Baltic Journal of Real Estate Economics and Construction Management

ISSN: 2255-9671 (online)
2018, *6*, 100–115
doi: 10.2478/bjreecm-2018-0008
https://content.sciendo.com

IRREGULAR RECEIPTS LEADING TO BUDGET DEFICITS IN KOSOVO

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Abstract: The aim of the paper is to analyse the irregular budget receipts, their behaviour and impact on budget deficits in Kosovo. Since its independence, Kosovo has been engaging in large infrastructure projects based mainly on initially high cash balances and overestimation of revenue capacity, in particular of irregular receipts. This led to the creation of future liabilities and budget deficits, which had to be financed by public debt. Further, the politically motivated increase of wage and salary bill and social transfers increased the burden on budget deficit already caused by infrastructure projects. Thus, budget deficits became the lasting feature of Kosovo economy. All this was supported by a lack of legal infrastructure or fiscal rules for several years. There is extensive literature on the causes of budget deficit, its definition and measurement. The literature review method is adopted in the present study, and research is refined by including selected papers that contain empirical and theoretical studies on budget deficit. Therefore, special-purpose deficit, the so-called "regular" budget deficit, which considers only regular receipts and outlays, has been defined and measured in the present study. This analysis leads to the conclusion that irregular receipts used by the government to engage in large infrastructure projects and/or the politically motivated increase of wage and salary bill and social transfers lead to a budget deficit that has to be financed through public debt. This is a case study of Kosovo and research has been carried out using primary data drawn from Kosovo budget annual financial reports. The implications of the paper may be of high importance for policymakers as well as for academic issues. This is a unique approach to the issues of Kosovo budget deficit and irregular receipts.

Keywords: *Budget deficit, fiscal rule, irregular receipts, political budget cycles, public debt.*

INTRODUCTION

Kosovo's public finances, in general, are considered to be sound. International UN administration, before the independence, focused on setting up a fiscal system that guaranteed stable finances and high liquidity. Simple tax system, consisting of both flat custom duty (10 %) and standard VAT rate (16 %) collected when goods entered the Kosovo borders, secured more than enough budget revenues to maintain low paid national and local public administration and minimum of necessary public investments. Impact of the budget on economic development of the country was not an issue to deal with. The new country started with a cash balance of 449.8 million euro equal to 13 % of GDP, with a real GDP growth rate of 8.3 % (2007) and neither budget deficit nor public debt. There was another 406.25 million euro in the privatization fund of Kosovo Trust Agency and 279.6 million euro in the Kosovo Pension Saving Trust (Kosovo's Ministry of Finance, 2009). Until then no dividend was received by the government from public companies, the most profitable one being Kosovo Telekom. Thus, cash amounting to about 30 % of GDP was idle in the eve of Kosovo independence, while the unemployment rate was estimated to be around 40 % and very bad public infrastructure (mainly roads) was considered one of the most serious obstacles to economic growth. Higher public investments were a necessity. Kosovo chronically suffers from large trade deficit, with around 10 % of exports covering imports while balance of deficit payments are being covered by FDI and remittances. There have been about 75,000 civil servants, both in central and local government, with the lowest average monthly salary in the region of only 230 euro.

During 10 years of independence, official figures of both fiscal and real sector showed no concern (Table 1). Both total receipts and total outlays showed a remarkable increase with low budget deficits, measured as the difference between total receipts and total outlays, while cash balances at the end of the year could be considered acceptable. Even more, there were years with budget surpluses (2012, 2015–2017) that excluded any doubt on good government fiscal stance. There were no signs of budget constraints though government engaged in large infrastructure projects, increased wage and salary bills and social transfers. This belief was also supported by continuous real GDP growth of 3–4 % per year (except in 2014), being the highest in the region (Kosovo's Agency of Statistics, 2017). At a glance, there seems to be no concern also on the public debt side. Its actual total public debt to GDP ratio is only 16.6 % that is considered to be low for almost any economy and with positive impact on economic growth (Kosovo's Ministry of Finance, 2018). Debt portfolio was established in 2009 following membership in the International Monetary Fund (IMF) and World Bank (WB) when the country agreed to take over the debt inherited from former Yugoslavia (Kosovo's Ministry of Finance, 2016). In fact, Kosovo made its first real external borrowing in 2010 from the IMF. Since 2011, Kosovo has started to borrow from other international financial institutions for financing specific projects (tied loans) in education, agriculture, health care, road and rail infrastructure, etc. The external debt, both principal and interest, was serviced regularly. The internal borrowing started in its fifth year of independence (2012) when according to the government annual financial statements, the cash balance at the end of the year was ample and budget recorded surplus. However, looking closer it was noticed that the government was not able to service any principal of internal debt but only the interest, though it continued to run smaller budget deficits in 2013–2014 followed by surpluses in 2015–2017. The government refinanced the internal debt by extending the maturity of newly issued treasury bills (Kosovo's Ministry of

Finance, 2017). The three-month and six-month treasury bills were gradually replaced by treasury bills with a maturity of twelve months and two years and later with bonds with three-year, five-year and seven-year maturity. Neither the annual financial statements nor audit reports showed any specific reason for increasing public debt. At the same time, there was no deficit rule to follow.

