

# THE EXTERNAL DEBT SUSTAINABILITY IN SOUTHEAST EUROPEAN COUNTRIES: THE ANALYSIS OF DEBT INDICATORS

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## 1. INTRODUCTION

Despite the overall improvement in macroeconomic situation in Southeast European countries (SEECs) after 2000, external imbalance is still one of the main macroeconomic problems in the region. Southeast European economies have recorded huge trade deficits, mainly results of the import boosting effect of the strong domestic demand, which greatly influence the development of current account balance. Although the current account balances in SEECs have been improving during 2005, the deficits are still very high and the average reaches 9.4 % of GDP.

Since there has been an increasing concern among economists and policymakers that the high external indebtedness is limiting growth of these transition countries, the paper is aiming to analyse the external debt indicators for seven Southeast European countries that have been included in the Stability Pact in order to assess their external position. According to the methodology of the IMF, we use two sets of debt indicators: those based on flow variables

(ratio of external debt to GDP, ratio of external debt to exports and ratio of external debt servicing to exports) and those based on stock variables (ratio of international reserves to short-term debt and total debt).

We conduct this external debt analysis within the overall macroeconomic framework of these transition economies, taking into account the expected key macroeconomic variables, especially GDP growth and current account deficit. Since the assessment of the external debt sustainability is strongly related to the external sustainability, the important part of our analysis refers to the level of the current account deficit in Southeast European countries.

## **2. CONCEPTUAL FRAMEWORK FOR THE EXTERNAL DEBT SUSTAINABILITY ANALYSIS**

There has been an increasing concern among economists that the high external indebtedness is limiting growth and development. Economic literature has found empirical support for a nonlinear impact of foreign debt on growth: at low levels, debt has positive effects on growth, but above certain thresholds or turning points, additional debt begins to have a negative impact on growth. (Pattillo, C., Poirson, H. and Ricci, L., 2004; Serven, 1997) It means that “reasonable” levels of borrowing are likely to give an impetus to growth, both through capital accumulation and productivity growth. The most well known explanation of high foreign debt’s negative impact on growth is related to “debt overhang “ theories, which show that the external debt that is larger than the country’s repayment ability would discourage further domestic and foreign investment and thus spur the growth. (Krugman, P., 1988; Sachs, J. 1989)

The external-debt-sustainability analysis is usually conducted in the medium-term context and takes into account the overall macroeconomic situation, especially the outlook for the current account, economic growth and policy uncertainties. Since the debt indicators, which will be discussed later, have an important role in identifying solvency and liquidity problems of a country, we will shortly clarify these aspects of debt sustainability.

According to IMF (IMF, 2000, 171-172), solvency can be defined as the country’s ability to discharge its external obligations on a continuing basis. Theoretically, a country is solvent if the present value of net interest payments does not exceed the present value of other current account inflows, especially export receipts, but in practice, a country can stop servicing its debt long before this constraint is reached. On the other hand, a country has liquidity problems when it is not able to discharge its immediate external obligations. These liquidity problems are usually interrelated with insolvency, but it is also possible that liquidity problems arise independently of insolvency. Important determinants of liquidity problems are following:

- The maturity structure of debt has a considerable impact on liquidity sustainability. For example, high share of short-term external debt makes the economy especially vulnerable in situations when investors change the country’s risk perception. Therefore, a maturity profile that leans towards longer-term obligations will reduce domestic liquidity risks. This also indicates that an important part of economic policy management during booms should be instruments that improve the maturity structures of the external liabilities. (Ocampo, 2005, p. 13)

- The currency composition of external debt is also important because sudden depreciation of domestic currency makes the external debt payable in foreign currency (and debt that is linked to foreign currency) very costly and has considerable economic and social impacts.
- The interest rate structure of external debt could also have significant implications for the external debt sustainability. For example, sharp increase in short-term interest rates increases the real cost of debt, especially in cases when the interest rates are linked to a floating rate such as LIBOR.
- The debt structure by borrowing sector is also an important criteria in the external debt analysis. Traditionally, the focus has been on public sector because the high government debt implies possible serious macroeconomic problems. Investments in public sector are usually long-term and in non-tradable goods and services and therefore the regulations and strong fiscal responsibility are required. The analysis of the debt structure by borrowing sector is especially important in the absence of capital controls, where weak financial position of the public sector can result in capital flight and pressure on international reserves.

Debt indicators have been very useful in helping to indicate potential debt-related risks and to sum up important trends. There are several widely used debt indicators and they can be broadly divided in two sets (IMF, 2000):

- Indicators based on flow variables like ratio of debt to GDP and ratio of debt to exports. They are called flow indicators because the numerator or denominator (or both) are flow variables.
- Indicators based on stock variables like ratio of international reserves to short-term and total debt, where both numerator and denominator are stock variables.

