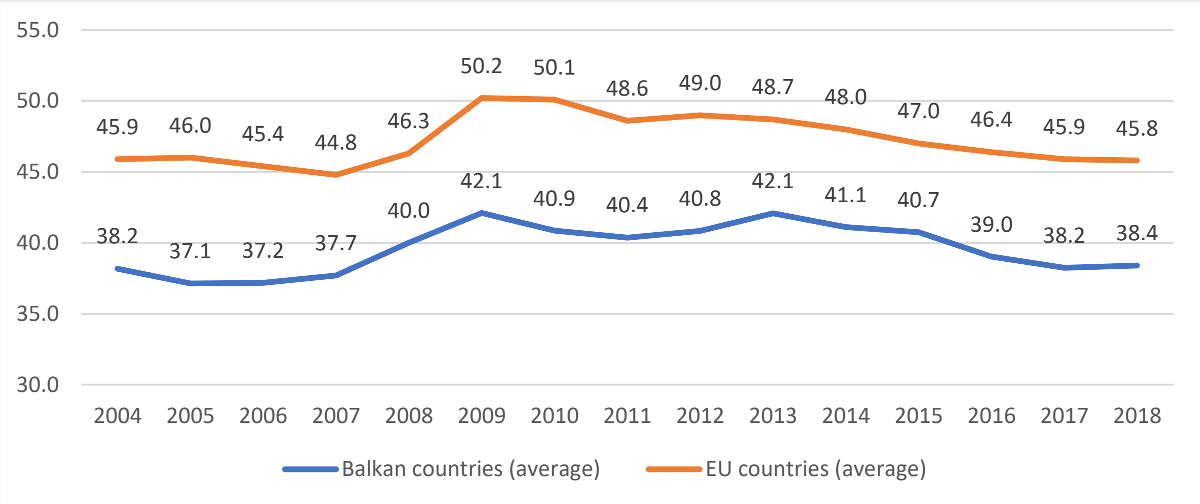
Figure 3. Tax revenue structure in 2018 (% of total tax revenues)

As a final point, revenue from social security contributions amounts to an average of about 31 % of all tax revenues of the Balkan countries, the same as the EU average. However, there are substantial differences among the countries. In terms of revenue from social security contributions, Slovenia, Romania and Bosnia and Herzegovina stand out, with around 40 %. Notably, no data is available for revenue from social security contributions for Kosovo. This is due to the fact that the system of public social security in that country is an early stage of development. On the spending side, social benefits are financed largely from the general budget revenue, with only a small portion covered through targeted social security contributions by employees and employers (Mustafa, Haxhikadrija, 2019, p. 13). The make-up of tax revenues of the Balkan countries is the result of their fiscal and tax policies. In the first years of transition to a market economy, they implemented large-scale reforms aimed at stimulating investment and economic growth. These reforms included a considerable decrease of taxation rates for direct taxes, and in some cases progressive tax rate scales were replaced by a flat rate applicable to personal income. In exchange, the fiscal burden on consumption was increased.

The tax structure of the Balkan countries, which is based primarily on indirect taxation, has had significant social, economic and fiscal effects. Firstly, that type of tax structure generally has relatively limited possibilities to redistribute national income. In specialized literature, taxes on consumption are often defined as regressive since they pose a greater burden on lower-income households. Secondly, the predominant share of revenue from indirect taxes in total tax revenue implies a certain degree of pro-cyclicity on the revenue side of the budget and reduces its capacity for macroeconomic stabilisation. Revenue from indirect taxation moves in a straight-line dependency with changes in economic activity. In their turn, direct taxes, and in particular progressive taxation of personal income, work to soften any economic imbalances to a greater extent. A relatively small share of direct taxes implies a weaker effect of the automatic fiscal stabilisers, hence the weaker stabilisation role of fiscal policy. It is the structure of tax revenue that largely explains the significant fluctuations in budget proceeds observed in the years prior to and after the global crisis.

Dynamics in public sector expenditure

In the period 2004—2018, there was substantial dynamics in the public sector spending figures of the Balkan countries. As can be seen from Figure 4, spending in the General Government sector in 2004 stood at 38.2 % of GDP, and declined slightly in the following years. After the onset of the global economic and financial crisis, the share of public spending in GDP went up and reached 42.1 % in 2009. In 2013, it went up again, but as from the following year, the public spending-to-GDP ratio started to go down, reaching 34.4 % in 2018. Over the entire analysed period, the average figure for public spending in the EU was considerably higher, at45.9 % in 2004 and 45.8 % in 2018, respectively.



Source: author's calculations

Figure 4. General government spending (% of GDP)

Balkan countries differ substantially in terms of the share of public spending in GDP (Table 5). In 2018, it had the highest value in Greece, Croatia and Montenegro, exceeding 46 % in these three countries. In that year, the share of public spending in GDP was the lowest in Kosovo, Albania and North Macedonia.