Table 1. Receipts, Outlays, Deficit/Surplus, Cash Balances and Public Debt (millions of EUR)

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Receipts	989	1161	1195	1313	1551	1445	1463	1707	1778	1923
Outlays	963	1252	1288	1400	1476	1512	1511	1614	1763	1837
Deficit/Surplus	26	−92	−93	−87	75	−66	−48	93	15	87
Cash Balance	476	384	291	204	278	212	164	257	271	358
Total Debt	–	249	260	254	410	476	583	749	853	996
Debt to GDP (%)	–	6.1	5.9	5.3	8.1	8.9	10.6	13.1	14.6	16.6
GDP growth (%)	4.5	3.6	3.3	4.4	2.8	3.4	1.2	4.1	4.1	3.7

Source: Annual Budget Financial Reports (2008 to 2017), National Accounts Statistics (2008 to 2017), Annual Bulletins on Public Debt (2009 to 2017)

To gain a better view of the causes of budget deficits and permanently increasing internal public debt, the author will read differently the data in the annual financial reports of Kosovo budget, including audit reports of these statements made by Kosovo National Audit Office, and legal infrastructure related to management and accountability of public finances. The present study will show that in 2012 the government run the highest yearly budget deficit since independence and faced the risk of being insolvent as a result of accumulated budget deficits since 2008. Among four ways of financing the public sector deficit – printing money, running down foreign exchange reserves, borrowing abroad and borrowing domestically (Fischer & Easterly, 1990) – the only solution for Kosovo government was to borrow domestically.

1. LITERATURE REVIEW

Measurement and definition of fiscal deficit are the starting points to analysing its causes, impact and financing. There are numerous definitions and measures based on the purpose of the analyses. As Jacobs et al. (2002) point out, “each definition highlights a particular aspect of fiscal exposure and can serve a valuable purpose from the viewpoint of investors and policy analysts. They support the idea to use a set of different definitions of the deficit to get the full picture of the country’s fiscal stance, but the determining factor is whether fiscal policy is sustainable in the longer term”. This is also in line with Fay and Porter (2006), who state that calculations of fiscal imbalance and government indebtedness vary depending on which assets, revenues and liabilities are included and how they are valued. Kotlikoff (1986) states that the deficit is an inherently arbitrary accounting construct that provides no real guide to fiscal policy since the official labelling of something as an asset or a liability is an arbitrary choice that has no general basis in economic theory. However, as Jacobs et al. (2002) maintain, “a comparison between the different definitions of the budget deficit indicated that they do not differ that much in magnitude, and in the end, the budget balance is matter of interpretation and management of fiscal policy, and there is no single superior measure of the budget balance, but rather a set of different budget balances measurements, each applicable to specific condition”.

The simplest definition of budget deficit, according to Irwin (2015), “could be the difference of spending and revenues, without reference to the government’s balance sheet. If defined in terms of changes in the balance sheet, it is measured as decline in the value of the government’s net assets, which is said to be clean, while one that excludes these changes is said to be dirty”. Further, according to Irwin (2015), different measures of the clean deficit arise from differences in the assets and liabilities that are recognised in the government’s accounting. Therefore, the clean cash deficit is just the change in the government’s cash balance, which is crucial when the government’s liquidity is in doubt, but not very informative otherwise. Blejer and Cheasty (1991) view the conventional public sector deficit as “a summary of government transactions during a single budget period – usually one year – without attention to their longer run implications. This deficit requires financing from the government’s “ordinary income” rather than from borrowing. However, most widely used is the public sector borrowing requirement (PSBR)”. Fay and Porter (2006), in their effort to define an optimal budget deficit, state, “standardized or cyclically-adjusted budget deficit or surplus which corrects for the business cycle effect on revenue and outlays (and some other transitory items); a primary deficit which nets out interest costs of servicing accumulated debt; and an operating budget which separates out public capital investment, net of depreciation”.