The debt-to-GDP ratio is the ratio of the total external debt at the end of the year to annual GDP and it indicates the country's potential to serve external debt in a way of shifting production to exports so as to enhance repayment capacity. This indicator may be less reliable in the situations of over or undervaluations of the real exchange rate that could distort the GDP denominator. It is possible that a country could have a high debt-to-exports ratio and, at the same time, a low debt-to-GDP ratio, in the case when exportable good comprises a small proportion of GDP. Although there are some conceptual dilemmas in defining the appropriate benchmarks for all debt ratios, it is usually considered that the debt-to-GDP ratio over 30% implies the solvency risks. (Babić, M. and Babić, A., 2000)

Another solvency indicator is the debt-to-exports ratio and it could be defined as the ratio of total debt at the end of the year to the country's exports of goods and services for any year. This indicator is a very useful measure of sustainability because the increasing ratio means that total debt is growing faster than the country's basic source of external income and it implies that the country could have difficulties in solving debt obligations in the future. It is the important trend indicator that is related to the country's repayment capacity. According to IMF (IMF, 2000, p. 173), it is important to monitor this indicator in medium-term context by using projected exports in years ahead. The reason is the fact that countries that use external borrowing for investments in productive capacities with long gestation periods usually have high debt-to-exports ratios, but these ratios will decline as the investments begin to produce exporting goods. Although temporarily large, this debt-to-exports ratio may not be considered too high in medium-term perspective. Having in mind these problems, it is usually considered that the debt-to-exports ratio over 200% indicates the repayment risks for the country. This

indicator is usually analysed with the other indicator that shows the ratio of external debt-service payments of principal and interests to exports of goods and services and it indicates how much of a country's export revenues are used in debt servicing.

The ratio of international reserves to debt, especially short-term debt, is a liquidity indicator that implies reserve adequacy and ability of the country to fulfil its financial obligations to non-residents by using its own international reserves.

### 3. MACROECONOMIC POSITION AND EXTERNAL DEBT ANALYSIS OF SOUTHEAST EUROPEAN COUNTRIES

#### 3.1. Macroeconomic overview and outlook for Southeast European countries

Southeast European countries are economies that are structurally diverse, but they have faced similar macroeconomic disequilibria during the 90s, especially lack of GDP growth, large trade and current account deficits as well as high unemployment rates. For the first time in the past 10 years, in 2000 a positive GDP growth is recorded in all SEE countries. It seems that the year 2000 was the turning point for the economic development in these economies, especially in the Western Balkans. At the same time, in the period after 2000 the inflation in SEECs steadily declined. Generally, overall macroeconomic situation has improved, but the region has experienced strong external imbalances. (Table 1.)

**Table 1 Overview of economic developments in Southeast European countries, 2000 and 2004**

Country	Consumer prices (change in % against previous year)		Unemployment, based on LFS (annual average in %)		Current account (in % of GDP)	
	2000	2004	2000	2004	2000	2004
Albania	0.0	2.9	16.8	14.4	-7.2	-4.7
B&H	5.1	0.2	38.7*	42.0	-20.8	-22.5
Bulgaria	10.3	6.2	16.9	12.0	-5.6	-8.5
Croatia	6.2	2.1	16.1	13.8	-2.3	-5.2
Macedonia	10.6	0.9	32.2	37.0	-3.0	-7.7
Romania	45.7	11.9	7.1	7.5	-3.7	-8.7
S&MN	85.6	10.8	12.6	15.0	-4.2	-10.8

Source: WIIW, 2004

The inflation rate has been falling in all SEECs and in 2004 only two countries (Romania and Serbia and Montenegro) have reached double-digit levels. In Romania the average inflation is expected to come down in 2005, despite the fact that National Bank of Romania has started to liberalise the capital account. At the same time, Romania has changed the exchange rate regime towards flexible inflation-targeting monetary regime. In Serbia and Montenegro, as another country with highest inflation rate, the speed up in inflation at the end of 2004 (mainly in Serbia) is due to the strong wage growth and increased in administered prices. (EBRD, 2005, p. 36.) Although the financial indicators do not indicate the tendencies of the increase in inflation rates, still some countries have decided to use certain monetary policy instruments, including reserve requirements and tightening the criteria for loans.

Unemployment has been high during the 1990s and still remains one of the serious macroeconomic problems. Such high unemployment rates in many SEECs, especially in Bosnia and Herzegovina (42%), Macedonia (37%) and Serbia (18.5%) have been the result of structural disruptions, slow job creation and the lack of market institutions. Fiscal adjustment, which has been rather strong in the Balkans, leads to the decline in public employment and thus adds to the problem of unemployment. Also, the speed up of transition tends to increase productivity so that employment continues to decline long after the path of sustainable growth is reached. (WIIW, 2006) However, it should be pointed out that the actual level of unemployment is much lower than formal figures due to the high share of “grey” economy.