Table 5. General Government spending (% of GDP)

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Albania	30.2	28.9	29.7	29.6	32.5	33.2	29.3	28.9	28.2	29.2	31.5	30.5	29.5	29.7	29.2
Bosnia and Herzegovina	36.7	38.0	40.1	42.5	44.8	46.0	45.2	44.5	45.7	44.8	45.8	42.5	41.5	40.4	40.8
Bulgaria	37.8	36.7	33.7	37.7	37.1	39.3	36.4	33.9	34.4	37.9	43.3	40.4	35.0	34.9	36.6
Greece	47.6	45.6	45.1	47.1	50.8	54.1	52.5	54.1	55.8	62.4	50.3	53.6	49.0	47.4	46.9
Kosovo	26.4	22.4	20.4	17.4	24.3	26.9	27.4	28.1	28.4	27.9	26.5	27.0	27.7	27.6	29.0
Romania	33.8	33.5	35.6	37.5	37.6	39.4	40.0	39.5	37.3	35.4	35.3	36.1	34.5	33.5	34.8
North Macedonia	35.8	33.7	32.8	33.0	35.3	35.4	34.8	34.3	36.0	34.1	33.9	34.5	33.3	33.8	31.6

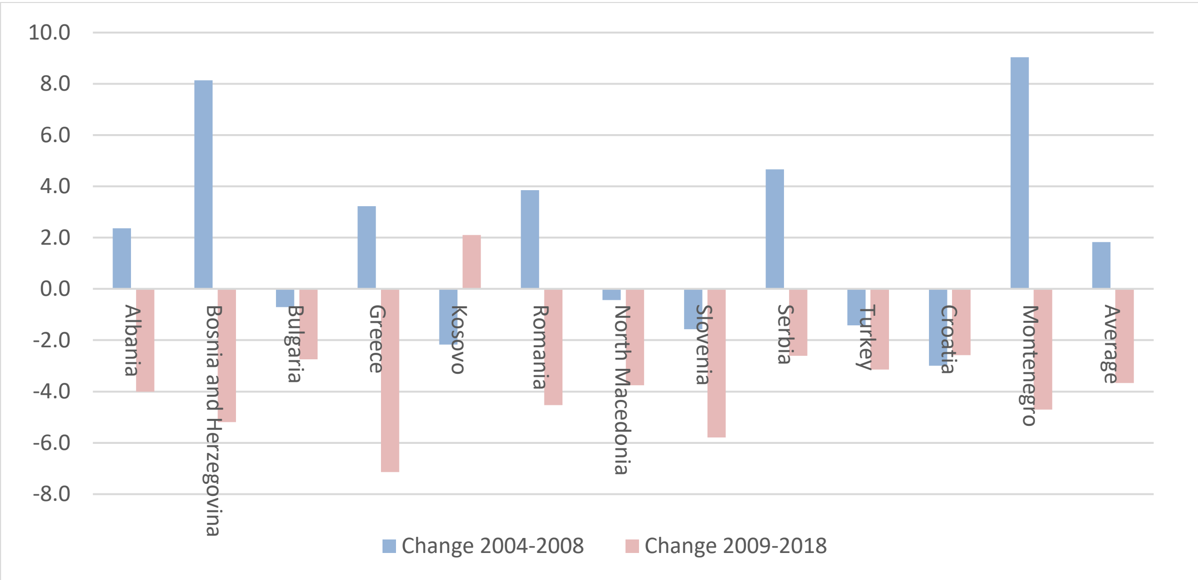
Slovenia	46.6	46.4	45.5	43.4	45.1	49.4	50.2	50.9	49.4	60.3	50.8	48.7	46.3	44.1	43.6
Serbia	38.9	39.8	43.0	43.3	43.5	43.5	43.7	42.3	45.1	42.5	45.2	42.8	41.9	40.4	40.9
Turkey	34.5	31.8	32.1	32.4	33.0	38.2	36.4	34.2	35.1	35.2	34.3	34.3	36.1	34.9	35.1
Croatia	48.8	46.9	46.5	45.6	45.8	48.9	48.6	49.0	48.3	48.3	48.7	48.6	47.4	45.3	46.3
Montenegro	41.2	41.9	42.0	43.2	50.3	50.9	45.8	44.8	46.4	47.2	47.7	50.0	46.2	46.8	46.2

Source: See Appendix 1, author's calculations

It is interesting to explore the developments in the level of public spending in each of the Balkan countries prior to and after the global crisis (Figure 5). From 2004 till 2008, public spending in GDP terms grew at an average rate of 1.8 percentage points, most notably in Montenegro (9 p.p.) and in Bosnia and Herzegovina (8.1 p.p.). The growth in spending in Montenegro was the result of a strong GDP growth in that period, and of the transition to an independent state (World Bank, 2019, p. 10). In that period, a more significant decrease was reported in Croatia (–3 p.p.) and in Kosovo (–2.2 p.p.)

The global financial and economic crisis interrupted the predominant upward trend in the value of public spending. From 2009 until 2018, public spending in GDP terms experienced a downturn in all countries on the Balkan Peninsula except for Kosovo. The most significant decreases were registered in Greece (–7.1 p.p.), Slovenia (–5.8 p.p.) and Bosnia and Herzegovina (–5.2 p.p.). The substantial reduction in public spending in that period can be attributed to the efforts to consolidate public finance.

Despite the overall reduction in public spending post-2009, certain countries display temporary, significant spikes. For instance, there was a considerable increase in Greece in the period from 2008 until 2013, after which spending dropped down drastically. Several Balkan countries experienced a banking crisis, with the cost of bailing out covered by the public sector. In 2013, the share of public spending in Slovenia went up by almost 11 percentage points from the previous year as a result of public refinancing of several large credit institutions. In the following year, the amount of spending went back down. A one-off increase in spending in GDP terms was reported in Bulgaria in 2014 as a result of problems in the banking sector.