When it comes to measuring, Meltzer (1992) points out that primary budget deficit – the deficit net of interest payments – is the most relevant measure for the economy, which makes the amount that the government has to finance currently. Jacobs et al. (2002) consider that conventional budget balance is not a sufficient correct indicator to measure the stance of fiscal policy (in South Africa). Along with conventional budget balance that could be measured on cash or an accrual basis they analyse additional 14 balance measures or other fiscal indicators. Blejer and Cheasty (1991) also state that “conventional measures of the fiscal deficit miscalculate the public sector’s true budget constraint and give a misleading picture of the economy’s fiscal stance”, which is why the budget should be viewed from several angles”. To highlight the differential impact of various budgetary transactions (such as investment, import purchase or debt service) on important macroeconomic variables (such as savings, the balance of payments and inflation), they analyse alternative measures of the deficit that policy-makers calculate, the so-called special-purpose deficit (the current deficit; the deficit measuring the contribution of different transactions to aggregate demand; the domestic deficit; structural and cyclically adjusted deficit and operational deficit). According to Eisner and Pieper (1985) and Eisner (1989), a measure of the real, actual surplus or deficit can be viewed as essentially the sum of three components: 1) the nominal surplus or deficit as currently measured; 2) an adjustment for changes in the market value of government financial assets and liabilities due to changing market rates of interest (interest effects); and 3) changes in the real value of net debt due to changing general price levels incident to inflation (price effects). Milesi-Ferreti (1996) also points out that the nominal budget deficit (inclusive of interest payments) may be a flawed measure of the actual fiscal stance for several reasons. First, it does not take into account the effects of inflation on interest payments, therefore counting anticipated debt repayment as deficit. Second, in the presence of economic growth, debt to GDP ratio can be kept constant even if the country is running a budget deficit. Third, seigniorage revenues are not included. Forth, a conventional measure of the fiscal deficit does not correspond to changes of government’s net worth: this implies that privatization proceeds always improve the government fiscal position by reducing public debt, because the decline in public sector assets is ignored. Finally, contingent liabilities are not explicitly accounted for in the budget. Since the deficit is defined as arbitrary accounting construct, Kotlikoff (1986) treats government simply as an institution that takes receipts and makes payments, finding nothing to learn about the underlying economy considering only the size of reported debt. He recommends examining “directly the lifetime budget constraints of different generations and asking whether government policies have expanded the lifetime consumption opportunities of older generations at the price of reduced lifetime consumption opportunities of younger and future generations” (Kotlikoff, 1986).

In principle, budget is always and everywhere politically influenced. However, the scope of political influence depends on institutional strength. As Shi and Svensson (2006) point out, “the strong institutional constraints on politicians in developed countries leave little room for public officials to expropriate public resources for private gains, and the large share of informed voters in these countries renders fiscal policy manipulations less effective”. However, according to Koczan (2015), the discretionary component appears to be larger for the Western Balkans, where less of the variation in spending is explained by cyclical factors and inertia. Milesi-Ferreti (1996) develops a model based on “fiscal illusion” with opportunistic policy-makers and naive voters. The policy-makers are opportunistic (they care about electoral prospects and not directly about private agents’ welfare) and use fiscal deficits to increase their electoral chances. Voters overestimate the benefit of current expenditure and/or underestimate future tax burdens and therefore do not “punish” politicians for fiscally irresponsible behaviour. As Milesi-Ferreti (1996) points out, in the situations of political polarization (mainly reflected in spending priorities between political parties) and electoral uncertainty, there is a tendency for increasing debt, i.e., increasing budget deficit, to constraint policy choices of future governments. Alesina and Peroti (1994) share this view, stating that in a nutshell “the idea of fiscal illusion is that the voters do not understand the intertemporal budget constraints of the government”. According to them, opportunistic politicians who want to be re-elected take advantage of this confusion by raising spending more than taxes to please the "fiscally illuded" voters (Alesina and Peroti, 1994). Thus, as a result of political influence, Shi and Svensson (2006) confirm that, on average, government deficit as share of GDP increases by almost one percentage point in election years, or, on average, fiscal deficit increases by 22 % in election years.

To avoid the political motivation of the budget deficit as much as possible, the fiscal rules are considered to be one of the solutions. According to Poterba (1996), budget rules provide a form of "self-control" for political actors, while Groneck (2008) defines budget rule as "a permanent constraint on fiscal policy, typically defined in terms of an indicator of overall fiscal performance". In general, there are two most used rules: the fixed deficit rule and the capital borrowing rule, often called a "golden rule". The fixed deficit rule allows public consumption to be financed by deficits, whereas the golden rule allows the government only to run deficits if they are used to finance investments in the public capital stock. Analysing growth and welfare effects of budget rules, Groneck (2008) points out that "the crucial difference between the two rules is the development of the growth rate of public investment. The golden rule leads to an immediate jump in the rate of growth of public capital and also a higher growth rate in the long run. Under the fixed deficit rule, this growth rate slightly falls in the medium run while maintaining the same value in the long run". According to Poterba (1996), budget rules may provide a mechanism for constraining the discretion of politicians when they prefer a larger budget deficit in the current period than they would have agreed to in the previous period. He concludes that the "anti-deficit tight rules accompanied with limits on government borrowing induce smaller deficits and more rapid adjustment of taxes and spending to unexpected fiscal shortfalls".