The growing demand in the SEECs has resulted in high increase in imports and current account deficit in all SEECs. Total exports grew faster than imports, though these countries have not been yet recovered from the breakdown of former Yugoslavia and loss of former market, wars and trade sanctions. The economists claim that the avoidance of a current account deficit and a high foreign debt is the best basis of development in a world with volatile international capital movements and an unstable global economy. Therefore these external imbalances in SEECs have become the main challenge to macroeconomic stabilization and sustainable growth in the region. The high external imbalances also means that access to external finance, from FDI or international capital markets, should be sustained in order to reduce current account deficits and overall debt burdens.

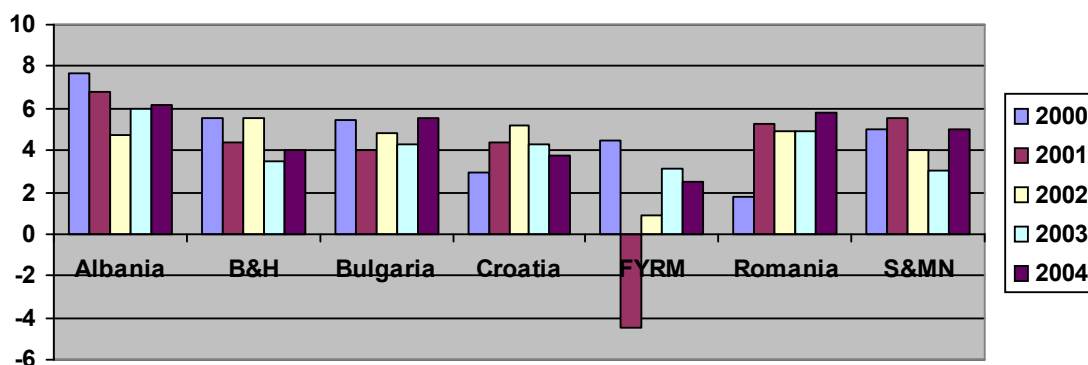
In some countries the current account deficits have also been associated with significant FDI inflows, including reinvested earnings of foreign investors because the SEE countries have experienced a strong increase in FDI inflows. These countries have started the privatization cycle more intensively in the late 90s and have become more attractive for foreign investors. While the Central and Eastern Europe<sup>1</sup> has recorded the huge decline in FDI inflows from \$23 billion in 2002 to \$11 billion in 2003, mostly due to a fall in privatization flows, the FDI inflows in Southeast Europe have reached almost \$7 billion in 2003 and 9.2 billion in 2004. In the context of capital flows, FDI should be preferred to portfolio flows due to several reasons: FDI has proven to be less volatile than portfolio investments, risks are shared with foreign investors, and FDI (especially greenfield investments) may improve access to new technology, management techniques and foreign markets. Still, till now FDI inflows to the SEE region have been largely driven by big ticket sales of state assets. The volume and the composition of FDI inflows have been linked mostly to large-scale privatization transactions in telecommunications, banking and heavy industry. (Broadman et. al., 2004, p. 19) There is no doubt that the privatization process has so far attracted most FDI and till now the greenfield investments have been very limited and directed primarily at servicing the domestic market.

As a consequence of high increase in domestic consumption due to the credit boom and considerable FDI inflows, the GDP growth has been considerable since 2000 in all countries and during whole period. (Chart 1)

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<sup>1</sup> The group of eight CEE countries that joined the EU in May 2004.

**Chart 1 GDP growth in Southeast European countries, 2000-2004 (in %)**



Source: WIIW, 2005

The growth in these countries has accelerated due to the improved political stability in the region and prospects for the EU accession countries Bulgaria, Romania and Croatia since June 2004. This growth has been particularly stimulated by credit expansion in all countries and especially in Croatia, Bosnia and Herzegovina, Bulgaria and Romania. Growth has been partly due to the post-conflict and post-depression recovery and partly due to lower political risks and improved opportunities for trade and investment. It should be pointed out that this growth has been more driven by consumption than investments or exports. On the supply side, industry is hardly recovering in all countries and services have been recorded strong growth.