Source: author's calculations

Figure 5. General government spending share in GDP (percentage points change)

The structure of public spending can be analysed on the basis of both an economic classification and a functional classification. The economic classification examines the cost of producing or purchasing from a third-party goods and services necessary for supplying goods by the public sector, and the direct transfers paid out to households and enterprises (Andjelkovic et al., 2010). Under the economic classification, public spending is distinguished into current and capital spending, and the former predominate in the total amount of public spending. Current spending includes the following components: compensation of employees in the public sector, use of goods and services (intermediate consumption), interest payments on public debt, subsidies, social spending, and other current spending.

Capital spending, in its turn, refers to spending incurred by the institutional entities within the General Government sector for the acquisition or improvement of long-term assets (consumption of fixed capital). For EU member states, statistical information about the amount of capital investment is available from Eurostat. Since the IMF database does not provide data for this indicator, for the rest of the countries under examination, data about the indicator ‘net acquisition of non-financial assets’ is used as a corresponding measure. According to the IMF definition, net acquisition of non-financial assets is equal to the difference between non-financial assets acquired and those released. It includes net investment in non-financial assets and fixed capital consumption. (IMF, 2014, 81).

Table 6 shows a breakdown of public spending in Balkan countries by type of economic activity as a ratio to GDP in 2004, 2010 and 2018. Within current spending, in all Balkan countries except for Kosovo, the largest relative share is that of social spending (in cash and in kind) paid out to households in order to overcome existing social risks and cover basic needs. Significant differences can be observed among the individual countries where, for 2018, social spending accounted for the largest relative share in Greece (20.7 % of GDP) and Slovenia (17.6 % of GDP), and the lowest was that in Kosovo (6.6 % of GDP) and Albania (10.3 % of GDP). Concerning its dynamics in time, in the period 2004—2018, social spending in GDP terms grew in most Balkan countries, with the most significant growth exhibited in Kosovo (6.6 p.p.), Greece (5.6 p.p.), Bosnia and Herzegovina (3.2 p.p.). Decreases are observed in Serbia, Turkey, Slovenia, Croatia and Montenegro. In the period under examination, social spending in the Balkan countries in GDP in terms grew by an average of 1.5 percentage points.

The second most significant component of current spending was compensation of employees, which includes salaries and social security contributions for people employed in the public sector of the economy. In 2018, the share of that component ranged from 11.8 % of GDP in Greece and Croatia to 4.5 % of GDP in Albania. From 2004 to 2018, this spending item decreased in 7 Balkan countries, most significantly in Albania (–2 p.p.) and in Serbia (–1.8 p.p.). Spending for compensation of employees marked the most substantial increase in Kosovo (2.3 p.p.).

The ‘consumption of goods and services’ (intermediate consumption) component measures the cost of goods and services (except for long-term assets) invested in the creation of public goods. In terms of that indicator, there also considerable differences across the analysed countries. In 2018, the share of spending for intermediate consumption ranged from 2.5 % of GDP in Montenegro to 8.1 % in Croatia. In 2004—2018, that component of current spending decreased in 9 Balkan countries, most significantly in Kosovo (–3.3 p.p.) and in Bulgaria (–3.1 p.p.). On the average, this spending item decreased by 0.9 p.p. during the analysed period.

The category of transfers shown in Table 6 brings together two items of current spending: subsidies and transfers (grants). Subsidies are defined as unilateral payments to public and private enterprises in the respective country with the aim to influence the level of production, the cost of output or the profits of those enterprises (IMF, 2014, p. 131). In their turn, transfers are payments to other institutional entities with the General Government sector, and payments to other countries and to international organisations. In 2018, the spending-to-GDP ratio was the highest in Montenegro (6.3 %), and the lowest in Greece (0.3 %).

Interest payments on public debt, on the whole, account for a small relative share in the GDP of the countries on the Balkans, and in 2018 it ranged from 3.3 % in Greece to 0.3 % in Kosovo. With regard to capital spending, there are also differences among the Balkan countries. In 2018, it recorded its highest value in Kosovo (7.9 % of GDP, while the lowest level was that in North Macedonia (2.5 % of GDP) and in Bosnia and Herzegovina (2.7 % of GDP). From 2004 to 2018, capital spending increased in 7 Balkan countries, most significantly in Montenegro (5 p.p.). The decrease was most pronounced in Greece (–4.1 p.p.) and in Croatia (–3.7 p.p.).