Dur et al. (2000) analysed the effects of fiscal rules on public investments if budget deficits were politically motivated. Policy-makers behave "fiscally irresponsible" when public debt can be used by the party in office to influence the next period policy-making. According to them, when parties have sharply different preferences, the one in office has an incentive to accumulate debt and spend more on its preferred public goods at the expense of future public consumption. Policy-makers have tendency of running budget deficits for strategic purposes that yield socially sub-optimal outcomes. However, they are of the opinion that political parties would unanimously agree on binding debt rule, some level of budget deficit that prevents strategic use of public debt. In this respect, Kosovo has taken few measures to limit the "fiscally irresponsible" behaviour of policy-makers. Thus, following an increase of wage and salary bill during the election process at the end of 2010, the Budget Law for 2011 (Kosovo's Assembly, 2011) contained specific provision saying that "no transfer of any Budgetary appropriation may be made into the Expenditure Category of Wages and Salaries from another economic category without the prior approval of the Assembly". Along with this, a provision has been included not allowing any employee to be paid through the "goods and services" category, which was a very common practice. The wage and salary bill again showed to be politically the most influenced budget category and that is why (and based on IMF Staff recommendation for introduction of a rule-based framework to guide public wage decisions) an amendment has been made to the Law on Management and

Accountability of Public Finances (Kosovo's Assembly, 2015) that limits wage increase beyond nominal GDP growth rate. There have also been efforts to "discipline" the capital investments, in particular large infrastructure projects, from being (ab) used by the party in office for election purposes. For instance, to prevent government from running budget deficits and thus creating future liabilities, the Budget Law for 2013 (Kosovo's Assembly, 2013a) included a provision saying that "funds for construction of Highway 6 will be allocated when the bank balance achieves the level of three hundred million (300,000,000) Euro". However, this provision was not included in the Law on Budget for 2014 (Kosovo's Assembly, 2014), and the contract on Highway 6 (in the amount of 600 million euros, equal to 11 % of the GDP) was signed shortly after the national elections of 2014. Within the Law on Management and Accountability of Public Finances in July 2013, for the first time, a fiscal rule has been adopted limiting the budget deficit to 2 % of GDP applicable as of the 2014 budget (Kosovo's Assembly, 2013b). This limit is lower than the deficit rule set for EU countries (3 %) based on Maastricht criteria. This deficit rule was further clarified and advanced at the end of 2015, but the limit was not changed.

2. REDEFINING BUDGET RECEIPTS AND OUTLAYS

Kosovo's budget is run on cash basis, as a traditional form of government accounting (Irwing, 2015). As mentioned, until July 2013 there was no legal restriction on budget deficits. Yet, there was no legal clarification of what budget deficit means and how it should be measured. Thus, the government's fiscal stance was followed based only on the cash balance (the difference between total receipts and total outlays), and it was publicly accepted as the budget deficit/surplus. As pointed out in the literature review, this principle does not give a real picture of public finance performance but is crucial for the government's liquidity.

Table 1 shows that both outlays and receipts experienced a real boom following independence (in particular, the capital investments). In spite of year by year improvements of taxes and fees and other no-tax revenues, total payments permanently exceeded total receipts. In this sense, the crucial problem seems to be overestimation of revenue capacity or overly optimistic revenue assumptions. Maintaining high budgetary payments was possible because of high initial cash balances and some of the "other revenue" items (dividend from public companies and proceeds from privatization being the main portion). When these "other revenue" items ended, the financing gap had to be closed by internal borrowing.