The medium-term outlook for these countries is expected to moderate a little and to be similar to the forecast for next years. (Table 2)

**Table 2 Economic outlook 2005-2007 for the Southeast European countries**

Country	GDP growth (in %)			Consumer prices (in %)			Unemployment based on LFS (in %)			Current account (in % of GDP)		
	2005	2006	2007	2005	2006	2007	2005	2006	2007	2005	2006	2007
Albania	5.5	5.5	6.0	2.4	2.5	2.0	14.0	14.0	14.0	-5.9	-5.0	-4.5
B&H	6.5	6.0	6.0	2.9	2.0	1.0	46.0	46.0	46.0	-22.0	-20.0	-18.4
Bulgaria	5.5	5.3	5.0	5.0	6.0	4.0	10.0	9.0	8.0	-14.0	-11.8	-9.6
Croatia	3.9	3.7	3.8	3.3	3.0	2.5	13.1	13.0	12.8	-7.3	-6.0	-5.3
Macedonia	3.6	4.0	4.0	0.6	2.0	2.0	37.5	37.0	37.0	-1.1	-4.1	-3.9
Montenegro	4.0	5.0	5.0	2.5	3.0	3.0	28.0	28.0	28.0	-9.1	-9.0	-7.9
Romania	4.0	4.5	4.5	9.0	8.0	7.0	7.0	7.0	7.0	-9.1	-8.5	-8.5
Serbia	6.5	4.0	4.0	16.2	15.0	15.0	20.0	22.0	23.0	-9.1	-10.0	-10.0

Source: WIIW, February 2006; Eurostat, Autumn 2005

According to the projected data, the region will experience a speed up in growth and in most countries GDP growth will average between 4 and 6 per cent per year in next three years that should be generally sustainable. The macroeconomic stability, defined primarily as price stability, will continue and only in Serbia inflation in two-digit level will still be a problem. In order to achieve macroeconomic stability and slowdown in the inflation, it is important to conduct sound fiscal policy and to have high foreign reserves. Fighting inflation by reducing aggregate demand via a restrictive monetary policy may become extremely costly in

developing countries, although this is the standard recipe of the Washington Consensus. (Herr, Priewe, 2005)

Positive trends in projected growth would partly influence the labour markets, but the unemployment rate will remain high, except in Romania and Bulgaria. More favourable macroeconomic environment in all Southeast European countries has given a strong incentive to the credit boom in these countries. One of the consequences of such a rapid credit growth has been high current account deficits in all countries, though it is expected to slow down till 2007. It seems that the key problems are the external imbalances – trade and current account deficits, as well as continuing increase of foreign debt, which is more thoroughly analysed in the next chapter.

### 3.2. Analysis of debt indicators

Trends of total external debt of SEE countries are shown in Table 3. Since the external debts in all analysed countries since 1999 have grown, there is a doubt whether these countries have reached upper limits of indebtedness, would their liquidity and solvency be endangered and whether there is a threat of debt crisis.

**Table 3 External debts in Southeast European countries, 1999-2003**  
(in millions USD)

Country/Year	1999.	2000.	2001.	2002.	2003.
<b>Total external debt</b>					
Albania	975	784	1.094	1.312	1.482
Bosnia and Herzegovina	1.962	2.828	2.226	2.515	2.920
Bulgaria	9.872	10.026	9.615	10.462	13.289
Croatia	9.443	12.120	10.742	15.347	23.452
Macedonia FYR	1.433	1.465	1.423	1.619	1.837
Romania	9.367	10.224	11.653	14.683	21.280
Serbia and Montenegro	12.949	11.960	11.740	12.688	14.885
<b>Long-term debt</b>					
Albania	865	659	981	1.200	1.242
Bosnia and Herzegovina	1.828	2.575	2.057	2.303	2.674
Bulgaria	8.246	8.282	8.159	8.585	9.439
Croatia	8.555	11.264	10.335	14.984	19.174
Macedonia FYR	1.264	1.304	1.284	1.476	1.713
Romania	7.968	9.410	10.744	13.780	19.320
Serbia and Montenegro	10.175	6.685	6.629	8.793	11.227
<b>Public and publicly guaranteed debt</b>					
Albania	849	644	970	1.187	1.230
Bosnia and Herzegovina	1.826	2.569	2.045	2.282	2.629
Bulgaria	7.602	7.513	7.378	7.474	7.749
Croatia	5.443	7.685	6.400	7.679	10.062
Macedonia FYR	1.135	1.165	1.136	1.262	1.438
Romania	5.985	6.430	6.682	8.112	11.730
Serbia and Montenegro	7.416	6.074	6.002	8.514	9.680
<b>Private nonguaranteed external debt</b>					

Albania	16	15	11	13	12
Bosnia and Herzegovina	3	7	12	21	45
Bulgaria	644	769	782	1.111	1.690
Croatia	3.112	3.578	3.935	7.305	9.112
Macedonia FYR	129	140	149	214	275
Romania	1.984	2.980	4.061	5.668	7.590
Serbia and Montenegro	2.759	611	627	280	1.548
<b>Short-term debt</b>					
Albania	110	125	113	112	240
Bosnia and Herzegovina	134	253	169	212	246
Bulgaria	1.626	1.744	1.456	1.877	3.850
Croatia	888	856	407	363	4.278
Macedonia FYR	169	161	139	143	124
Romania	1.399	814	909	903	1.960
Serbia and Montenegro	2.774	5.275	5.111	3.895	3.658