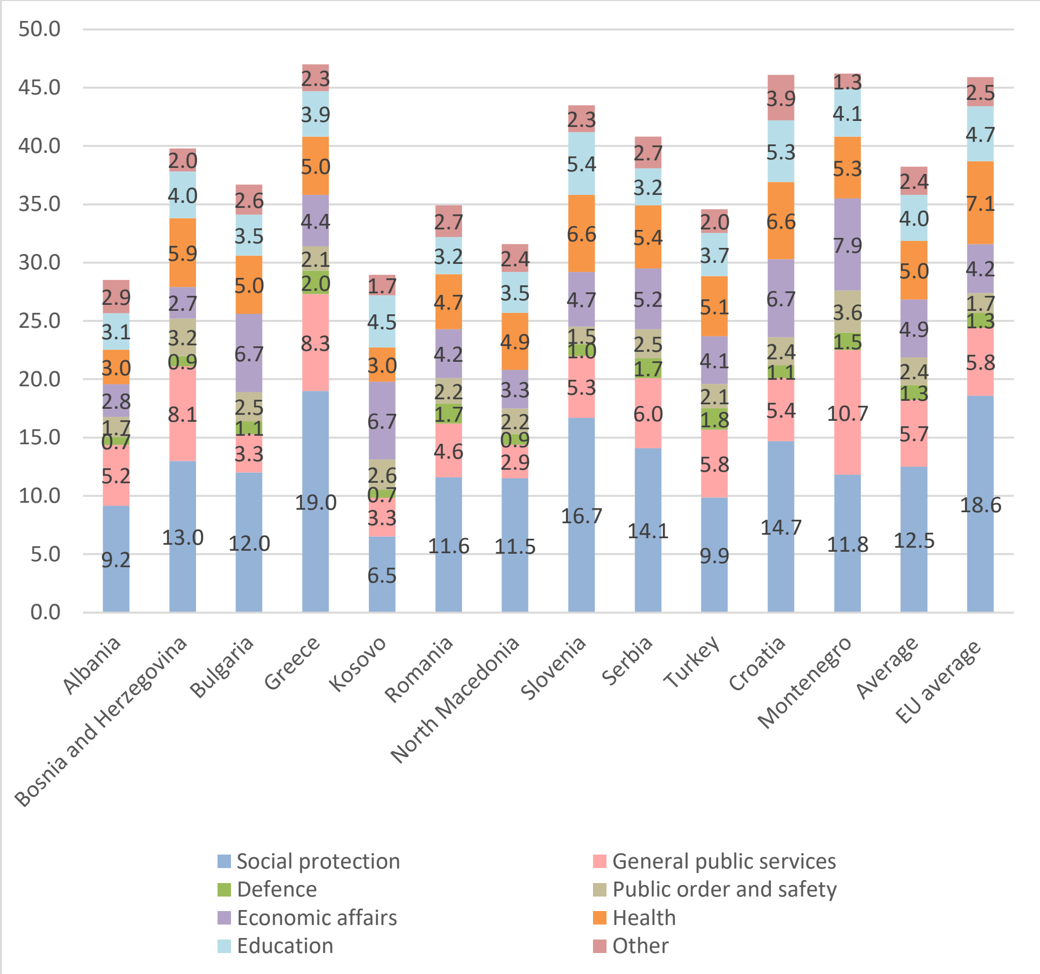
Table 6. General government spending structure by economic purpose (% of GDP)

		Compensation of employees	Intermediate consumption	Interest payments	Transfers	Social benefits	Other current	Capital expenditure
Albania	2004	6.6	3.3	3.9	2.8	6.8	1.6	5.2
	2010	5.3	2.8	3.4	2.8	8.6	1.5	5.4
	2018	4.5	2.8	2.2	3.2	10.3	1.3	4.8
Bosnia and Herzegovina	2004	10.6	8.5	0.5	1.1	11.8	2.8	1.4
	2010	12.5	10.2	0.5	1.9	14.9	2.8	2.5
	2018	10.2	7.2	0.7	1.4	15.0	3.1	2.7
Bulgaria	2004	9.9	7.9	1.8	0.9	12.2	1.3	3.9
	2010	9.1	5.7	0.7	1.1	13.5	1.2	4.9
	2018	9.5	4.8	0.7	2.2	13.0	2.3	4.0

Greece	2004	11.3	6.4	4.8	0.1	15.1	2.0	8.0
	2010	12.4	6.0	6.0	0.2	20.9	1.9	5.0
	2018	11.8	4.6	3.3	0.8	20.7	1.8	3.9
Kosovo	2004	6.3	7.0	n/a	n/a	n/a	n/a	6.6
	2010	7.1	4.1	0.1	1.8	3.9	0.0	10.3
	2018	8.8	3.7	0.3	1.7	6.6	0	7.9
Romania	2004	8.2	5.7	1.5	2.0	9.8	1.2	5.4
	2010	9.6	5.5	1.5	1.0	13.9	1.9	6.6
	2018	10.9	5.1	1.1	0.4	11.6	1.8	3.9
North Macedonia	2004	7.6	4.8	0.8	n/a	n/a	n/a	4.2
	2010	7.9	4.8	0.7	n/a	n/a	n/a	4.5
	2018	6.3	3.4	1.2	2.4	14.6	0.8	2.5
Slovenia	2004	11.5	6.0	1.7	1.7	18.7	2.0	5.2
	2010	12.5	6.8	1.6	1.8	20.1	1.9	5.5
	2018	11.1	6.2	2.0	0.8	17.6	1.8	4.1
Serbia	2004	8.7	7.5	1.2	2.9	16.1	0.0	2.4
	2010	11.2	6.3	1.1	2.4	17.8	0.7	3.2
	2018	9.2	6.8	2.1	2.2	14.7	1.4	3.9
Turkey	2008	7.3	4.0	4.6	0.8	12.7	1.2	3.7
	2010	8.2	4.8	3.5	1.2	13.2	1.6	3.4
	2018	8.0	4.9	3.0	1.7	11.7	1.1	4.0
Croatia	2004	11.8	6.9	1.8	2.3	15.7	1.3	9.1
	2010	12.2	7.6	2.4	2.4	15.9	1.8	6.3
	2018	11.8	8.1	2.3	1.6	15.5	1.5	5.4
Montenegro	2004	14.5	4.3	1.5	2.3	13.9	2.7	1.8
	2010	10.9	5.2	1.0	7.7	13.6	0.9	4.7
	2018	11.2	3.1	2.2	6.3	11.7	1.5	6.8