To analyse the causes of the budget deficits that led to public debt, the author will start with the annual financial reports on Kosovo's Consolidated Budget. The reports, based on cash accounting, represent receipts and outlays and cash balance at the end of the year. However, during the period of 2008–2017, there was no consistent form of reporting, particularly within receipts. Until 2013, no distinction was made between taxes, custom duties, or fees, and all of these were simply recorded as taxes. Furthermore, "own source revenues", grants and aids, borrowings, deposit funds, fines, tariffs, royalties, interests, one-time privatization proceeds and other receipts were separately recorded. During the period of 2014–2017, the item "taxes" was divided into direct taxes, indirect taxes and non-tax revenues. The item "other receipts" gathered the rest of the receipts, while separate recordings of grants and aids and borrowing continued. Within outlays, there are four main categories: wages and salaries, goods and services and utilities, social transfers and subsidies and capital investments. The debt service, lending to public companies and other outlays are also separately recorded. The difference between total receipts and total outlays is reflected in the cash balance. Following adoption of the fixed deficit rule (2 % of GDP) in July 2013, the budget deficit started for the first time to be reported only for fiscal year 2014 and on. Considering the fixed deficit rule of 2 % of GDP to be too tight, and to make room for more capital investments, a new fiscal rule that excludes from the primary deficit both spending of the privatization proceeds and spending from own source revenues carried forward was adopted by the end of 2015 within the amendments of the Law on Management and Accountability of Public Finances.

Following Blejer and Cheasty (1991) reasoning on special-purpose deficit, an alternative measure of the budget deficit will be calculated. For this purpose, both receipts and outlays will be "revised" and budget deficit will be defined as a difference between total "*regular*" receipts and outlays. "Regular" will mean receipts and outlays that are permanent, non-discretionary, with no significant variation from year to year, and on which fiscal policy relies. "Regular receipts" exclude borrowings, grants and aids, privatization proceeds, dividend from public companies and "extraordinary revenues" as defined in the Law on Management and Accountability of Public Finances. The simple reason for excluding these receipts from "regular" one is that they do not meet the criteria mentioned above: they are discretionary financing, can vary significantly from year to year and usually are "one-time" receipts and their inclusion as "regular" revenue leads to an inappropriate confidence in their permanence and the sustainability of the government's policy stance. As happened in Kosovo, they had to be replaced by government borrowing at a certain point. In the same way, regular outlays will not include lending to public companies because they also do not meet the "regular" criteria, nor they are operational budget expenditures. In the analysis, "net dividend" will be included as an "irregular" receipt that is measured as gross dividend received minus lending to public companies plus repayment of these loans. Normally, the expenditures financed by borrowings will not be included in the outlays. Thus, after revising total receipts and outlays, the "regular" budget deficit will be viewed as a special-purpose deficit.

2.1. Regular and Irregular Receipts

Following the concept of "regular" deficit, the total receipts will be revised and grouped in two categories:

1. "Regular" receipts such as taxation (collected from the Customs and Tax Administration) and own source revenues (collected from municipalities and central government), and

2. "Irregular" receipts that have character of discretionary financing can vary significantly from year to year and usually are "one-time" receipts.

As Table 2 and Fig. 1 show, the "regular" receipts (tax and own source revenues) demonstrated a remarkable increase during the period confirming the consolidation of both fiscal agencies (tax and custom administrations) as pointed also by Koczan (2015). There is no single year with a declining trend. The main increase was recorded during the period of 2009–2011 (post-independence) and during the period of 2014–2017 that was mainly characterised by fiscal consolidation measures (increase of VAT standard rate from 16 % to 18 % and introduction of a new VAT reduced rate of 8 %). Prudent fiscal policy recommends that all budgetary outlays should be projected on these revenues.

The category of "irregular" receipts recorded high fluctuation. The highest level of "irregular" receipts was reached in 2009 and amounted to 219.3 million euro or 19.3 % of total receipts for that year. The "irregular" receipts almost completely ceased in 2017 amounting to only 18.0 million euro or 1.1 % of total receipts for that year. Thus, financing of expenditures being based on non-realistic revenues, and left with no other financing solution, could be continued only relying on internal public debt.

Table 2. Regular and Irregular Receipts (millions of EUR)

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Regular Receipts	928	941	1030	1218	1241	1247	1337	1450	1608	1693
Irregular Receipts	61	219	142	90	143	115	12	91	16	18

Source: Recalculated data based on Annual Budget Financial Reports (2008 to 2017)

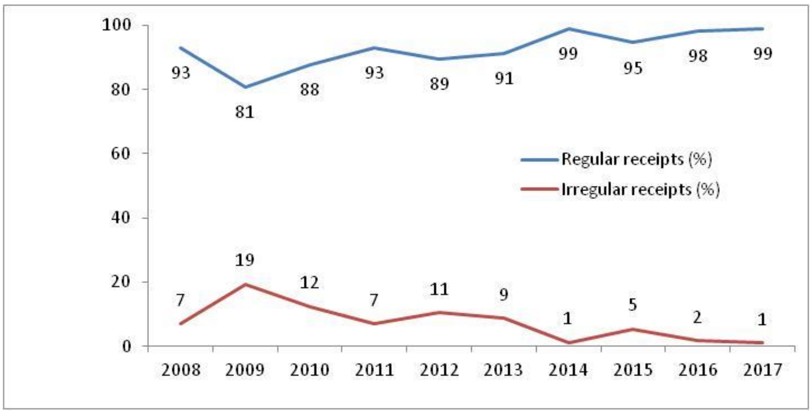

Fig. 1. Ratios of regular and irregular receipts (%).