Source: World Bank, 2001, 2002, 2003, 2004 and 2005

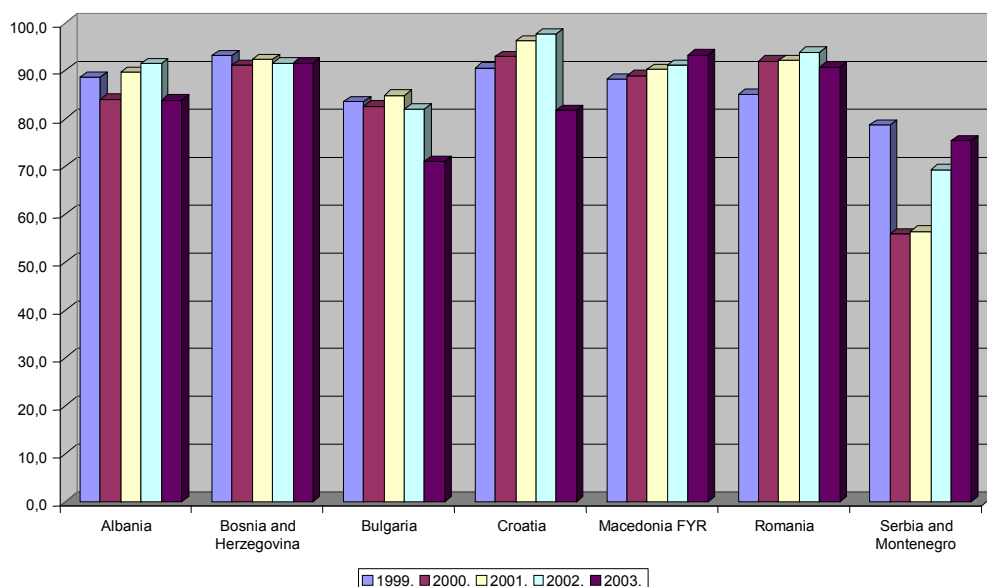
According to the presented data, Albania, Bosnia and Herzegovina, Macedonia and Serbia and Montenegro have not experienced the significant growth of external debt, although some of them have had high growth rates during this period. In the case of Serbia, inherited foreign debt has been written off so the growth of external debt was not significant. The external debt of Croatia and Romania has increased in absolute numbers. The favourable macroeconomic environment in these countries and prospects of European integration have influenced the consumption and credit boom, while high liquidity in international money markets and low interest rates in past several years have also contributed to the increase of their external debt, where firms and other economic agents have greater possibilities for getting foreign loans. This has been supported by data on public and publicly guaranteed debt portion in total external debt, where Croatia, with 42.9% and Romania with 55.1%, are countries with the lowest portion. It has been the result of a shift in the composition of public sector debt from external to domestic sources, especially because many governments have been able to finance their activities by drawing on growing domestic debt markets. The liberalisation of capital accounts and implementation of relatively sound macroeconomic and regulatory policies have also affected the growing share of domestic public debt.

Although these data are significant for indebtedness evaluation and credit ranking, it has to be mentioned that countries are very often forced to take responsibility for private sector debts. Governments have to provide the possibility for private sector to acquire foreign exchange for their own debt service. Because of that, external debt service of private sector affects the international reserves.

Since the maturity structure is also important in debt sustainability analysis because it indicates its impact on liquidity, next chart shows the portion of long-term debt in total debt in these countries.



**Chart 2 The share of long-term debt in total debt of Southeast European countries, 1999-2003**



Source: Table 3

It seems that the maturity composition of foreign debt in Southeast European countries is favourable because all countries have recorded high shares of long-term debt in total debt, with Bulgaria as the only exception. It also means that these economies are less vulnerable to unexpected downturns in international financial markets and changes in situations when investors change the country's risk perception. As a direct result of such maturity composition of foreign debt, the other debt indicator that shows the ratio of international reserves to short-term debt has been also favourable. The next table shows the coverage of total debt by international reserves.