Source: See Appendix 1, author's calculations

Figure 6 shows the structure of public spending in 2018 by economic function. The classification of spending according to the functions of Government (COFOG) is a detailed presentation of the functions or social and economic purposes, which the institutional entities included in the General Government sector aim to achieve by means of the various types of public spending (IMF, 2014). The functional classification is a statistical tool suitable for measuring and comparing the relative significance of key functions of the public sector in each country. As seen from the graph, spending for social protection accounted for the largest relative share in all Balkan countries in 2018, standing at an average of 12.6 % of GDP, compared to 18.6 % in the EU. It is worth noting the substantial difference in the percentage of social spending among the individual Balkan countries, ranging from 19 % of GDP in Greece to 6.5 % of GPD in Kosovo. The second most significant spending category is 'General public services', where the average share in GDP for the Balkan countries and for the EU equals 5.8 % of GDP. In 2018, the highest numbers for spending in that category were those for Montenegro (10.7 % of GDP), Greece (8.3 % of GDP) and in Bosnia and Herzegovina (8.1 % of GDP). Spending for economic affairs ranked third in the Balkan countries. It averaged 5.4 % of GDP, compared to 4.2 % for the EU. The substantial share of this spending category in Montenegro (7.9 % of GDP) stands out. A significant difference in the relative share of health spending among the countries on the Balkan Peninsula and the EU is observed, with 4.9 % and 7.1 % of GDP, respectively, for 2018. Among the Balkan countries, Slovenia and Croatia (6.6 % of GDP) had the highest level of health spending, while the lowest level was that in Albania and in Kosovo (3 % of GDP). In 2018, spending for education in GDP terms in the Balkan countries averaged 4 %, against 4.7 % in the EU. The share of defence spending was equal in both groups of countries and amounted to 1.2 %.



Source: See Appendix 1, author's calculations

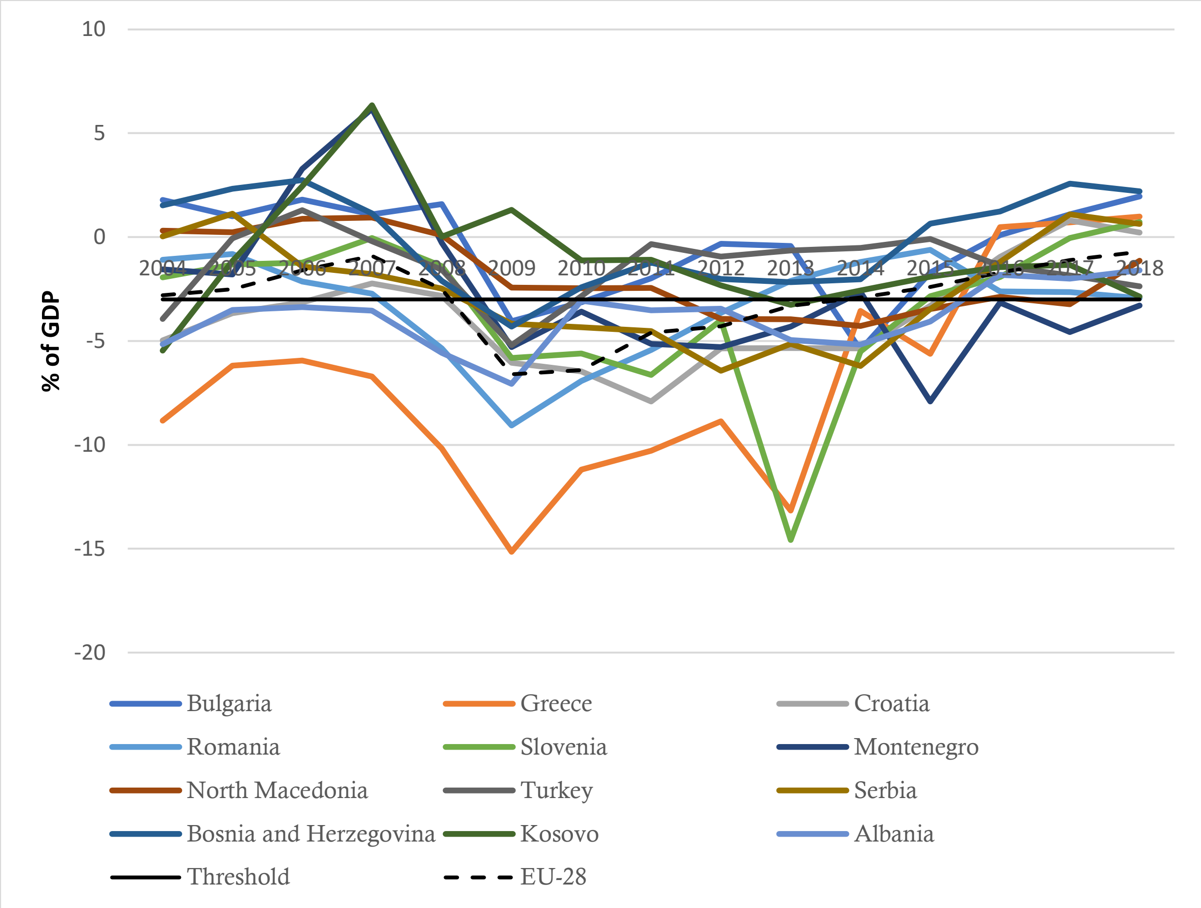
Figure 6. General government spending according to COFOG in 2018 (% of GDP)
Note: The heading "Other expenditure" comprises "Environmental protection", "Housing and community amenities" and "Recreation, culture and religion".