Defining "irregular" receipts, the following budget items are considered to fulfil the above- mentioned criteria: grants and aids, interest receipts, concession tax, royalties, dividends from public companies, privatization proceeds and repayment of loans from public companies, as shown in Table 3. The concept of "irregular" receipts is broader than the definition of "extraordinary revenues" used in the Law on Management of Public Finances and Accountability, though some of items are the same. The "extraordinary revenues" are those attributed to an event that happens less than once a year, such as sale of an asset, issuing a license, award of concession contract, or temporary increase of the price of a commodity or natural resources (Kosovo's Assembly, 2008). The "irregular" receipts also include items that may happen every year but their number is uncertain due to their discretionary financing character (grants and aids) and significant variation from year to year (privatization proceeds and dividends from public companies). It should be mentioned that it is not their "one-time" character that makes concern for the budget, but rather (ab) use by government to create long-run liabilities. As Koczan (2015) points out, these cyclical revenues and one-off receipts from privatization increased the appetite for spending, especially in the run-up to elections, thus resulting in surged government expenditures, particularly on public wages and pensions and ambitious infrastructure projects, as was the case in Kosovo.

Table 3. Items of Irregular Receipts (millions of EUR)

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Grants and Aids	12.8	13.9	45.3	28.2	48.7	12.6	12.1	13.3	8.7	8.3
Interest	17.3	5.4	11.7	1.6	–	–	–	–	–	–
Concession Tax	–	–	–	–	–	2.0	–	–	–	–
Royalties	–	–	–	–	–	24.7	–	–	–	–
Dividends	30.8	200.0	85.0	60.0	45.0	43.0	–	15.0	–	–
Privatization Proceeds	–	–	–	–	45.2	26.3	–	61.3	–	0.3
PC Loan Repayment	–	–	–	–	4.0	6.0	–	1.5	7.2	9.4
Total	60.9	219.3	142.1	89.8	142.9	114.6	12.1	91.1	15.9	18.0

Source: Annual Budget Financial Reports (2008 to 2017)

The two items that have typical character of "irregular" receipts are dividends from public companies and privatization proceeds. In total, during the period of 2008–2017, dividend receipts amounted to 478.8 million euro or 52.8 % of total "irregular" receipts. The second one is privatization proceeds amounting to 133.1 million euro or 14.7 % of total "irregular" receipts. Both these items of receipts have been considered a firm financial ground to start large infrastructure projects, and increase of wage and salary bill, which later on led to budget deficits. Interest receipts, 4 % of total "irregular" receipts, were present only during the first post-independence period as revenues from investing high cash balances. Typical "extraordinary revenue" that is considered "irregular" receipt is concession tax in the amount of 2 million euro in 2013. The same holds true for royalties that make 2.7 % of total "irregular" receipts. On the other hand, grants and aids did not contribute to budget deficit due to their link to specific projects, though they were the second largest item (22.5 % of total "irregular" receipts).

2.2. Budget Outlays

In general, the budget deficits in Kosovo are consequences of continuous discretionary increases of outlays that could not be met by receipts. To determine the impact of different outlay categories on budget deficit, the author will briefly analyse behaviour of each separately as shown in Table 4 for the period of 2008–2017. It is obvious that goods and services were the only category with stable and permanent increase (156 %). However, they had to be slightly cut (by 5 %) during the period of 2014–2016 due to an increase of wage and salary bill and social transfers. On the other hand, capital investment, which is much needed due to poor public infrastructure in Kosovo, wages & salaries and social transfers and subsidies showed high variations that could only be explained by political budget cycles. Thus, large capital investments and the politically motivated increase in the wage and salary bill and social transfers are considered the main causes of lasting budget deficits.

Table 4. Budget Outlays (millions of EUR)

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Wage and Salaries	227	264	311	385	408	417	485	525	544	550
Goods and Services	158	171	182	177	191	216	205	206	202	226
Subsides and Transfers	210	257	253	256	280	313	361	418	475	506
Capital Investments	347	400	455	528	550	529	411	404	444	468

Source: Annual Budget Financial Reports (2008 to 2017)

Wages and salaries are almost tripled (264 %) during the period of 2007–2017. Although the author of the paper does not disagree about the need to increase the low average salary, two cases show typical political behaviour of these expenditures. In both cases, wages and salaries were increased just before or following national elections. The 2011 wage and salary bill increased by about 24 % after the national elections of December 2010. The second one occurred in 2014, when the wage and salary bill was higher by 16 % (IMF, 2015) than in 2013 running up to and following national elections in June 2014.