**Table 4 Total external debt in % of international reserves in Southeast European countries, 1999-2004**

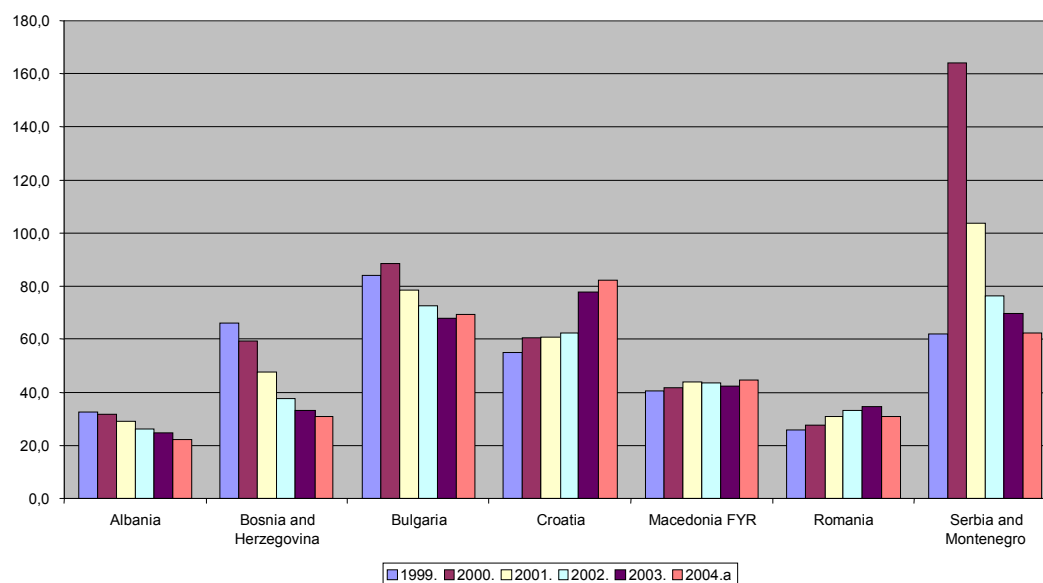
Country/Year	1999	2000	2001	2002	2003	2004
<b>Albania</b>	43.7	51.8	61.4	72.9	72.3	82.1
<b>Bosnia and Herzegovina</b>	14.7	17.7	51.3	61.3	74.9	93.0
<b>Bulgaria</b>	26.6	31.0	33.8	39.0	46.8	52.5
<b>Croatia</b>	29.8	31.2	39.6	37.5	33.1	28.8
<b>Macedonia FYR</b>	31.5	48.0	51.5	45.0	49.8	41.4
<b>Romania</b>	16.6	24.3	31.8	40.4	41.2	59.0
<b>Serbia and Montenegro</b>	2.7	4.5	9.8	19.3	24.9	28.9

Source: Authors' calculation according to data in EBRD, 2005

Relatively high coverage of external debt by international reserves in Albania and Bosnia and Herzegovina, and partly in Romania, Macedonia and Bulgaria, significantly declines possibilities of liquidity problems. In Romania and Bulgaria this high coverage is the result of high amount of international reserves that exceed by a large margin the conventional measures of reserve adequacy. According to the World Bank (World Bank, 2005a, p. 5), countries accumulating substantial excess reserves will have to reconcile the benefits of higher reserves with the potential for capital losses and growing quasi-fiscal carrying costs. The main problem would be the limit of their ability to sterilize the impact of large reserve accumulations. On the other hand, the high coverage of external debt by international reserves in Macedonia, Albania and Bosnia and Herzegovina is the result of low external debt in these countries. The lowest shares have been recorded in Serbia and Montenegro and Croatia that could indicate the possibilities of future vulnerability to liquidity crises.

One of the most relevant flow debt indicators that shows the country's indebtedness assessment is the ratio of total external debt to GDP. It is especially useful because it relates the external debt to resource base and repayment capacity of the economy. Increase of this debt indicator implies the solvency problems of the country. Chart 3 shows the share of total external debt of SEE countries in their GDP.