Containing the levels of public debt is key to reducing macroeconomic risks, especially considering the non-availability of other mechanisms for macroeconomic stabilisation in some of the Balkan countries, including the absence of an independent currency (European Commission, 2019, p. 6). After the onset of the crisis, the Balkan countries varied in the fiscal stimulus tools at their disposal, which largely depend on the condition of their public finance. The analyses provided by the European Commission concerning the structure of fiscal adjustment show that fiscal position improvements can be attributed mostly to improved revenue collection rates, while lower interest payments have largely been offset by increases in other items of public spending. In Serbia, Montenegro and Albania, corrections to budget deficits were archived mostly through measures undertaken on the revenue side. In North Macedonia and Croatia, the improvement in the budget balance was the result of cutting current spending. The structure of budget consolidation is an indicator for potential weaknesses in public finance in the conditions of an economic downturn. If the increase in budget revenue is driven mostly by cyclical factors, then it can be expected that revenue would decrease rapidly, once the stage in the business cycles changes (European Commission, 2009, p. 7).

4. Changes in government budget balance

Budget balance is a key indicator of the direction of the fiscal policy pursued. There is no unanimity in economic theory as to whether a balanced-budget policy should be pursued, or whether the state should use the budget as a tool to pursue a policy of macroeconomic stabilisation. Moreover, the genesis of budget deficit is very important. A budget deficit may be due to ineffective spending policy or to a targeted investment policy aimed at upgrading public infrastructure, which is a precondition for a higher economic growth in the future. A policy of budget deficit has a counter-cyclical effect on the economy when it is implemented in the conditions of a recession (irrespective of whether it is the result of the automatic fiscal stabilisers or the discretionary government policy at work). It should be noted that it is more difficult to implement a policy of budget surplus in periods of economic growth, particularly in developing countries, where there is an acute need for infrastructure improvement (IMF, WP 15/172). Governments are often subject to strong pressure from certain interest groups (lobbies, trade unions, etc.) which demand that additional spending should be incurred, where such spending had been postponed on the argument of non-availability of funds; in the presence of a budget surplus, however, that argument does not hold. For that reason, although economic theory prescribes that reserves for absorbing economic shocks must be set up, the pursuit of an austere fiscal policy is not a particularly common approach in governing public finance. That is why government policies are often pro-cyclical in a period of economic expansion.

The fiscal instability of a country has an impact on the whole monetary and economic union and erodes its trustworthiness. Although fiscal policy is a national prerogative, the deepening of the economic integration among countries requires a certain degree of coordination. The budget deficit indicator is an important indicator of the stability of public finance; hence the EU's Stability and Growth Pact sets a limit to its share in GDP of up to 3 % of GDP (EU, Council Regulation No 1466/97, Article 2-a). In the case of non-compliance with that requirement, an excessive deficit procedure is launched, requiring the country concerned to undertake corrective measures to manage the situation. In the period 2010—2011, such procedures were launched for 24 EU member states. The common failure to comply with that requirement, and with the debt criterion, as well as the need to strengthen the sustainability of public finance in EU member states led to the formulation of fiscal ruled that are binding on the member states of the Union. The fiscal rules are long-term quantitative restrictions on government spending, deficit, debt or other fiscal indicators. Several decades ago, only a few countries had fiscal rules. Currently, however, over 90 countries abide by such restrictions, including, of course, the EU member states. There is evidence that strict fiscal rules promote fiscal discipline, at least in countries that tend to run large deficits (WB, WP Fiscal Rules for the Western Balkans, 2019). Western Balkan countries, which are not members of the EU yet but wish to accede to it, must comply with the EU requirements for maintaining fiscal discipline and must follow the established quantitative fiscal rules.



Source: See Appendix 1, author's calculations

Figure 7. General government balance (% of GDP)

The budget balances of the countries under examination have fluctuated during the past 15 years, which is largely but not exclusively the result of the cyclical development of their economies. The discretionary measures undertaken by governments with respect to fiscal incentives or fiscal consolidation also play a role. The analysis of the dynamics of one of the most important fiscal indicators, budget balance, in the countries from the Balkan Region informs the following conclusions:

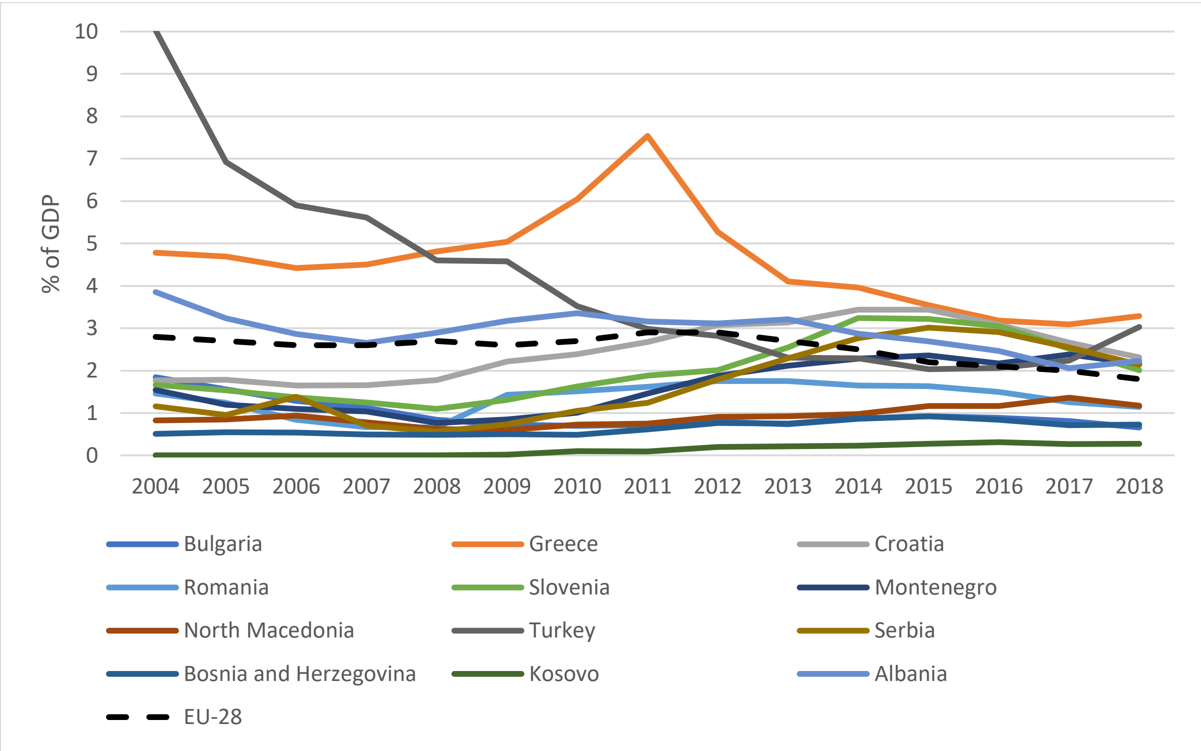
- The countries under examination exhibit a marked tendency to stick to a policy of budget deficit. The budget balance is negative, on the average, for the European countries throughout the observed period.
- The global financial and economic crisis in 2009 put the public finance of the Balkan countries to the test and reflected in a sharp increase in their budget deficits considerably in excess of the limit of 3 % of GDP only for one year. A lesser deficit is recorded only for North Macedonia, and Kosovo even has a slight surplus.
- Still, the severe worsening of the budget balance in 2009 in the countries under examination is not as drastic, compared to EU countries (8 of the countries have a deficit below the EU average).
- As early as in 2010, 8 countries shrunk their budget deficit, which is in line with the economic development recovery.
- Over the 15-year period, the highest surpluses (over 6 %) were achieved by Kosovo and Montenegro in 2007, melting away during the next year, 2008.
- In the period 2010—2014, all countries had a negative budget balance.
- The deficit in the year of the crisis, 2009, ranged from 2 % to 6 % in GDP terms in most countries, but Greece and Romania reached record-high deficits of 15 % and 9 % of GDP, respectively. Bulgaria is among the countries with the lowest deficit.
- In 2014 Bulgaria breached the budget deficit limit for the second time but managed to avoid the excessive deficit procedure since the European Commission agreed that it was due to an

extraordinary event relating to the declaration of bankruptcy of a key bank (Corporate Commercial Bank) and the need to finance the Deposit Guarantee Fund.

- During the first 10 years of the period, Greece stands out as the country with the largest deficits, but in the last three years it has registered a positive balance already.
- Slovenia ended 2013 with a much higher deficit than 2009, with –14.6 % of GDP, against –5.8 % in 2009, the reason being that the country carried out a major bank recapitalisation (about EUR 3 billion).
- In the last 3 years of the period under observation, almost all of the countries had budget balances above the threshold of –3 % of GDP (except for Montenegro).
- A budget deficit policy was pursued throughout the period by Romania and Albania. For Albania, a policy to restrict the budget deficit in the last three years is observed, bringing it down to around 2 %, whereas earlier it was in the range of 4—5 %. In 2018 Slovenia reported a budget surplus for the first time in 22 years.

In the period under examination, the strongest driver behind the fluctuations in the budget balances of the Balkan countries was the global financial and economic crisis, along with certain one-off events such as the recapitalisation of banks in Slovenia in 2013 (Stability Programme of the Republic of Slovenia, 2014, p.21) and the failure of Corporate Commercial Bank in Bulgaria in 2014. Those factors led to an increase in the deficit-to-GDP ratio, which, in its turn, raises the issue of sustainability of public finance systems and the levels of government debt.