Subsides and transfers more than tripled (331 %) during the period. "The composition of social spending has significantly changed, with pension and social assistance increasing in relative size. Only 7 percent of benefits are allocated based on economic welfare. Almost two-thirds of benefits are for age, health care, and family benefits, while close to 30 percent are for war-related benefits" (IMF, 2018). Table 4 shows that the main increase (162 %) was recorded during the period of 2014–2017 as a consequence of review of social schemes and war benefits.

Capital investments are much needed for economic development of the country. Following independence in 2008, the government engaged in a very ambitious programme of capital investment that focused mainly on road infrastructure (construction of two new motorways, Route 7 with the cost of 800 million euro or about 18 % of GDP and Route 6 with an estimated cost of 600 million euro or about 11 % of GDP). Capital investments more than doubled in the first year of independence and continued substantially to increase (14 %–16 % per year) for several years, reaching the highest level in the period of 2011–2012 (11 % of GDP). But, the increasing trend was sharply stopped in 2014 as a consequence of a high increase in the wage and salary bill, subsidies and social transfers. Capital investments were cut by about 30 % even though the government had signed the contract for the new motorway (Route 6) from Prishtina to Macedonia. Its level was kept at about 7 % of the GDP during the period of 2014–2017 due to budgetary adjustments. Since then, capital investments were permanently below the level of wages and salaries, subsidies and social transfers, confirming worsening of the composition of the budget. Thus, one of the main drivers of economy growth was sacrificed to keep the budget deficit within legally determined limit of 2 % of the GDP.

2.3. "Regular" Budget Deficits

As mentioned, officially reported figures based on cash accounting do not tell the real fiscal stance. The data in Table 1 show a gap of no concern between total receipts and total outlays. However, now the picture is different viewed from the point of "regular" receipts and outlays. Table 5 shows that regular receipts could not meet regular outlays in any year from 2008 to 2017. They were permanently below the outlay level even though their increase was high and continuous (190 %). However, regular outlays grew much more (261 %). It is obvious that government has been running permanent and growing "regular" deficits since independence. There was no single year with a budget surplus, and fiscal adjustments started only in 2014 following deficit rule adopted in mid-2013. In particular, the regular primary deficits were high for 5 consecutive years (2009–2013), keeping the level almost constantly above 4 % of GDP, except for 2011. The primary "regular" budget deficit reached its highest level in 2013, amounting to 239.1 million euro or 4.7 % of GDP. At the end of 2017, the total accumulated "regular" budget deficit amounted to 1.348 billion euro, about 3/4 of which was financed through public borrowing and reduction of cash balances.

Table 5. Regular Budget Deficit (millions of EUR)

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Regular Receipts	928	941	1030	1218	1241	1247	1337	1450	1608	1693
Regular Outlays	953	1107	1216	1358	1438	1486	1476	1569	1678	1759

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Regular Primary Deficit	−25	−166	−185	−140	−197	−239	−139	−119	−70	−66
Interest	−	0.7	9.0	8.8	10.1	11.5	12.5	17.3	19.2	18.7
Regular Deficit	−25	−167	−194	−149	−207	−250	−152	−137	−90	−85
Short-term Liabilities	16	4	29	39	27	49	165	201	209	199
Primary Deficit to GDP (%)	−0.7	−4.3	−4.6	−3.2	−4.1	−4.7	−2.6	−2.2	−1.2	−1.1
Nominal GDP	3883	4070	4402	4815	5059	5627	5567	5807	6070	6256

Source: Recalculated data based on Annual Budget Financial Reports (2008 to 2017); National Accounts Statistics (2008 to 2017)

Fiscal adjustments during the period of 2015–2017 succeeded in decreasing budget deficit viewed from cash based accounting system only. The annual budget reports show surpluses (Table 1) as the difference between total receipts and total outlays. The special purpose "regular" deficit shows a decreasing trend during the same period. However, this is achieved by creating hidden deficits through a tremendous increase in short-term liabilities that makes more than 3 % of GDP during the period of 2014–2017. Since land expropriation for infrastructure projects makes about 70 % of these liabilities, it was easy for the government to postpone these outlays without risking its liquidity.