**Chart 3 The share of external debt in GDP of Southeast European countries, 1999-2004**

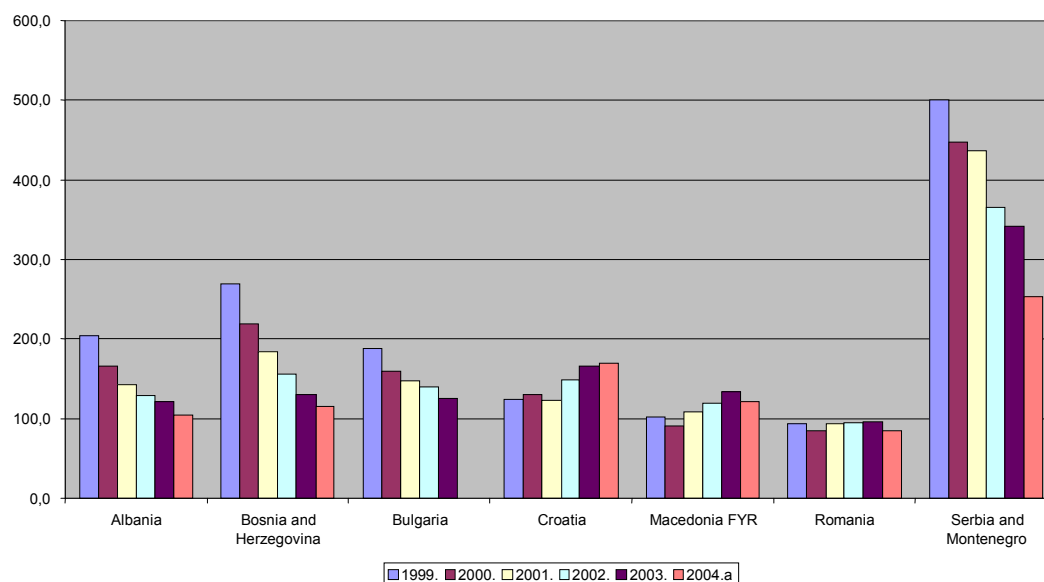


Source: EBRD, 2005

According to the debt-to-GDP ratio, Albania, Bosnia and Herzegovina, and Bulgaria have decreased the indebtedness, while Croatia has considerably increased this share and reached the level above 80 %, which indicates high indebtedness level. Besides Croatia, Bulgaria and Serbia and Montenegro have also recorded high debt-to-GDP ratios above 60 % in 2004. Generally, the risk of insolvency appears when the relation between debt and GDP is over 30%, but it doesn't have to be rule and this debt indicator should be accompanied by other flow indicators, especially debt-to-exports ratio that takes into account the repayment capacity

of a country. Next chart shows the ratio between total external debt and exports of goods and services in SEE countries.

**Chart 4 The share of external debt in exports of goods and services in Southeast European countries, 1999-2004**

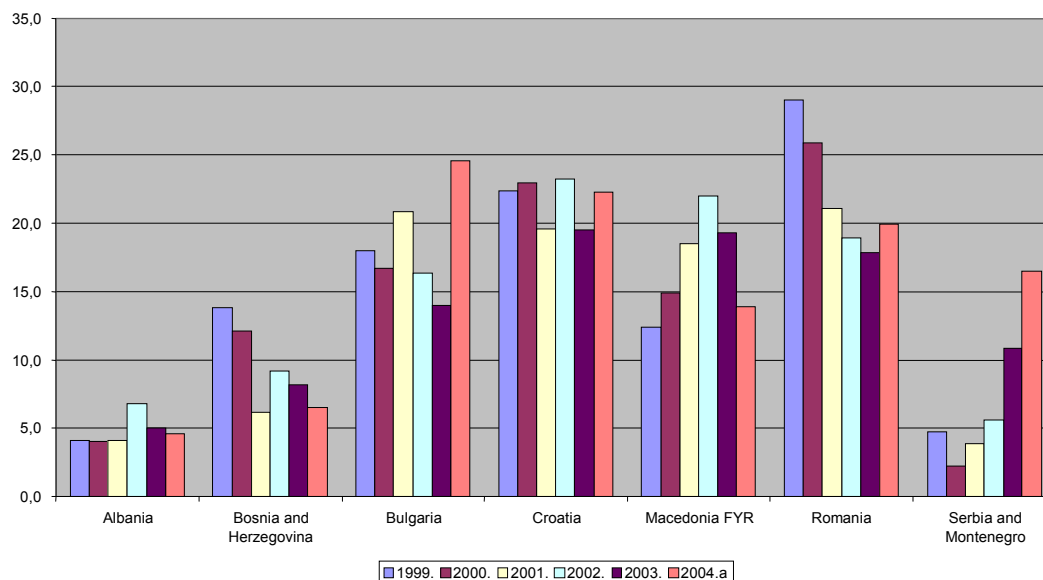


Source: EBRD, 2005

While the analysed debt-to-exports indicator has increased in Croatia and Macedonia in 2004 compared to 1999, only Serbia and Montenegro still has high share of the external debt in its exports, though considerably decreased after 1999. Albania, Bosnia and Herzegovina and Serbia and Montenegro have succeeded to decrease the share of debt in exports of goods and services due to the gradual normalization of political and economic relations and recovery of exports activities of these countries. Since Bulgaria and Romania have accomplished a significant export growth, the increase of external debt in these countries has not undermined their solvency. Croatia is the country with the highest indicator (169.4) and it is usually assumed that the solvency and liquidity of a country is endangered when debt exceeds double size of exports, i.e. when this indicator is higher than 200. However, the debt sustainability analysis should also take into consideration some other factors like country's export perspectives, export orientation and the share of exports in GDP, flexibility of economic policy etc.

Another possible indicator of debt sustainability indicates how much of a country's export revenues are used in servicing its debt and how vulnerable the payment of debt-service obligations is to sudden falls in export revenues. Following chart shows the relation between debt service and exports of goods and services in SEE countries during the observed period.