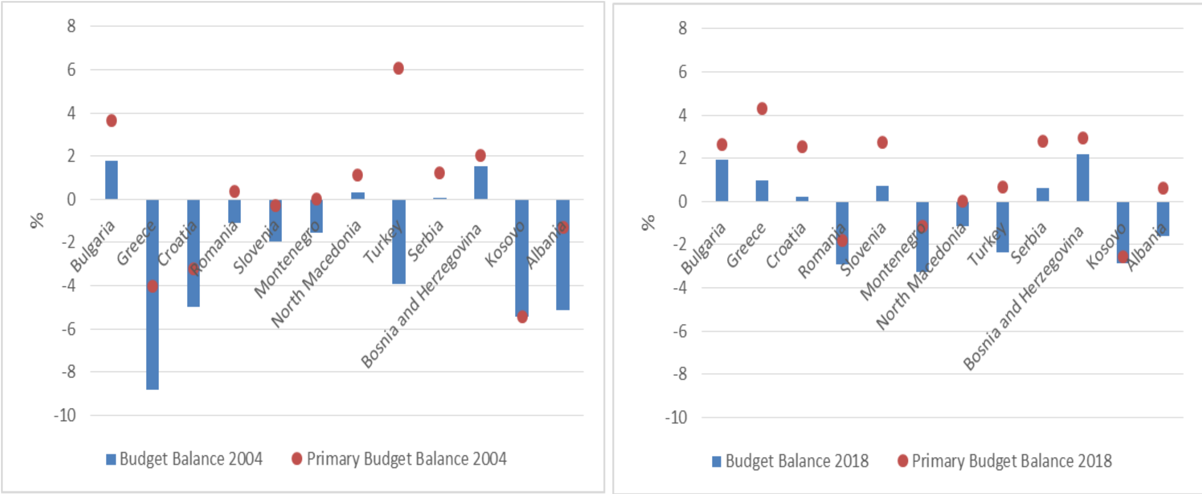
The overall budget balance is affected also by the countries' level of indebtedness, since interest costs can be a major spending item. The burden of interest payments over the period under observation in the Balkan countries was below 4 % of GDP, except for Turkey and Greece. At the beginning of the period, Turkey allocated 10 % of its GDP to interest payments, but in the following 6 years, it managed to bring down that share to below 4 %, while Greece registered record-high interest spending of around 7.5 % of GDP in 2011. The burden of debt repayment was lower in most Balkan countries compared to the average burden in the EU at the start of the period, but the situation reversed post-2013. In the EU, in 2018 it went down even below 2 % of GDP, while in the Balkan countries it climbed up.



Source: See Appendix 1, author's calculations

Figure 8. Government interest expenditure (% of GDP)

To get a better understanding of the fiscal situation, let us examine how the elimination of interest spending affects it, i.e. what the budget balance would look like if countries had no debts. To that end, let us compare the budget balance to the primary budget balance available at the beginning and at the end of the period under examination. The results are shown in the figure below.



Source: See Appendix 1, author's calculations

Figure 9. Budget balance and primary budget balance (% of GDP)

The primary budget balance available looks better for all of the countries under examination, since each country has some degree of indebtedness, the largest deviations between the two indicators are noticeable for the most indebted countries, i.e. Turkey, Greece, Montenegro, Serbia, Slovenia and Albania. Compared to the beginning of the period, the largest improvements in the primary budget balance are exhibited by Greece, Croatia, Slovenia and Kosovo, while in the case of Turkey there is a serious worsening. Overall, in 2018 the primary budget balance available is closer to the budget balance as at the beginning of the period (2004). The absence or presence of a correlation between the budget balance available and the real rate of economic growth over the period 2004—2018 is shown in the table below.

Table 7. Correlation between the budget balance and the real rate of economic growth over the period 2004—2018

	Correlation coefficient	
Bulgaria	0.704486	Strong correlation
Greece	0.494235	Medium correlation
Croatia	0.596686	Medium correlation
Romania	0.67786	Strong correlation
Slovenia	0.598439	Medium correlation
Montenegro	0.60807	Medium correlation
North Macedonia	0.690461	Strong correlation
Turkey	0.478209	Medium correlation
Serbia	0.682901	Strong correlation
Bosnia and Herzegovina	0.713847	Strong correlation
Kosovo	0.691888	Strong correlation
Albania	-0.01925	Very weak negative correlation

Source: author's calculations

With the exception of Albania, for all other countries the assumption that there is a statistically significant link between the budget balance and the real rate of economic growth is confirmed (the correlation factor is between 0.5 and 0.7). Albania has maintained some of the highest growth rates throughout the period and it is the only country that did not slip into a recession, even in 2009, but instead registered a growth rate of 3.4 %. At the same time, the country stimulated domestic demand through major fiscal incentives as well, as it pursued a policy of budget deficit throughout the period.

CONCLUSIONS

The overview of the dynamics of public revenue in the period 2004—2018 has shown that the Balkan countries have a lower public revenue-to-GDP ratio compared to the EU. Over the analysed period, there was an increase in revenue but despite that, there are distinct fluctuations in the years prior to and during the global economic crisis. These fluctuations are particularly manifest in Montenegro. The dynamics in total public revenue and tax revenue of the Balkan countries exhibits a certain pro-cyclicity that is the result of the fiscal policy pursued. The structure of tax revenue in a large number of the Balkan countries is characterised by a large share of indirect taxes, mostly at the expense of direct taxes. This implies both a weaker re-distributional role of the public sector and relatively limited capacity to implement macroeconomic stabilisation.

In the period 2004—2018, the share of public spending in the GDP of most of the Balkan countries remained lower than the EU average, with the exception of Greece, Montenegro and Croatia. Those three countries stand out among the rest with the considerable involvement of the government in the economy. In 2008, the number of countries having a large public sector went up, but at the end of the period, this number gradually went down, mostly due to the action undertaken to reduce public spending in some of the Balkan countries. The trend shows that at the end of the period in quite a few of the countries in the Balkan Region the government yielded in the running of the country’s economy. Despite the overall reduction in spending post-2009, some of the countries display temporary, significant spikes. In the structure of public spending according to an economic classification and a classification by function, the most significant item in GDP terms was social spending. That is why that component of public spending showed the most significant increase in the period 2004—2018.

The budget balance remained negative during most of the investigated period, which comes to show a tendency for the countries in the study to pursue a policy of budget deficit both in times of economic downturn and in economically more favourable times. The financial and economic crisis of 2009 is the main reason for the worsening in the performance of the budget balances across the board in the countries examined.

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APPENDIX 1. SOURCES:

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