3. FINANCING OF "REGULAR" BUDGET DEFICIT

High level of regular outlays was mainly based on "irregular" receipts and initial high cash balance. They started with large infrastructure projects and continued with politically motivated expenditures in wage and salary bill and social transfers. Continuously increasing long-run liabilities could not be met by regular receipts. As a result, "regular" budget deficit was a permanent feature of the government fiscal stance. Therefore, a continuous decrease of "irregular" receipts and cash balance had to be replaced with public debt if outlays were to be kept at a high level. As a logical consequence, budget deficit was accompanied by higher public debt. Table 6 shows that internal borrowing, as the only financing solution for the government, started in 2012, i.e., in the 5-th year of independence following serious liquidity difficulties. Therefore, public debt is a direct consequence of falling cash balances (the lowest level since 2007) and high "regular" budget deficits that were initially caused by increasing public investments based on "irregular" receipts. Further, as shown above, since 2014 decreasing "regular" budget deficits have been replaced by hidden budget deficits through an increase of liabilities.

Table 6. Regular Primary Deficit and its Financing (millions of EUR)

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Regular Primary Deficit	−25	−166	−185	−140	−197	−239	−139	−119	−70	−66
Irregular Receipts	61	219	142	90	143	115	12	91	16	18
Internal Debt Issues	–	–	–	–	73	79	104	121	101	95
External Debt (IMF)	–	–	22	–	94	–	–	36	36	100
Cash Balance	476	384	291	204	278	212	164	257	271	358

Source: Recalculated data based on Annual Budget Financial Reports (2008 to 2017); Annual Bulletins on Public Debt (2010 to 2017)

In total, during the period of 2008–2017 "regular" primary budget deficit reached about 1.348 billion euro. The financing of "regular" primary budget deficit was mainly made through public borrowing consisting of internal public debt in the amount of 574 million euro (42.6 %) and external public debt (IMF), the so-called untied loans, in the amount of 287 million euro (21.3 %), and reduction of cash balance in the amount of 118 million euro (8.7 %).

4. CONCLUSION

It has been shown that Kosovo entered its independence era with high cash balance, small budget surplus, high privatization proceeds being accumulated for several years and a few profitable public companies that paid no dividend to the government as a sole shareholder. Considering public infrastructure as the main obstacle to economic growth, the government engaged in very ambitious public investment (mainly road infrastructure) based on overly optimistic revenue estimation mainly in the category of "irregular" receipts. These investments led to the creation of long-run liabilities that caused budget deficits. "Politically" motivated increase of wage and salary bill, social transfers and subsidies worsened further the budget deficit. All this was supported by the lack of legal infrastructure that limits budget deficit and public debt. To limit "fiscally irresponsible" behaviour of policy-makers, Kosovo has introduced 2 % budget deficit rule and linked an increase in wage with nominal GDP growth rate.

Literature review has shown that there are numerous definitions and measures of budget deficit based on the purpose of the analysis. In this line of reasoning, the special purpose deficit, the so-called "regular deficit", has been calculated as an alternative measure of the budget deficit. For this purpose, total receipts and outlays have been disaggregated in "regular" and "irregular". "Irregular" items have character of discretionary financing, not permanent, can vary significantly from year to year and usually are "one-time" receipts/outlays. Typical "irregular" receipts are considered dividends from public companies and privatizations proceeds. Thus, after having redefined total receipts and outlays, it has been shown that for several years, government run up the so-called “regular” budget deficits that were underestimated and not known to the public.

Faced with liquidity issues as a result of falling cash balances, the government resorted to external (IMF untied loans) and internal public borrowing as the only choice. About 2/3 of “regular” budget deficit is financed through public borrowing. External public debt is serviced regularly. Internal public debt has been growing constantly, but no principal debt has been serviced – only interest has been paid thus far. To ease the debt burden, the government is extending its maturity gradually by replacing short-term treasury bills with long-term treasury bills and bonds. The consolidation fiscal measures (increase of VAT standard rate) undertaken by the government have improved the fiscal stance viewed from cash base accounting system. The difference between total receipts and outlays shows surpluses and “regular” budget deficits have a decreasing trend. However, surging liabilities (mainly land expropriation for road infrastructure) confirm the replacement of “regular” with hidden budget deficits.

As a recommendation, the government should engage in large capital projects and/or increase of wage and salary bill and social transfers only after having secured financing sources based on “regular” revenues and/or borrowings. The “irregular” budgetary items should be considered as a temporary source regardless of their size. The government should refrain from creating long-term liabilities based on their doubtful permanence as they lead to budget deficits. To avoid “politically” motivated budget deficits, there should be clear legal rules that limit the government’s use for electoral purposes of public resources while in the office by increasing budget deficit and/or public debt.

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