**Chart 5 Debt service in % of exports of goods and services**



Source: Table 5

Relation between debt repayment (principal and interest) and exports of goods and services is also considered as the important indebtedness flow indicator. It is supposed that there exists real danger of insolvency problem when mentioned indicator is higher than 20%. In 2004 the highest ratio was recorded Bulgaria (24.6), Croatia (22.3) and Romania (19.9). A sustainable level is determined by the debt-to-exports ratio and interest rates, as well as by the maturity structure of debt obligations. The higher is the share of short-term debt in total foreign debt, the larger and more vulnerable is the annual flow of debt-service obligations. Bulgaria with the highest ratio of debt service to exports and, at the same time, with the highest share of short-term debt and thus relatively higher current liabilities, is the most vulnerable. Still, this flow indicator has some limitations in special circumstances. For example, almost all SEE economies have strongly liberalized their trade regimes and are now exporting a large share of their output, but their import orientation is also rising. Therefore the debt service-to-exports ratio should be corrected with the import intensity of exports. (Kiguel, 1999)

The above analysed debt indicators affect the creditworthiness and risks rankings. According to the World Bank criteria, in 2003 there have been no moderately indebted SEE country, just severely indebted or less indebted. It should be mentioned that The World Bank classifies countries according to the following indicators: external debt in relation with GDP and external debt in relation with exports of goods and services. Indebtedness classification is shown in the table 5.

**Table 5 Indebtedness classification of Southeast European countries in 2003**

Country/Year	1999	2000	2001	2002	2003
<b>Albania</b>	L	L	L	L	L
<b>Bosnia and Herzegovina</b>	S	M	L	L	L
<b>Bulgaria</b>	S	M	M	M	S
<b>Croatia</b>	L	M	M	M	S
<b>Macedonia FYR</b>	L	L	L	L	L
<b>Romania</b>	L	L	L	L	L
<b>Serbia and Montenegro</b>	..	L	S	S	S

Source: World Bank, 2001, 2002, 2003, 2004 and 2005

Notes: S – severely indebted, M – moderately indebted, L – less indebted

The World Bank's classification confirms our debt analysis because it classifies Bulgaria, Croatia and Serbia and Montenegro as the severely indebted economies in 2003. Large external imbalances, external debt stocks and future debt servicing are the concern, particularly in Croatia and Serbia and Montenegro, while the maturity debt structure in Bulgaria is less favourable due to the high share of short-term debt.

#### **4. CONCLUDING REMARKS**

Since there has been an increasing concern among economists and policymakers that the high external indebtedness in Southeast European countries is limiting their economic growth, our paper has analysed the external debt indicators for these seven SEE countries in order to assess their external vulnerability. According to the methodology of the IMF, we have used two sets of debt indicators: those based on flow variables and those based on stock variables.

We have conducted the external debt analysis within the overall macroeconomic framework of these transition economies and have concluded that the key macroeconomic problems are still the external imbalances – trade and current account deficits, together with the high and continuing unemployment. In some countries, the current account deficits have also been associated with significant FDI inflows, including reinvested earnings of foreign investors because the SEE countries have experienced a strong increase in FDI inflows.

The analysis has shown that in the cases of Croatia and Romania, the sustainability of macroeconomic stability may be threatened by the strong growth of foreign debt. The favourable macroeconomic environment in these countries and prospects of European integration have influenced the consumption and credit boom, while high liquidity in international money markets and low interest rates in past several years have also contributed to the increase of their external debt. The maturity composition of foreign debt in Southeast European countries is favourable because all countries have recorded high shares of long-term debt in total debt, with Bulgaria as the only exception. It also means that these economies are less vulnerable to unexpected downturns in international financial markets and changes in situations when investors change the country's risk perception. Regarding the ratio of international reserves to external debt, the lowest shares have been recorded in Serbia and Montenegro and Croatia, which could indicate the possibilities of future vulnerability to liquidity crises. According to the debt-to-GDP ratio, Albania, Bosnia and Herzegovina, and Bulgaria have decreased the indebtedness, while Croatia has considerably increased this share and reached the level above 80 %. Besides Croatia, Bulgaria and Serbia and Montenegro have

also recorded high debt-to-GDP ratios above 60 % in 2004. Again, Croatia is the country with the highest debt-to-exports indicator (169.4) and it is usually assumed that the solvency and liquidity of a country is endangered when debt exceeds double size of exports, i.e. when this indicator is higher than 200. Relation between debt repayment (principal and interest) and exports of goods and services is also considered as the important indebtedness flow indicator. According to the data, the highest ratio in 2004 was recorded in Bulgaria (24.6), Croatia (22.3) and Romania (19.9). The World Bank classification has also confirmed these findings by ranking Bulgaria, Croatia and Serbia and Montenegro as the severely indebted economies. However, addressing these vulnerabilities, pursuing further integration towards the European Union and continuing with the structural reforms could reduce overall debt burdens and sustain high rates of growth in the short and medium term.

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